

Private Wealth Management

InSight



Spring and summer months bring the sense of a fresh start, and for many of us, that triggers an urge to organize and clean up areas of our everyday

lives. I encourage this same mindset when it comes to evaluating your wealth management goals. The bloom of spring presents a good reminder to sit down with your wealth advisor to check in on the progress of your goals, evaluate whether priorities have shifted and allow us to further discuss where your story is headed. Quite possibly you'll find this 'spring cleaning' is the one that is most beneficial this season.

In this edition of InSight, you'll hear from KC Mathews, UMB Bank executive vice president and chief investment officer, give some insight into what a correction in the market means to investors. KC recently completed a busy winter delivering his economic forecast presentation to more than a thousand attendees across a dozen cities. This year he had good news to share: home values have gone up, companies have increased hiring and the market is recovering overall.

Also timely with spring graduations, you'll read an article addressing the escalating costs of college education and how proper planning can effectively prepare for funding success without derailing overall wealth planning.

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Tempering Emotions During Stock Market Corrections

KC Mathews

Executive Vice President & Chief Investment Officer, UMB

Stock market corrections are interesting and many times emotional events. Some investors wait anxiously for them, like the first sign of spring after a long, cold winter. Pundits watch for them with the careful eye of a left fielder, knowing that what goes up must come down. And at times they surprise us like a sudden rainstorm on what appears to be a clear day. Once a correction starts, investors once again wait anxiously for the bottom, which is difficult, as no one knows what will be the extent of the correction. Everyone is after the best deal possible, not wanting to buy too early or sell too late. Once the trigger is pulled to purchase stocks, investors can't wait for the correction to be over and let the bull market run once again. Simply stated, human emotions do not mix well with disciplined investing.

The root cause of a correction can be difficult to identify and I will not claim to know any differently. However, I feel confident concluding that corrections are a normal and healthy variable of a secular bull market.

All investors realize that volatility can happen and does occur at some point when investing in equity markets. I learned that lesson early in my career, which began in the brokerage business in 1986. In October of 1987, the market witnessed a significant correction, as it was down 30 percent. Emotions ran high, investors sold stock and the most commonly uttered phrase became, "Just get me out." Yet for the calendar year, the S&P 500 returned 5.25 percent – a positive return. This may not sound stellar, but it was not the end of the world as emotionally driven investor chatter suggested. The years 1988 and 1989 were also productive, with both posting double-digit returns (See Figure 1). The moral of the story is that even a good year can have a rough patch. Volatility can be less painful to accept when it happens if there is a focus on buying quality companies, preparing to hang on for a little while, and understanding that volatility and corrections will happen. I personally stand by the belief that smart investors buy stocks, not rent them.

Historically Speaking

Since 1980 there has been plenty of market volatility. The average intra-year decline in the S&P 500 has been 14 percent. During this time period the market has witnessed some type of correction, the peak to trough ranges

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And while sending our children off to college is a major milestone, other milestones in life can trigger a liquidity event. Having an action plan for events such as selling a business, making an exit out of a career or accepting a large commission, all require sound advice to proceed confidently.

We hope you find this information helpful and informative and look forward to talking with you soon.

Sincerely,

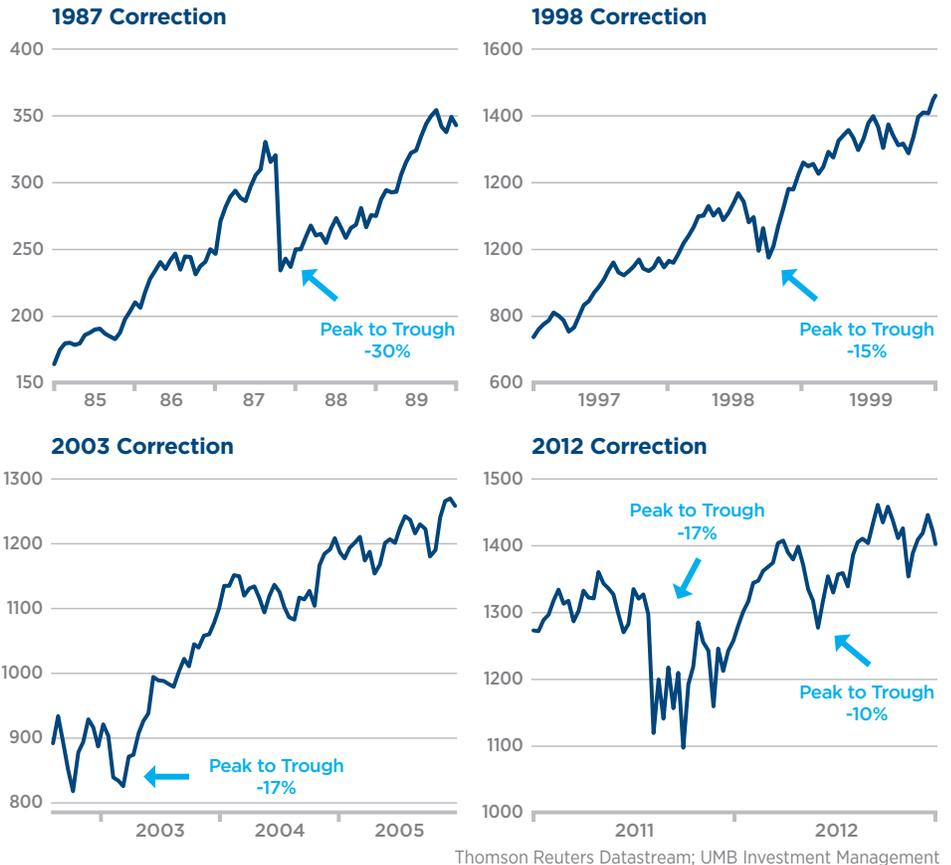


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from three percent to 49 percent. The challenge in waiting for a correction to invest is that when the market is down 49 percent, such as 2008, things look pretty bad and it becomes very difficult to deploy capital into equity markets.

Figure 1

S&P 500 Market Corrections



As previously noted, there is a high probability of some type of correction every year. However, this year there is a growing probability of a “meaningful” correction of 10 to 20 percent, since the market has not seen one in almost two years (the market corrected 9.8 percent in June 2012). To gain a historical perspective, I examined data back to 1930 and the corrections between five to 10 percent and 10 to 20 percent. Typically, a 20 percent correction is defined as a bear market. Given that the average economic cycle lasts six years, it was discovered that recessions happen every five to eight years.

In going back 34 years to 1980, smaller corrections of five to 10 percent were seen 15 of the 34 years. Corrections greater than 10 percent plagued the market in 18 of the 34 years, or more than half of the period in question. Clearly one can see that corrections are quite common and should be expected if history is any guide.

Corrections in Today’s Market

So where does the market stand currently, and where could it go in the future? In January of this year, the market sold off six percent, so it got the small correction out of the way. However, one could conclude that we are still due for

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a 10 percent correction. Then again, I have not received a speeding ticket in numerous years. Does that mean that am I due? Hopefully not. In other words, there is no way to be certain of future events, because history has created a pattern; however, it may warrant increased attentiveness.

Perhaps the most important question is, “What do we do about corrections and how do we protect our assets?” Since corrections are seen as a natural part of bull markets, we favor buying good quality companies and foregoing attempts to trade the anticipated corrections. Remember that successfully trading corrections requires one to sell at the top and buy at or near the bottom. In my 26-year career, I have yet to see a sustainable model that can accomplish that task.

If a person’s objectives warrant it, corrections provide an opportunity to deploy capital into equities. A person doesn’t have to call the bottom correctly, just get in when valuations become more attractive. Figure 1 illustrates that the market historically has always recovered after a correction.

When it comes to stock market corrections, the glass needn’t be half empty, and depending how you look at it, it may actually be half full. If you are in the accumulation phase of your investing lifetime, corrections can be an opportunity to allow you to accumulate additional shares through a disciplined dollar cost average plan or a dividend reinvestment program. Each portfolio is unique, and an investment professional is there to provide an objective point of view, ensuring cooler heads prevail in the decision-making process, regardless of what the market is experiencing.

Upon reviewing the aforementioned evidence, it is clear that the market will experience many corrections in the future. They cannot be prevented, and while it’s difficult to nearly impossible to forecast when they will occur and to what magnitude, perhaps the most prudent advice is to tolerate them. Corrections come and go, pundits will continue to attempt to forecast them and sooner or later, they will be correct. The question will be, “What price did you pay in missed opportunities as you waited for the next correction?” ■



As executive vice president and chief investment officer, KC Mathews is responsible for the development, execution and oversight of UMB’s investment strategy. Mathews has more than 20 years of diverse experience in the investment industry. He earned a bachelor’s degree from the University of Minnesota and a master’s degree in business administration from the University of Notre Dame. He also attended the ABA National Trust School at Northwestern University and is a Chartered Financial Analyst (CFA) and member of the CFA Institute.

Action Plan Needed for Liquidity Events

There are many occurrences in a professional's life that can result in liquidity events. Whether it's selling a business, earning a large commission or accepting an executive buyout, these are milestone events that provide individuals with a significant sum of money. With that influx of cash come numerous investment questions and options—particularly when current employment is affected, but retirement is not the end goal.

Understanding and evaluating the different personal and professional areas that may be affected by a liquidity event is extremely important, as individuals will have many financial decisions to make once the event occurs. Career desires, economic activity, day-to-day finances and employer-provided benefits are a few items to consider.

Determine Next Career Step

In many cases, these types of liquidity events may signal an exit out of a current job or profession. If this is the case, individuals need to know what their personal short- and long-term goals are for subsequent employment. Are they going to take some time off? Do they want to start a new business? Do they want to venture into an entirely new profession? Understanding where they are currently and where they want to land 12 months or more from now will help provide a framework for strategic planning and decisions.

Evaluate Market Environment

The market has changed dramatically over the past few years, and these shifts are expected to carry on for the foreseeable future. The current interest rate environment continues to provide challenges that didn't exist for investors five and 10 years ago. For example, fixed income assets such as long duration bonds were previously popular options for investors, whereas today many have more exposure in equity portfolios. Understanding current market conditions and how they will likely affect an individual's investments is critical.

Establish a Cash Flow Plan

Once timeframes have been established and a market assessment has occurred, cash flow needs should be analyzed to determine if there is a gap or an income to expense deficit. If there is, asset allocation inside current portfolios becomes extremely important, as there will be a need to fill the deficit without eroding the portfolio's principal. For example, if an individual is making an annual salary of \$100,000, a goal might be to replace that money with the interest gained from the portfolio as opposed to taking direct withdrawals. Advisors can provide recommendations and options on how to achieve these goals, while continuing to position the portfolio for long-term needs as well.

Evaluate Ancillary Benefits

Next, individuals need to evaluate whether other benefits were affected by the liquidity event. Items such as health care, life insurance, savings vehicles and so on are oftentimes tied to employment and either cease or need to transition when current job service ends. Advisors can help identify areas to review and provide recommendations on the best ways to proceed based on the strategic plan.

Liquidity events can provide individuals with a variety of exciting opportunities, but those come with challenges as well. Taking the time to evaluate and plan how to proceed, both personally and professionally, is extremely important. A trusted advisor can work with individuals to navigate these different areas so they can help ensure desired outcomes are realized. ■

Tips for Funding Education Goals

It's no secret that college tuition prices have steadily risen over the past few years. According to the College Board, over the last 20 years, the actual price of a year at a private college, including tuition, fees, room and board, has risen at an annual average of 1.6 percent on top of inflation and 2.3 percent for a four-year public university.

As these costs continue to escalate, many parents are left wondering how they can most effectively plan for their children's education. Creating a strategic plan with specific goals, timelines and communication elements provides the necessary framework to help individuals prepare for this important milestone.

Know the Numbers

Start from the beginning. Parents should begin the process by understanding what the expected tuition costs will be when funds are needed. While there is no crystal ball to predict exactly what these costs will amount to by the time of the child's graduation, modeling tools have become quite sophisticated and can provide strong estimates. A financial advisor can help project costs based on your child's age, current tuition prices and expected inflation rates.

Determine How Much to Fund

After a figure has been established, parents need to determine how much of the estimated cost they would like to fund. This is very personal and varies greatly from person to person, sometimes even within the same couple. When discussing this issue, it may come to light that one parent had their entire education funded and wants to do the same for their children while the other parent may have paid for a portion of their education and expects their kids to do so as well. Uncovering these different viewpoints and having an open discussion in order to come to an agreement that makes both people comfortable is critical.

Establish Investing Timetable

Once an agreement has been reached, the next step is to put this financial goal in writing and begin weighing options to successfully achieve the required savings. First, designate monthly or annual contributions to your preferred education savings vehicles. Parents should understand that allocations might change over time, depending on expenses and income. They should not become discouraged

if projected savings do not align perfectly with the end goal as adjustments will more than likely need to be made throughout the savings cycle. The most important item is to consistently save to ensure the funds continue to grow.

Evaluate Options

There are a variety of college savings vehicles available, including 529 Plans and Coverdell Education Savings Accounts. In addition, parents can establish general savings accounts either in their own names or by setting up UTMA's (Uniform Transfer to Minors Accounts) for their children. For larger gifts, gifts in trust may be used. In addition, certain education expenses may be paid directly to the educational institution without any limitation on amounts that may be given "gift tax free." Financial advisors can provide recommendations on specific vehicles to ensure the deployed strategy is in line with the strategic plan.

Communicate the Strategy

Communicating these education and savings plans to the child is very important in setting reasonable expectations. When the time is right, parents should start the conversation with their child about the educational path the child envisions for their post-secondary education. Parents can help a child weigh their desires to attend a public or private university, in-state or out-of-state, and begin assessing how many degrees he or she may like to acquire. Talking about these topics is a logical way to begin discussions regarding personal goals and financial needs. Conversations should clearly outline the financial support the parents plan to provide toward the child's educational needs, and where they expect the child to share responsibility. This will help the child begin establishing his or her own goals and promote accountability for educational expenses as well.

With the rising costs of education today, having a strategic and intentional plan is critical. Working with a financial advisor to create a formal strategy can help families prepare for this very important and meaningful gift. ■

Economic Indicators

2014 Outlook by the Numbers

	2010	2011	2012	2013	Current May	2014 (estimated)	Trend (year end)
Real GDP Growth Rate	2.50%	1.80%	2.80%	1.90%	0.10% ¹	2.60%	↗
Housing Starts	526K	681K	780K	900K	1,072K ²	1,100K	↗
Unemployment Rate	9.40%	8.50%	7.80%	7.10%	6.30%	6.30%	↘
Projected Fed Funds Rate (Fed Target)	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	→
Projected 10-Year Treasury Rate	3.29%	2.00%	1.76%	3.00%	2.65% ³	3.25%	↗
S&P 500 Price	1257	1257	1426	1848	1875 ³	2050	↗
S&P 500 Operating EPS Growth	47.00%	15.10%	0.50%	7.00%	5.00%	5.00%	↗
Inflation - Core CPI (Year-over-Year)	0.80%	2.20%	1.80%	1.75%	1.80% ⁴	1.80%	↗
Core PCE Deflator (Year-over-Year)	0.90%	1.90%	1.50%	1.25%	1.20% ⁵	1.30%	↗

¹Quarter-over-Quarter Seasonally Adjusted Annualized Rate as of 4Q 2013

²Monthly Seasonally Adjusted Annualized Rate as of March 2014

³End of Month

⁴Year-over-Year, as of April 2014

⁵Year-over-Year, as of March 2014

Thomson Reuters Datastream; UMB Investment Management

2014 Global Economic Growth Forecasts

Areas	% of World Nominal GDP*	Average GDP 1990-2007	2011	2012	2013	2014 (estimated)
Developed World	60%	2.40%	1.10%	0.80%	1.10%	2.80%
U.S.	22%	2.90%	1.80%	2.00%	1.80%	2.60%
Eurozone	19%	1.90%	1.50%	-0.75%	0.00%	1.40%
Japan	8%	1.60%	-0.50%	1.00%	1.50%	1.30%
Emerging Economies	40%	6.50%	6.80%	5.50%	5.00%	3.80%
China	10%	10.20%	8.50%	7.00%	7.00%	7.25%
Total World		3.60%	2.90%	2.40%	3.00%	3.30%

*December 31, 2012

Thomson Reuters Datastream; UMB Investment Management

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