

The New Normal - 5 Ways Your Investment Plans Must Change Now By Jeff Kennat, EA, CFP®

“The New Normal” is a phrase recently popularized describing slower economic growth in the years ahead as predicted by many prominent economists. The general consensus is that 2.5-3.5% per year growth in the economy is the range of optimum benefit; enough to provide for business profits and full employment yet moderate enough to quell inflationary concerns.

“The New Normal” predicts growth at a slower rate of around 2%. Because an economy that grows less rapidly generates less return, the future long-term return for stocks may be much lower.

What are the primary causes of slower growth in the future?

De-leveraging

Consumers are using excess cash to pay down debt and save rather than consume. This has a negative effect on growth since consumers account for two-thirds of the U.S. economy.

Increasing Taxes and Governmental Regulations

New policies aimed at preventing another financial crisis and reducing the budget deficit could reduce business profits.

De-globalization

A reduction in global trade and the threat of protectionism may also limit profits.

So how do you take advantage of the *opportunities* and protect yourself from the *threats* of “The New Normal” economy?

1. Favor stocks of dividend paying companies with low debt-to-equity ratios and cash surpluses.

These companies may be able to maneuver quickly when opportunities arise without having to rely on expensive or constrained credit.

2. Allocate some assets toward emerging market economies. ¹

The International Monetary Fund is projecting growth for developed economies of 2.4% in 2011 vs. growth for emerging and developing economies of 6.4%. ²

3. Don't have too much of your portfolio invested in volatile (risky) investments.

Make sure your current investment mix can weather a sharp market downturn. Back-test your asset mix to see how it weathered during extreme market moves in the past. ³ If you're over-invested in stocks, junk bonds, preferred stocks and commodities, these assets can fall in price together reducing the benefits of diversification.

4. Use new assumptions to re-calculate how much you need to save for retirement.

Don't use assumed rates of return based on the 10%+ annual stock returns of a couple of decades ago. If you are saving a percentage of your income for retirement based on outdated assumptions, you may have much less than you planned for at retirement age.

5. Protect your investments against extreme volatility or "tail events".

Diversify broadly and be certain that the investments you choose have low enough correlations in the event of a sudden downturn. You may want to look into some of the new investment products that have become available recently that are designed to hedge against extreme market moves.

You must accept the reality that no one can predict the future. The most brilliant minds on Wall Street were unable to predict the recent financial crisis. A well designed investment plan should be positioned to perform well no matter what the future brings.

1. Portfolios that invest in non-US stocks and bonds, especially emerging markets, may be affected by more significant risks including political and social instability, differing securities violations, differences in accounting standards and limited public information.

2. Source: [World Economic Outlook Update 7/7/2010](http://www.imf.org/external/pubs/ft/weo/2010/update/02/)
<http://www.imf.org/external/pubs/ft/weo/2010/update/02/>

3. Past performance is not an indicator of future results.