

October 2010 Issue

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The Recession's Impact on Employment

Although the recession has not officially ended, it is likely to be the longest since 1945. It is also associated with the largest drop in payroll employment of any U.S. recession, with the largest jump in the unemployment rate. From the beginning of the recession in December 2007 to the end of February 2010, total nonfarm payroll employment declined about 8.4 million, or 6.1% (Source: Federal Reserve Bank of Cleveland, March 22, 2010). In the same period, the unemployment rate jumped from 5% to 10.1%.

The Overall Picture

In a typical postwar business cycle, the unemployment rate starts leveling off about 14 months after the start of a recession (recessions typically last around 10 months), but it usually takes more than 30 months to return to prerecession levels. The current labor market downturn presents a drastically different picture. The unemployment rate did not stop rising until 23 months after the start of the recession, and the cumulative rise is well above the normal range.

Similarly, in a typical recession, payroll employment starts to decline at the start of the recession and takes about 12 months to stabilize. Unlike the unemployment rate, payroll employment goes back to prerecession levels relatively quickly once the recession ends, on average 21 months after the start of the recession. The past two recessions, in 1990-91 and 2001, were exceptions, taking 31 and 47 months respectively for employment to recover. Thus, these recessions have come to be known as jobless recoveries. The

pattern of employment decline in the present downturn resembles the last jobless recovery in many ways, suggesting a large decline over a prolonged period.

The unemployment rate reports the number of workers who are unemployed as a fraction of the labor force, but it does not indicate whether the rate is high because people are staying unemployed longer or because more workers have lost their jobs. That information is found in the job-finding and separation rates. Recessions can differ in how much either of these rates contributes to the overall increase in unemployment, which affects the course of the recovery.

In general, during recessions, separations start rising as the economy enters a downturn, and job finding rates start declining. After some initial rise in unemployment, mostly in the form of layoffs, separations usually start tapering off before the unemployment rate peaks. What accounts for most of the subsequent rise in the unemployment rate is the low rate of job finding among the unemployed, implying that the average duration of unemployment goes up. This suggests that most firms are not ready to begin rehiring as soon as they stop cutting jobs, even though they may have significantly reduced their payrolls. As the economy finally starts recovering, durations get shorter because firms create new jobs and absorb part of the unemployed.

Though separations increased sharply early on in the current recession, more than 95% of the change in the unemployment rate can be explained by the decline in job finding rates. In other words, the sharp rise in unemployment is not due primarily to a wave of job losses but due to the fact that once unemployed, workers' chances of finding employment have fallen dramatically. This could have a number of important consequences for the recovery.

Long-term unemployment reduces workers' industry- and occupation-specific skills, which reduces productivity when they find a job. Once workers find a job, their new starting wages are lower than similarly educated workers, and this disparity continues for a long time. Additionally, many workers are tempted to take the first job they find after a long period of unemployment, regardless of how good a match the job is for them. They will also be more likely to change employers when job prospects improve. This excessive labor market churning could be detrimental to overall productivity during the recovery.

Demographic Differences

Although the overall unemployment situation has been bleak, the effects have not been evenly distributed across demographic groups. The difference between men and women has garnered the most attention, because men accounted for 78% of the job losses despite constituting 51% of nonfarm employment at the start of the recession. The dominant explanation for this discrepancy is the difference in the severity of the recession across industries. Men predominate in goods-producing industries, such as natural resources and mining, construction,

and manufacturing, which accounted for about half of total losses. Women comprise the majority in recession-resistant fields such as education and health care, which saw an increase in jobs during the recession.

However, men always bear the brunt of job losses during recessions. Between 1969 and 1991, male employment fell by an average of 3.1% during the five recessions experienced during the period. Female employment, on the other hand, tended to rise by an average of 0.3% during recessions (Source: *The Effects of Recession Across Demographic Groups*, September 2009).

Between the fourth quarter of 2007 and the second quarter of 2009, total employment losses amounted to 4%. Male employment fell by 5.7% and female employment by 2%. Employment of single adults fell at more than twice the rate of married individuals, while white employment fell by only two-thirds as much as black employment.

By age, employment fell 14.8% for those ages 16 to 19, 7.1% for those ages 20 to 24, 5.2% for those ages 25 to 34, 7.3% for those ages 35 to 44, 2.7% for those ages 45 to 54, and increased 3.8% for those over age 55.

By education level, employment fell 8.8% for those with no high school diploma, 5.3% for those with a high school diploma, 3.2% for those with some college, and only .1% for those with a bachelor's degree or higher.

What do these differences indicate? The primary reason cited for the difference between males and females is the change in industries. Men are also less likely to have attended college than women. Single people might have lost proportionately more jobs because the average single person is younger, thus less experienced and less educated, than the average married person.

At this point, whether we have a muted, jobless recovery or a rapid one featuring full employment will depend on the demand for labor. The unemployment rate is stabilizing, but the demand for workers has not been showing any signs of major improvement yet. Of course, some kinds of slack might exist that prevent rising demand for labor from translating immediately into new jobs. Employers could demand more hours from current employees before hiring new employees. The average weekly hours of production workers, which stands at 33.1 hours, indicates that this is likely to happen. Similarly, part-time employees can be made full-time employees.

No two recessions are the same. Structural changes, such as labor force participation, the skill level of workers, and the shift from manufacturing to services, can make comparisons with prior recessions difficult. However, one thing is for sure - this recession is unusual in the depth and breadth of employment losses.

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The Basics of Growth and Value Investing

The two basic investing styles are growth and value. While one style tends to perform better at any given time, the dominant style varies over time. The basic elements of each style include:

Growth Investing

Growth investors look for stocks with above-average growth in sales and earnings, typically at a 15% or higher annual rate. These are typically stocks of younger companies in a rapid growth stage of development, although larger companies can also qualify as growth companies. Growth companies tend to have higher price/earnings (P/E) ratios with little or no dividends, since earnings are typically used to finance future growth. As growth stocks gain favor, investors tend to bid their prices up to lofty levels. Thus, the P/E ratios of growth companies can be two or three times higher than the overall market. Earnings projections largely drive the value of these companies, so earnings disappointments can dramatically impact their value.

When searching for appropriate growth stocks, you should be looking for a fast-growing company that you feel will be able to sustain that growth for an extended period of time.

Value Investing

Value investors emphasize stocks with market values that are low based on earnings, dividends, or assets. Companies in this category typically include those in out-of-favor industries, turnaround or troubled companies, or mature and stable companies with modest growth expectations. Dividend yield may be higher than average since the stock price is low. Signals that a company may be turning around include insider buying, improving profit margins, increasing earnings estimates, or higher trading volumes. Value investors must typically exhibit

patience, since it can take a while for the market to realize a particular stock's value.

When searching for value stocks, you should look for a company with depressed earnings and a stock price that you feel will recover soon.

Which Style Performs Better?

Growth stocks typically do well when the economy is growing and the stock market is rising, while value stocks typically do well when the stock market is peaking or falling. Many investors are naturally drawn to a growth investing style since growth stocks usually have exciting news, capturing much press attention. Value companies often receive unfavorable press, requiring more resolve on the investor's part to continue holding them.

So which style will excel in the future? Just as you can't predict where the market is headed, it is difficult to determine when each style will dominate. Thus, it may make more sense to include both styles in your portfolio. That way, no matter what style dominates, it will be represented in your portfolio.

Growth investing does not guarantee a profit or eliminate risk. The stocks of these companies can have relatively high valuations. Because of these high valuations, an investment in a growth stock can be more risky than an investment in a company with more modest growth expectations. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated.

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Selecting a Guardian for Your Children

For parents with minor children, the most important reason for estate planning is to ensure that provisions have been made for their children. While it can seem overwhelming to deal with all the issues involved, consider what would happen if you and your spouse died without a will, with no provisions for a guardian, and without adequate money to help raise your children. One of your most important parental responsibilities is to make sure that does not happen. Some items to consider include:

- **Carefully select a guardian.** While your first inclination may be to select your parents, make sure they have the energy to raise your children. A better alternative may be a sibling or friend. If you have several children, decide whether it is reasonable to expect one person to raise them all. You may want to name more than one guardian, but make sure the guardians will work together to keep the children as close as possible. If the person lives in another city or state, consider whether you want to uproot your children while they are going through the trauma of their parent's death.
- **Talk to your selected guardian.** Once you've settled on a guardian, discuss your decision with that person to make sure he/she is willing to take on the responsibility. Name a contingent guardian in case your first choice is unable to serve.
- **Make adequate financial arrangements.** You wouldn't want your children to be a financial burden, or their presence may be resented. Determine how much is needed for living expenses, hobbies, medical expenses, and college. Other items need to be considered as well. For instance, will your guardian's home comfortably accommodate your children, or should you leave funds for an addition to the home? Include a financial cushion so there is plenty of money until your children reach adulthood.
- **Decide who should manage your children's finances.** The person with physical custody of your children may not be the best person to handle their finances. Thus, you may want to select another individual for that role. You should also consider whether trusts will need to be set up and how money should be distributed when your children reach adulthood.
- **Express your wishes to your selected guardian.** This will help ensure your children are raised according to your beliefs. Make sure to indicate your preferences for education, religion, lifestyle, and other important issues.
- **Review your choice of guardian every year.** As your children grow, you may realize that the person you originally selected as guardian is no longer the right choice.

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Make Saving a Habit

Habits are all about the principle of human inertia - we tend to keep doing what we've always done and shy away from doing something new. The principle may work against you at first. If you're not used to saving money, it can be hard to get started. But once you gain some momentum with your new saving habits, it will be relatively easy to keep it up. If you haven't started saving or aren't saving enough, here are some tips:

- **Take full advantage of payroll saving plans.** Payroll deduction is a great financial innovation. With one authorization form, you can start a savings program that works for you without any more effort on your part. It doesn't matter what type of plan it is or how much you put in. Just get started and you have a new habit.
- **Aim to max out your company match.** When a company offers you a matching contribution, it's like they are saying, "Here's some free money. Want it?" Make sure you contribute enough to get the full matching contribution.
- **Treat saving as a bill.** The old adage for saving is, "Pay yourself first." The trick is to treat saving like any other bill. Name an amount and a date to pay it, then make the payment when it comes due.
- **Set annual goals for account balances.** You can never reach a goal if you don't have one. Specific annual targets for your account balances become incentives to save, and by dividing the difference between your current balance and your target, you can easily derive the periodic amount you need to contribute.
- **Devote your raises to saving.** When you get a raise, don't forget to increase your savings. If you can afford to, bank the entire raise. If you can't do that, at least increase your savings by a portion of the raise.
- **Save your loose change.** Keep a savings jar and at the end of the week, put your loose change in it. You may also want to put bills below a specific denomination in the savings jar. At the end of the month, deposit the money in savings.

Saving is all about discipline - denying yourself immediate gratification in favor of securing your future. The tips above can take some of the pain out of creating a new habit or adjusting an existing one to help you pursue your goals.

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Review Your Personal Liability Coverage

A personal liability umbrella policy increases the liability coverage of your homeowners and automobile policies. It also expands coverage to include damages caused by non-owned property in your possession and suits for libel, slander, defamation of character, or invasion of privacy. The policy also pays attorney fees to defend you against claims covered by your policy. Thus, even if you carry high limits on your homeowners and automobile policies, you should consider an umbrella policy.

Your homeowners and automobile policies will typically cover you for personal liability of anywhere from \$100,000 to \$500,000. However, if a judgment in excess of that amount is awarded against you, the amount in excess of your insurance limits will have to be paid personally, unless you carry personal liability insurance.

You may not think you need an umbrella policy because your actions would never necessitate the need for this coverage. However, liability can arise from auto-related accidents or accidents on your property. Liability awards are typically based on the severity of the plaintiff's injuries, not on whether you intended to harm the person.

Umbrella policies can be purchased in increments of \$1 million. They are designed to kick in once the limits of your homeowners and automobile policies are exceeded, so you'll be required to maintain certain limits on those policies. Umbrella policies don't cover intentional acts or damages resulting from a business, even a home-based business. Separate coverage is required for business risks. This coverage is relatively inexpensive, since claims are usually rare.