

INVESTMENT UPDATE

THE MUNCY BANK & TRUST COMPANY

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Using cash for most spending may help to cure your budget woes. 4

Points of interest:

- Only 1931 and 1937 were worse years for U.S. stocks than 2008.
- Some of the best years for stocks came after some of the worst years.
- The market's best year came at the height of the Great Depression, in 1933, when stocks gained 54 percent.
- The stock market usually improves before the economy does.

IT WAS A YEAR OF FINANCIAL CHAOS, BUT WHAT COMES NEXT?

Last year was the third-worst ever for the U.S. stock market.

Only in 1931 and 1937 did the Standard & Poor's index fall by more than 38.5 percent, turning in a worse showing than 2008. The loss of trillions of investors' wealth has them running scared as the new year begins.

Adding to the fear is a year-old recession that appears to be deepening with increased unemployment and uncertainty about the timing of a turnaround.

Now, however, investors face a new year: what are the possibilities for their portfolios?

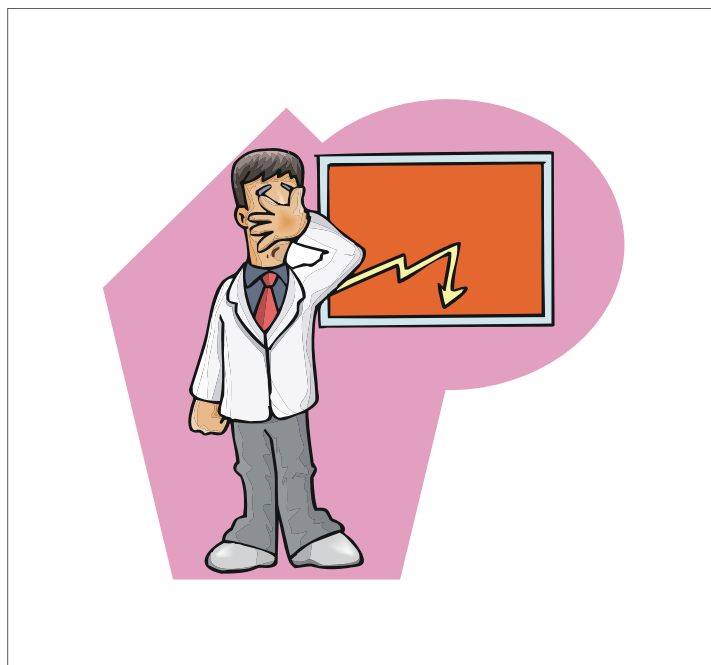
Good follows bad

Many investors may say they expect the market to continue to decline. In fact, that happened after 1931: in the next year, stocks fell an additional 8.2 percent.

However, that is not the norm. Many of the best years in the stock market have come after miserable years.

Two of the best came after the worst years. In 1933, the best year ever, stocks rose by 54 percent. Two years later, they gained another 48 percent.

It is also notable that the second best year came at the height of a recession when stocks rose by nearly 53 percent in 1954. The same happened in the recession year of 1958, when stocks went up by 43 percent.



The year 2008 was the third-worst ever and one that investors would rather forget about.

Roger Ibbotson, professor of finance at Yale, notes that the odds are always good for a positive year in stocks. The market has gone up during 59 of the 83 years since 1926, or 71 percent of the time. Moving the time horizon out over five and ten years increases the odds of positive returns.

Although there is no way of knowing when the market will begin to rise again, Ibbotson urges investors not to wait to invest until things are clear. "Unless you have more knowledge than the market, the long run starts now," he wrote in *Wealth Manager* magazine in December.

The last big bear

It is also instructive to look at the last severe recession and bear market to hit the United States.

Back in 1973-1974 the market fell by 43 percent over 21 months. This was also the last time that the U.S. economy posted three consecutive quarters of negative growth in Gross Domestic Product, a measure of the growth or decline in all goods and services.

The first decline in GDP occurred in the third quarter of 1974, well after the stock market had experienced most

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IF YOU WAIT FOR THE ECONOMY TO HEAL IT MAY BE TOO LATE TO INVEST

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of its decline. The economy went on to contract for another two calendar quarters.

However, an investment made in the S&P 500 Index during that first quarter of economic decline in 1974 would have returned almost 31 percent over the next year, notes U.S. Trust, a subsidiary of Bank of America.

"The point is that markets bottomed well before the economy," U.S. Trust says. "It goes without saying 2008 is

quite different from 1974, but the concept of markets looking forward will apply at some point during this bear market."

Policy response

Many experts also note that the federal government has taken, and promises to take, significant action to shore up the economy and financial markets.

During the last quarter of 2008 significant easing in interest rates, increase in money supply, and financial backing for financial institu-



Stocks can turn as the economy sinks.

tions took place. The incoming Administration has pledged to spend significant sums to spur the economy.

COLLEGE COSTS RISE DRAMATICALLY IN 2008

Current and prospective college students got a double dose of bad news last year: costs rose sharply while college lending dried up.

The independent College Board reported that costs jumped by an average of 6.4 percent in the fall of 2008, even as the general rate of inflation plummeted.

The average list price of tuition and fees at four-year public universities rose to \$6,585 per year, while the cost of the average private college increased to \$25,143, the Board said.

Easing the sting

The good news was that the average student does not pay full price, the Board says.

On average, students get \$3,700 in grants and tax benefits toward public schools and \$10,200 for private schools, it reported.

Also, more than half of all students attend schools that cost \$9,000 a year or less, it said. Only a small minority go to the top colleges that now cost \$50,000 a year or more.

The best deals remain at public two-year colleges, which cost an average of \$2,402 a year and whose costs increased by just 4.7 percent last year, the College Board said.

Lending declines

After years of large increases in private sector lending to college students and their families, private credit became scarce last year. That caused a scramble for federal student loans, which in-

creased by 6 percent over 2007, the College Board reported.

Banks and other private lenders were already cutting back on college lending early in the year as the profitability of such loans declined. Then

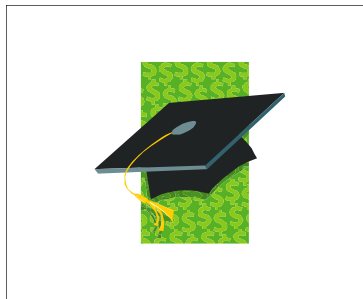
they were hit by a full-blown credit crisis in the fall and some stopped making loans.

Although most students were still able to get loans for the current school year, an increase in private lender fees and interest rates have raised the costs for many.

To add insult to injury, about two-thirds of college graduates leave school with student debt. The average debt load at graduation was \$22,700, the College Board said. Until now rising incomes and the availability of jobs helped to ease the debt

burden.

However, in the midst of the current recession jobs are disappearing and graduates are finding it harder to begin careers that pay enough to help them make their loan payments.



College costs increased by an average of 6.4 percent in 2008 even as a decline in private lending made it harder to raise money to pay for college.

"On average, students get \$3,700 in grants and tax benefits toward public schools and \$10,200 for private schools."

UPENDING A HISTORICAL RELATION BETWEEN BOND AND STOCK YIELDS

Amid all of the financial market upheaval of 2008, an unexpected and significant turnabout occurred whose significance was missed by many investors.

For the first time in 50 years, the dividend yield on U.S. stocks rose above the yield on the benchmark U.S. Treasury 10-year note.

That had not happened since 1958, when stock yields dropped below bond yields for the first time ever. Back then, investors were disturbed over the flip-flop in what had been the usual relation between yields on the two assets.

Reward for stock risk

Through most of U.S. market history, stocks paid dividends that were much higher than the yield on bonds, because investors perceived stocks as riskier and wanted compensation for the risk. Whenever stock prices rose and their yields dropped to near that of bonds, bear markets would follow.

Indeed, in 1958 a *Busi-*

ness Week headline warned that “An Evil Omen Returns” when dividend yields reversed. However, instead of heralding bad times, the stock market roared ahead throughout the next decade and appreciated an astounding 11,000 percent through November 2008.

Last year the sharp fall in the stock market, coupled with a flight to safety into U.S. Treasury securities, pushed the yield on the 10-year Treasury to 2.1 percent. The average dividend yield on stocks in the Standard & Poor’s 500 Index rose to about 3 percent.

Reasons uncertain

Some experts believe the difference in dividend yields had to do with increased expectations of inflation in the postwar period. Bond investors had to be paid more interest to compensate for inflation, while stocks became more valuable because they



Higher stock yields improve their attraction over lower-yielding bonds.

were seen as inflation hedges. A recent study theorizes that instead it has to do with expectations about volatility of stocks. Now that the market has become much more volatile investors demand higher dividends in compensation.

Whatever the reason, the dividend yield makes stocks very attractive to long-term investors who want income and inflation-protection. The attraction is enhanced by tax law that favors stock dividends over bond interest.

“For the first time in 50 years, the dividend yield on U.S. stocks rose above the yield on the benchmark U.S. Treasury 10-year note.”

RETIREMENT WOES, RICH ARE HURT, & MORE

The recession and bear market of 2008 are hurting Americans’ retirement prospects because they are saving less money, a survey by Bank of America has found.

The good news from the survey was that 60 percent of those surveyed said they were spending less than they were three months earlier.

But economic hard times were making it harder for Americans to save: 51 percent said they were saving less than before. It also found



an increasing instance of retirement savers tapping their retirement accounts prematurely to meet current obligations.

The rich are hurting

America’s affluent and millionaire households are feeling the pinch of recession, says the Spectrem Group, which regularly surveys the affluent.

Its latest monthly surveys fell to the lowest levels ever, as household assets declined by 23 percent from the previous month, it said. Affluent

households are being hurt by major cuts in year-end bonuses and the decline in value of high end housing, Spectrem said.

Retirement income

Retirement savers are usually focused on building up their portfolios before retirement by taking investment risk.

However, a new study by Russell Investments found that 60 percent of retirement income is generated by a portfolio *after* retirement.

That means the investment strategy in retirement is even more important than the one used prior to retiring.

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WANT TO CUT DOWN ON YOUR SPENDING? TRY USING ONLY CASH

New findings in behavioral and neuro-economic research support a long-recommended strategy for cutting down on spending.

Some financial experts have recommended that the fastest way to help reduce your spending is to cut up credit cards and switch to cash for all purchases.

It was believed that handing over cold, hard cash caused consumers to think more about the value of their purchases than they did when using plastic.

This is supported by new studies showing distinct regions of the brain that either register negative feelings about spending, or pleasure at the prospect of acquiring something new.

There is a region of the brain known as the insula



Using cash can make you think twice about your purchases.

associated with negative feelings like unfairness and bad smells. It is activated more when you use cash for a purchase than when you use credit, possibly because of the tangible feeling of loss in handing over cash. There is no feeling of loss when using a credit card, so it appears credit cards dampen the pain of paying.

A behavioral study at MIT

in Boston asked subjects to submit sealed bids for Boston Celtics tickets. Half of the subjects paid with cash, half with credit. Those who used charge cards bid twice as high for the tickets as those who used cash, researchers found.

You can use those findings to get back on a good spending budget and regain control of your finances. After all, using a credit card can greatly increase the cost of your purchases, since many card users carry their balances forward, incurring interest charges.

The high credit limits on many credit cards also encourage shoppers to buy more than they can afford.

Carrying cash discourages impulse purchases, since we generally have less access to cash than to credit.