BURKE
FINANCIAL STRATEGIES
99 Wood Avenue South, Suite 102
Iselin, NJ 08830
(866) 603-3700
(732) 744-1240 Fax

Steven Criscuolo, CPA
Financial Advisor
steven.criscuolo@burkefinancialstrategies.com

John B. Burke, MS, CFP®
Financial Advisor
john.b.burke@burkefinancialstrategies.com

Christopher M. Trainor, CFP®
Financial Advisor
christopher.trainor@burkefinancialstrategies.com

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How Do You Know If You're Saving Enough?

Most people think when they start earning more money, they'll start saving more money. But what often happens is the more you make, the more you spend.

If you want financial independence, you have to establish a savings routine. The more money you make, the more your savings rate needs to increase.

While it may seem like a daunting task, it can be accomplished. The only way to reach financial independence is if you save and live within your means. Your savings should include retirement account contributions, matching funds from your company if available, cash savings, and any other investments.

Savings at Every Age

Your 20s: You are just starting out and, hopefully, you've found a good job that pays a reasonable salary. This is the beginning of the accumulation stage, so you need to start by paying off debt if you have student loans and work to save at least 10%–25% of your income.

If your employer offers a 401(k) plan, start investing right away. Try to contribute as much as possible or at least contribute as much as your employer will match.

Your 30s: Hopefully, you have now found out what you want to do for a living and had a jump in income. You are still in the accumulation stage, so you should be increasing contributions to your retirement accounts and trying to contribute the maximum per year.

By the end of your 30s, you'll want at least twice your annual salary saved. A simple example: If you're making $50,000 annually, you'll want to have $100,000 accumulated in savings by age 39. But remember this includes retirement accounts.

Your 40s: This is the decade

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The Traveling Investor

This summer, I had the pleasure of visiting the country where my father's grandparents came from, Ireland; and in the fall, I visited the country where my wife's father came from, Croatia. As I do whenever I visit a foreign country, I checked out real estate prices and was shocked at how high they were in both countries.

In this piece, I want to make a comparison between how people approach their real estate investments and how they approach their stock investments. The difference is remarkable.

I know that many of you have been to Ireland. This was my first visit. It is nearly a cliché to say how beautiful Ireland is or how rainy it is. Both are true. But what I found most interesting is how competitive the Irish are — and this extends to real estate.

Maybe the roots of Ireland's competitiveness lie in their castles. There are thousands of castles in Ireland, but they weren't built to protect the Irish from foreigners. They were built to protect the Irish…from the Irish. The rivalries between the counties and families go way back and are just as fierce, though not as violent, today with competitions in Gaelic football and hurling (which is somewhat like lacrosse). Now the competition extends to real estate. The Irish have a competition called the Tidy Towns competition.

I was shocked to find out how valuable Irish real estate is. Over the last five years, the price for the average four-bedroom home in Dublin rose from $668,000 to $1,000,000.[1]

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How Do You Know?

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of major responsibilities, as you probably have dependents. Your income may have increased as you climbed the ladder at your job or moved to a new one. And even with the increase in expenses, you'll need to also be increasing your savings rate.

By the end of your 40s, you should have saved four times your salary. You will want to now be maxing out your contributions to retirement accounts, as well as monitoring your investments for performance.

Your 50s: You are now at your peak earning years and your saving rate needs to be at its highest. Your expenses are still pretty high but by the end of this decade, you will most likely be an empty nester, and your expenses should decrease.

By the time you reach 59, you'll want to have saved seven times your income. Monitor your investments so you can make adjustments to increase your returns.

Your 60s: You're getting close to or have retired. Your mortgage may be paid off and expenses have decreased. Your saving should be at its peak, which is 10 times your income prior to retiring. You can now start to relax as you will receive distributions from your retirement accounts as well as Social Security. You'll need to make sure that you are informed about distribution requirements of your retirement accounts.

Your 70s and beyond: Now all of your expenses are being covered by your retirement account distributions and Social Security. Hopefully, you have saved well and are reaping the benefits of all those years of saving.

Watch for These Warning Signs

As you go through the journey to retirement, you may not be able to accumulate the level of savings you need, but you should have acquired a good amount of savings for a comfortable retirement.

Take stock of how much you are saving every year and look for warning signs that you are not saving enough.

If you experience any of the following, you need to take a hard look at your financial situation to get on track:

✔ You have no idea how much money you're spending every month, which means you are most likely overspending.

✔ You don't have savings goals or a savings plan. If you don't have goals and a plan to achieve them, you will have a hard time saving for important milestones.

✔ You're living paycheck to paycheck. It's time to take a serious look at your finances to see what can be reduced or eliminated.

✔ You're putting off saving for retirement. It will get here quicker than you think, and this is the one thing you really need to start saving for as early as possible.

✔ You can't pay your credit card balance in full, which means you probably have significant debt.

✔ You don't have an emergency fund. You know the unexpected will happen and need to be prepared.

Please call if you'd like to discuss this in more detail. ❍❍❍

Watching Your Stocks

No matter how often you prefer to monitor your stocks' performance, there are certain items you should consider. Here are five things to review:

✔ **Earnings** — Pay attention to each company's quarterly and annual earnings statements, which include comparisons with the recent past and often reviews of what management expects for the next quarter and year. Review that stock's earnings trend and how the company performs compared to analysts' estimates.

✔ **Price and dividends** — Follow a stock's price compared to its 52-week highs and lows. Examine its trailing total returns year to date and over the last one-, three-, five-, and 10-year periods. Look for changes in the absolute dollar amount of dividends and the current yield.

✔ **P/E and PEG ratios** — Price/earnings (P/E) and price/earnings to growth (PEG) ratios are often better indicators than the stock price as to how relatively expensive or cheap a stock is. The P/E ratio is useful for comparing the stock to other stocks and the market in general, while the PEG ratio is a strong indicator of whether the stock is overpriced or underpriced compared to its projected earnings growth rate over the next five years.

✔ **Insider transactions and stock buybacks** — A company buying back its own stock or whose senior executives and directors are accumulating more shares is a bullish sign. On the other hand, when insiders are selling off major holdings of their own stock, it's quite often an indication that the stock price has peaked.

✔ **Sudden and large price changes on high volume** — When a stock makes a sudden, high-volume move — particularly when it opens much higher or lower than the previous day's high or low — it can be the start of a new, long-term trend. ❍❍❍

Looking for Signals to Buy and Sell?

While practiced for more than 100 years, the methods of technical analysis aren't nearly as familiar to the investing public as those of fundamental analysis. Fundamental analysis tells the company's essential story — who runs it, what it does or makes, how much money it spends, and how much and fast it earns money.

Technicals, though, sound altogether different. Instead of talking about the company, technicians focus on the statistics about the stock: how the price has changed and how many shares were bought and sold as the price changed. Their domain is lines drawn on a chart and the patterns they make, and their job is to infer where the stock price is likely to go next.

The difference between the approaches is defined by Wall Street like this: fundamental analysis tells you *what stock you should buy*, and technical analysis tells you *when to buy it*. Here are a few of the signals technicians use to make buy-and-sell recommendations.

Changes in price and volume. Technical analysis is grounded in the concept that stock prices are determined much in the way the prices of any other goods or services are set: by the relative balance of supply and demand. In the case of stocks, it's a matter of how many people are anxious to buy or sell shares at any given price point. If more people want to buy, the price will go higher; if more want to sell, the price will go down.

By looking at whether volume was higher or lower when the stock price changes, technicians can make a reasonable inference as to whether the buyers outnumbered the sellers or vice versa. Generally speaking, if volume increases on a day the price goes up, the inference is that the buyers outnumbered the sellers and the stock price is likely to continue going higher. If the stock price rises on lower volume, the inference is that fewer and fewer people are eager to buy the stock, and the upward movement is likely to slow down or reverse.

Levels of support and resistance. These are price points where the trend in a stock price either hesitates or reverses. If the stock stops going up, it's said to be meeting resistance; and if it stops going down, it's encountering support. While this sounds like an architectural feature, in reality these points are prices where a shift occurs in the balance of buyers and sellers.

Levels are visible on stock charts when the price goes sideways for a period of time, or the price line forms peaks and valleys below and above certain levels. Technicians identify these points by looking at the chart history. Often, when a level of resistance or support is broken — especially on higher volume than the day before — the stock may seek that next price level.

Moving averages. Technicians draw lines on charts that plot moving averages of a stock's closing price. These are calculated as the average closing price over a given period of time. Among the most popular are the 20-, 50-, and 200-day moving averages. They're useful in two ways: they serve as additional points of support and resistance, and they can be used to identify buy-and-sell signals.

For example, when a stock price crosses the 200-day moving average, a very important signal is generated. If a stock crosses its 200-day moving average from above to below, it's often taken as a sell signal, which occurs after a long downtrend that is getting worse. When the price crosses the 200-day moving average from below to above, it's often seen as buy signal — a sign that a long down trend has ended and a new up trend is beginning.

Moving Average Convergence and Divergence (MACD). This indicator is of a level of complexity above the three concepts we've just reviewed. It's a barometer of the momentum a stock's price trend has and how it changes over time. Technicians use it to forecast changes in stock trends and to recognize the difference between a relatively meaningless fluctuation in a stock's price and the beginning of a meaningful, new trend. Identifying new trends is another way technicians recognize buy-and-sell signals.

Interestingly, technical analysis is equally useful when analyzing stock indices as well as individual stocks. The benefit to analyzing indices is technicians can identify broad market trends. Since most stocks move in the same direction as broad indices, technicians can help investors decide when it's a good time to act on buy or sell signals generated on individual stock charts. ❍❍❍

Traveling Investor

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That may be cheaper than New York, but it is certainly more expensive than the average four-bedroom in the U.S. Statistics countrywide are hard to come by, but I have both relatives and friends who have purchased real estate in Ireland and have done very well. Prices have gone up quite a bit.

Some of them purchased in 2008 when the economy collapsed, and some of them even purchased before the cessation of Irish infighting was brokered in 1998 with the Good Friday Agreement. Most people don't sell their real estate when things get tough, but I will get back to that.

In Croatia, we found that real estate was even more expensive, though we were vacationing primarily on the beautiful Dalmation Coast where it is most expensive. Tour guides explained that prices along the coast are now well over $1.5 million for a four-bedroom home. Croatian coastal properties are more expensive than New York City properties.[2]

This is incredible given the unstable history of Croatia. Interestingly, Croatia was not even a country until 1991. In fact, here are my notes from what I learned about Croatian history during my travels:

They were Greek, then Roman, then Venetian after the Roman Empire collapsed, except that a lot of it was part of the Byzantine empire, then 1000 years ago for a brief period they were ruled by a Croatian King, then they were Hungarian, then part of Venice again, then Ottoman (at least part of it), then Austria–Hungarian, then Napoleon came for a while, then they were Austro–Hungarian again, then Croatian for a short time again, then a country called Yugoslavia was formed by uniting the Slavic nations, then Hitler came, then they were Yugoslavia again until in 1991, they became independent.

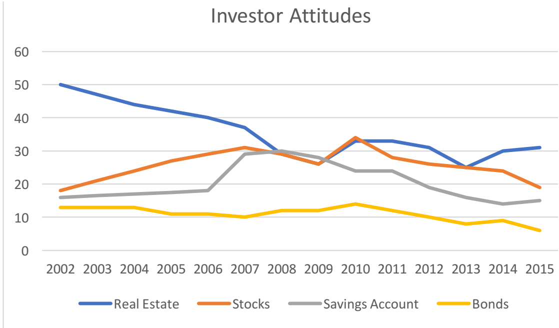
Get all that?

Would you buy real estate in Croatia? Apparently, most would, given the way prices have gone up.

Being a long-time student of investing, I have observed that investors, in general, treat real estate with more reverence than other investments. To the right is a chart of data on investor attitudes from Gallup, the polling company.

Investors were given the opportunity to rate real estate, stock, savings accounts, and bonds as investment opportunities with the results shown.[3]

Real estate has clearly been favored. And my experience in Ireland and Croatia shows me that investors are inclined to look for real estate bargains during and despite tumultuous times.



As stock investors, this is frustrating because the data do not support the belief that real estate is the best-performing investment. According to Thornburg Investments, in the 30 years to 2012, stocks returned 10.98% compared to home price appreciation that averaged 3.94%.[4] A more impartial source, *Forbes*, reported in 2005 that stocks in the 25 years to 2004 returned 9.65% compared to home price appreciation of 3.68%.[5] Of course, you can rent out a house (or it saves you paying rent), but on the other hand, there are significant costs involved in buying real estate, including property taxes.

Many people will remark that their home has been their best investment. Maybe, but again the numbers don't support those conclusions. I bought my first free-standing home in 1996 for $240,000. In 2014, I sold that home for just over $800,000. "Wow!" or "Nice profit" you might say. Crunch the numbers, however, and you will find that was a 6.9% annualized return. Not bad, but that was slightly worse than the return for stocks during that time, with stocks represented by the S&P 500.

From that 6.9% return, you have to subtract real estate taxes. For me, that came to about 2% per year.

You could add in rental income (or the savings of not having to pay rent), but the numbers were apples to apples in that the real estate returns did not include rent (I could have rented the home) and the S&P 500 returns did not include dividends.

Further, real estate requires maintenance, which is probably higher than the expenses associated with stock investing.

No matter how you cut it, the returns do not justify the elevated place that real estate has in investors' minds.

But maybe there is a lesson here.

In 1991, Croatia gained its independence. In 1992, it was attacked by Serbia. Would you have purchased real estate in 1992?

Perhaps you are more familiar with Ireland. Ten years before Croatia gained its independence, the British army rolled into Belfast in Northern Ireland to quell the violence. Would you have purchased real estate in Ireland in 1981?

Nathan Rothschild increased his family's wealth in March of 1815 by buying financial assets just as the battle of Waterloo got underway. Rothschild was in London, and legend has it, he bought before he knew that Wellington was going to defeat Napoleon.

Would you buy financial assets as war breaks out?

To buy real estate cheaply, you have to buy when things are rough. We all hope we will never see war in this country, but we may well see nasty times like 2008 again. Real estate investors seem more inclined to realize that you can profit when you buy during tough times like 2008.

We don't know when stocks will become cheap again. We suspect, however, that the variable that will make stocks cheap will also make you hesitate or perhaps miss the opportunity entirely. The bear market will have been caused by an economic recession, by war breaking out somewhere, or perhaps by a default by one of the large central banks in the world.

Most people will want to sell. But successful investors will consider buying more.

The next time markets pull back, we hope that you will take our suggestion to consider buying more stocks.

Sincerely,

John B. Burke

John B. Burke, MS, CFP®
Financial Advisor

[1] Delmendo, L.C. "Dublin's housing market is now cooling, but rest of Ireland remains very strong." *www.globalpropertyguide.com*. November 1, 2016. www.globalpropertyguide.com/Europe/Ireland/Price-History

[2] "Croatia's housing market is recovering, along with its economy." *www.globalpropertyguide.com*. May 30, 2017. www.globalpropertyguide.com/Europe/Croatia/Price-History

[3] *Gallup News*, April 17, 2014

[4] "A Study of *Real* Real Returns." Thornburg Investments. Retrieved from: thornburg.com/pdf/TH1401_real_real_returns.pdf

[5] *Forbes*, May 2005