



THE COMPASS CHRONICLE

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Wealth Management Update

Politics and Investment Performance

With the Nov. 2 elections come and gone, here's the result of an investigation into the relationship between the composition of the legislative and executive branches of the U.S. government and market performance. The data table displays the average annual returns for the S&P 500® and a 60% stock/40% bond portfolio in three different situations. The "unified" situation refers to years when the Senate, the House of Representatives, and the White House were all controlled by the same party. The "partially divided" situation represents years when the House and Senate were controlled by the same party, but the White House was held by a different party. The "completely divided" situation uses data from years in which the two houses of Congress were divided. Both the S&P 500 and the diversified portfolio averaged the highest returns during unified years, lower returns during partially divided years, and the lowest under completely divided years.

Average Annual Returns 1926–2010

	S&P 500	Diversified portfolio	Number of years
"Unified" years	14.8%	9.9%	45
"Partially divided" years	11.1%	9.5%	30
"Completely divided" years	1.0%	6.8%	10

Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Diversification does not eliminate the risk of experiencing investment losses. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. The time period examined is 1926–2010, and the returns are average annual returns.

Stocks—Standard & Poor's 500 index, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds—20-year U.S. government bond.



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Advisor Corner

I pride myself in offering you expert financial advice along with personalized service. Assisting you in reaching your financial goals is my business and I take that responsibility very seriously.

As an objective and independent fee-only wealth manager, my sole interest is to ensure my recommendations meet your financial goals.

COMPASS Wealth Management, LLC is a client-focused wealth management firm dedicated to providing superior advice to individuals, families, and corporate retirement plans.

Our wealth management services include investment management, retirement and gift planning, education funding, and other advisory services.

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Monthly Market Commentary

- ▶ Despite unsettling events around the globe, the U.S. economy remains on its expansionary track.
- ▶ Even the employment picture is beginning to brighten.
- ▶ Unfortunately, the housing market continues to struggle.

The market has had its ups and downs in March, but the overall atmosphere has been optimistic in light of less negative news from Japan and the Middle East. On the not-so-optimistic side, however, bad news on the European debt crisis (Portugal in particular) may signal some dark clouds looming ahead.

Employment: After a year of almost no progress, employment statistics have finally begun to show some improvement. Current unemployment claims are in the 300,000–350,000 range, approximately half of the 674,000 we've seen in the early months of 2009. Since 20%–25% of the jobs lost during the recession were in the construction sector, significant improvement in unemployment numbers may not occur until both the homebuilding and construction industries recover. Still, in light of these recent positive numbers, next week's jobs report is an eagerly awaited piece of news.

Consumer spending: Other statistics to be released next week include personal income and spending data for the first quarter of 2011, which may provide insight into whether consumer confidence is back or still waning. Consumption numbers are crucial data points for quarterly GDP forecasts, which for now appear to be in the 2.0%–4.0% range. With higher inflation rates and volatile import numbers, Morningstar analysts estimate that first-quarter GDP growth may be on the lower side of this range. However, companies will start reporting corporate earnings next month, significantly impacting the market and economic forecasts.

Tech sector: Excellent news from the tech sector fueled the market in recent weeks, with some technology companies reporting revenue growth as high as 25% and raising their dividends. In the improving economic environment, businesses now have more money to invest in new technologies, such as cloud computing, which in turn may fuel future growth.

Housing market: Unfortunately, housing data still does not indicate any significant improvement.

New and existing home sales in February were dismal; only 250,000 units were sold, a new record low dating back to the 1960s. This is in sharp contradiction with realtors' and builders' optimism about the spring selling season. Even when taking seasonal factors into account, such as bad weather and low temperatures, the outlook remains bleak.

Economic growth: The GDP number for the fourth quarter of 2010 has been revised for a third and final time, from 3.3% to 2.8% and now back to 3.1%. Increasing consumer confidence was reflected in strong spending on consumer durables, with modest growth in non-durable goods and consumer services displaying the smallest growth. The overall message is clear: consumers are back, increasingly confident and willing to spend.

The tale of two recoveries (rich versus not so rich): As worrisome as this news may be, it is by now clear that so far in the recovery higher earners have fared much better than their counterparts (especially those with less education). The latter continue to face double-digit unemployment and have difficulties confronting the higher food and energy costs. Further pain in the lower income brackets may create a ripple effect and stall overall economic growth.

Quarter-end insights: Although this year started on a bad note, Morningstar economists are optimistic and predict that real GDP growth of 3.5%–4.0% may still be possible if inflation doesn't get out of control. However, this is a big "if." Judging by the already-rising fuel and food prices, inflation may reach 3% in no time (the annualized increase in the Consumer Price Index over the last six months is an even more frightening 3.9%). Looking forward, consumer spending remains key, as well as business investing. These may well be the two most important determinants of the recovery for the rest of the year.

Compound and Compare

- ▶ This article reviews the power of compounding returns.
- ▶ Compounding leverages time so that it works for you, rather than against you.
- ▶ The earlier you begin saving toward a goal (e.g., retirement, college expenses), the more likely you are to reach it.

Approaching retirement with too little money is unfortunate. Furthermore, getting sucked into the daily hype that has people jumping in and out of the stock market can be disastrous. The market will inevitably go down once in a while, but history proves that despite this, the long-term trend for the market is up. Taking that into account, the earlier an individual begins to invest, the better.

Data from the Bureau of Economic Analysis indicates that the U.S. overall savings rate has been drastically falling since the early 1980s, and only recently started to recover a little (since 2005). Even so, most people simply aren't saving enough for retirement, in an era when even more responsibility for retirement savings has been shifted from corporations to individuals.

This long-term lack of savings is partly a cultural phenomenon. Baby boomers have a stronger sense of optimism than the World War II generation, and have not placed the same priority on saving. Worse yet, they have relatively easy access to credit and a habit of spending beyond their means, regardless of how much money they make. This trend continued in subsequent generations. The problem is that nowadays people should be saving more, considering the declining availability in pensions provided by employers and the level of confidence in receiving Social Security benefits. The good news is that people have started to realize this recently.

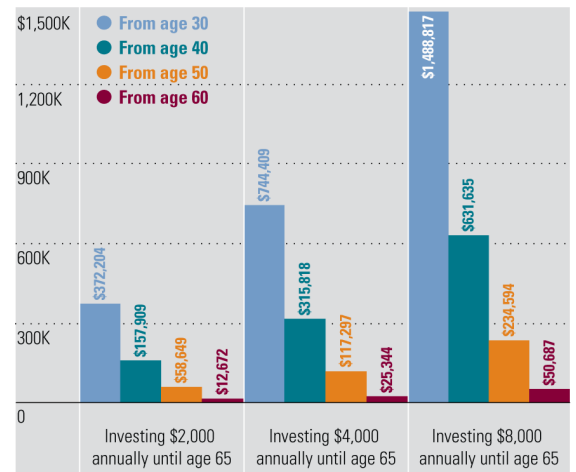
By contributing early and often to an investment plan, an investor's money compounds over time. Compounding, otherwise known as the ability of an asset to generate earnings from previous earnings, accelerates the growth of your assets over time. How does compounding work, exactly? Let's say you begin in year 1 by investing \$1,000. Year 1 proves to be a very good year for the market, and your investment returns 12%. You now have $\$1,000 + \$120 = \$1,120$. Year 2, however, is not so great, and your return for year 2 is now only 7%. The power of compounding is that you have now gained not 7% of your principal value (7% of \$1,000 = \$70), but 7% of your total investment value at the beginning of year 2: 7% of \$1,120 =

\$78.4. Now imagine what continuous compounding over a longer period or time can do.

The image below illustrates the growth of an account based on an investor's age and the amount contributed annually until age 65. The 30-year-old investor contributing \$8,000 per year will have nearly \$1.5 million at the age of 65. This is more than double the ending wealth value of an investor who saved the same amount per year but waited until age 40 to begin saving. It is quite clear that the earlier you start and the more you invest, the easier it is to achieve your retirement savings goal, thanks to the power of compounding investment returns.

But all is not lost for investors who do not start to aggressively save for retirement until they reach their 40s or 50s. The good news for these investors is that they still have enough time to change their savings behavior and achieve their goals, but they will need to act quickly and be extremely disciplined about their savings. Time waits for no one, so don't procrastinate-get started now.

The Power of Compounding



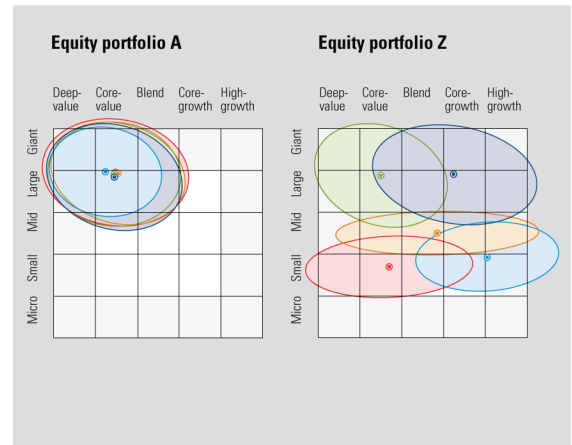
The image is for illustrative purposes only and does not represent an investment in any specific security. The calculations assume an 8% annual rate of return, compounded annually. The values represented do not account for inflation or taxes. Savings rate information from the Bureau of Economic Analysis.

Exploration in Diversification

- ▶ COMPASS Wealth Management is focused on creating a disciplined structure for each client portfolio.
- ▶ This structure is based on an appropriate asset allocation, as well as a diversified mix of mutual funds.
- ▶ The goal of our approach is to manage portfolio risk exposure, consistent with Portfolio Z in the graph to the right, rather than the undiversified approach depicted by Portfolio A.

Investors seeking a well-rounded portfolio often wonder how many funds they need to reduce risk through diversification. The answer isn't a specific number of funds, but rather the holdings of each fund in the portfolio. If multiple funds in a portfolio have similar holdings, an investor can fail to achieve diversification benefits. Portfolio A and Portfolio Z in the image contain five mutual funds. Each oval represents the ownership zone, which accounts for 75% of the fund's holdings. The funds in Portfolio A overlap, indicating that each fund shares similar style characteristics. Too much overlap defeats the purpose of using multiple funds to create a diversified portfolio. Portfolio Z spans across many styles, so positive performance by some investments can neutralize the negative effect of others. As illustrated, it is important to be aware of the possibility of security overlap when constructing a diversified portfolio.

More Concentrated Portfolio Versus Diversified Portfolio



Diversification does not eliminate the risk of experiencing investment losses. Source: Funds chosen from Morningstar's open-end database.

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