The COMPASS Chronicle

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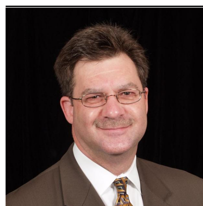
Floating-Rate Options When Interest Rates Rise

- Given COMPASS' expectation for higher interest rates, our clients often have exposure to floating-rate and bank loan securities to help diversify their bond exposure.
- We typically combine these securities with a high quality, short-term bond fund so that the overall credit quality of their short-term bond holdings remain investment grade.

Given the expectations that interest rates will rise in the not-too-distant future, it's no wonder that many fixed-income investors are considering floating-rate securities for their portfolios. The key distinction between floating-rate and fixed-rate securities involves how each investment type reacts to movements in market rates. A floating-rate bond tends to keep its value if rates rise, whereas a fixed-rate bond will lose value. That's because an existing bond with a fixed rate is worth less if investors can buy new bonds at higher rates. If rates drop, the opposite occurs: The existing fixed-rate bond will increase in value.

Because of the protection that floating-rate bonds may offer against rising interest rates, some investors may use them to reduce the rate sensitivity of their portfolios. One commonly used type is known as a bank loan. Corporations needing to borrow money may do so with help from one or several commercial or investment banks, which syndicate the loans and help sell them to investors. These loans typically receive below-investment-grade ratings, reflecting a relatively high risk of default. As is the case with other bond types, investment-grade floating-rate securities tend to pay lower interest rates than fixed-rate bonds do, while non-investment-grade floating-rate securities offer higher rates but also carry more credit risk.

For fixed-income investors concerned about a rise in interest rates, floating-rate securities may be a viable option. But investors may have to either settle for reduced yields (in the case of investment-grade floating bonds) or added credit risk and volatility (as in the case of bank loans). With corporate bonds, an investor is a creditor of the corporation and the bond is subject to default risk. High-yield corporate bonds exhibit significantly more risk of default than investment grade corporate bonds.



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More about COMPASS Wealth Management, LLC

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.

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

For details on the selection criteria used to determine the recipients of the FIVE STAR Wealth Manager award, please visit our web site.

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Morningstar Research Examines Retirement Costs

- Though a rule of thumb exists that individuals should plan on spending 70% - 80% of their preretirement annual income in retirement, COMPASS prepares customized retirement planning analyses for clients that incorporate their individual circumstances, including whether they plan to relocate to another state during their retirement.

Morningstar Investment Management published new research in December that examines the most common assumptions used to estimate retirement needs and lays out a framework for investors to take a more personalized approach to setting retirement savings goals.

“There are three common assumptions that many software tools and financial advisors use to come up with a retirement savings goal—a 70 or 80 percent replacement rate based on pre-retirement income, an income need that rises with inflation, and a 30-year retirement time horizon,” David Blanchett, head of retirement research for Morningstar Investment Management, said. “When we looked at actual retiree spending patterns and life expectancy, however, we found that these assumptions don’t hold true for many people and, on average, can significantly overestimate how much people will actually need to fund their retirement.”

Many expenses disappear after retirement, such as Medicare taxes, Social Security taxes, and retirement savings. The paper first demonstrates the effect on replacement rate calculations of accounting for taxable and non-taxable expenses that are no longer paid after retirement. Next, using government data, the analysis explores the actual spending patterns of retirees, and finds that they grow at a rate lower than inflation through most of retirement and then accelerate in later years because of higher health care costs. While the difference between the actual spending growth rate and the inflation rate is relatively small, it has a material effect over time. When the researchers modeled actual spending patterns over a couple’s life expectancy, rather than a fixed 30-year period, the data showed that many retirees may need approximately 20% less in savings than the common assumptions would indicate.

Results from this research show the actual replacement rate is likely to vary considerably by retiree household, from under 54% to over 87%. Retiree expenditures do not, on average, increase each year by inflation or by some otherwise static percentage; the actual “spending curve” of a retiree household varies by total consumption and funding level. Specifically, households with lower levels of consumption and higher funding ratios tend to increase spending through the retirement period and households with higher levels of consumption but relatively lower funding ratios tend to decrease spending through the retirement period. When consumption and funding levels are combined and correctly modeled, the true cost of retirement is highly personalized based on each household’s unique facts and circum¬stances, and is likely to be lower than amounts determined using more traditional models.

“While a replacement rate between 70 and 80 percent may be a reasonable starting place for many households, we find that the actual replacement rate can vary considerably,” Blanchett continued. “Take, for example, a high-income couple, living in a high income tax state like California, and saving a significant amount for retirement each year. If that couple retires in Florida or Texas, where there is no income tax, the replacement rate might be closer to 60 percent. By contrast, a low-income couple saving very little for retirement and retiring in California could have a replacement around 85 percent. It’s important for investors to consider their level of pre-retirement household income, expenses that discontinue after retirement, and post-retirement taxation.”

These findings have important implications for retirees, especially when estimating the amount that must be saved to fund retirement. A more advanced perspective on retiree spending needs can significantly change the estimate of the true cost of retirement.

Source: David Blanchett, CFA, CFP, Head of Retirement Research, Morningstar Investment Management: Estimating the True Cost of Retirement, Working Paper, Nov. 5, 2013.

Do You Have a Plan for Your Digital 'Estate'?

- With the integration of electronic devices into our everyday lives, be sure that those who rely upon you have the means to access your digital information if you cannot.
- You also want to ensure that you can access your information if your device crashes, is misplaced, or is stolen.

Even people who think they've ticked off all of the usual boxes on their estate-planning to-do lists may have overlooked an increasingly important component of the process: ensuring the proper management and orderly transfer of their digital assets. Just as traditional estate-planning relates to the management and transfer of financial accounts and hard assets, digital estate-planning encompasses digital possessions, including data stored on tangible digital devices (computers and smartphones), data stored in the cloud, and online user accounts.

Digital estate planning is, in many respects, more complicated than traditional estate planning. The field of digital estate planning is evolving rapidly, as are digital providers' policies on what should happen to digital assets that are left behind. Digital assets are also governed by a complex web of rapidly evolving laws, both at the state and federal levels. Precisely because of all the potential complications, it's important to take a few minutes and get a plan in order. Here are several key steps to take.

1) Conduct a Digital 'Fire Drill.' A good first step in the digital estate-planning process is to conduct a digital fire drill, which tends to jog your memory about what digital assets you deem important. Consider the following questions. What valuable items would you lose if your computer was lost or stolen today? If you were in an accident, would your loved ones be able to gain access to your valuable or significant digital information while you were incapacitated? If you were to die today, to what valuable or significant digital property would you like your loved ones to have access?

2) Take an Inventory of Your Assets. The next must-do is to create an inventory of the digital assets you named during the fire drill. Document the item/account name as well as user names and passwords associated with that item. Among the items to document in your digital inventory are: digital devices such as computers and smartphones, data-storage devices or media, electronically stored data, including online financial records, whether stored in the cloud or on your device, user accounts, domain names, and intellectual property in electronic format. This document would be chock-full of sensitive information, so keeping it safe is crucial. A printed document should be stored in a safe or safe deposit box, and an electronic document should, of course, be password protected.

3) Back It Up. We've all been schooled on the importance of regularly backing up digital assets, and estate-planning considerations make it doubly important to do so. Even if a specific device malfunctions, storing digital assets on another storage device or in the cloud helps ensure the longevity of those assets. Moreover, online account service providers may voluntarily disclose the contents of electronic communications, but they're not compelled to do so. If you want to help ensure that your loved ones have access to the information in your online accounts, backing it up on your own device is a best practice.

4) Put Your Plan in Writing. Experts also recommend formalizing your digital estate plan. That means naming a digital executor—someone who can ensure that your digital assets are managed or disposed of in accordance with your wishes after you're gone. If your primary executor is savvy with technology, there's probably no need to name a separate digital executor. But if not, or if you have particularly valuable or special digital property, such as intellectual property, experts advise a separate fiduciary/executor for digital assets. Depending on the type of property, the fiduciary may also need special powers and authorizations to deal with specific assets.

This is for information purposes only and should not be construed as legal, tax, or financial planning advice. Please consult a legal, tax, and/or financial professional for advice regarding your personal estate planning situation.

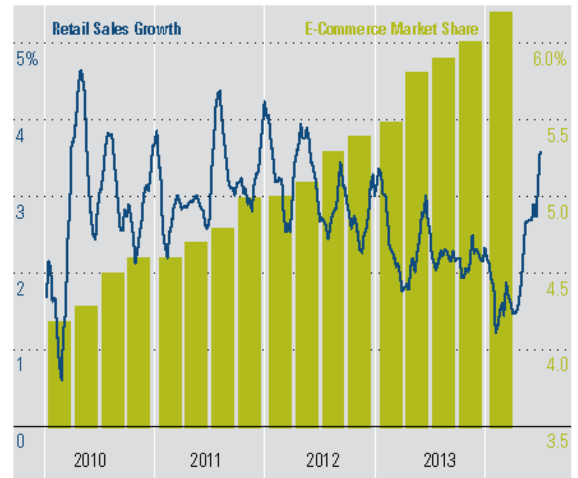
Shopping Center Sales Fall as E-Commerce Grows

- The rebound that brick-and-mortar retailers enjoyed in the second quarter is most likely a seasonal rebound from the tough winter weather suffered by many areas during the first quarter.
- Longer term, brick-and-mortar retailers will likely continue to lose market share to web-based retailers, which tend to have lower cost structures and can compete more effectively on price.

The secular trend in shopping center retail sales has been faltering for some time. Recent weather and e-commerce trends are two factors that can explain this general decline. E-commerce has been growing as a percentage of all retail sales, as more and more consumers are shopping online.

Though year-over-year growth in same-store sales has been showing lower highs and lower lows since 2012, weekly sales growth has generally fallen in the 2%–4% range. After poor weather conditions in the first quarter of 2014, sales growth fell below that range, approaching 1%. However, brick-and-mortar retailers appear to have finally found a way to attract more customers into their stores. Mall retail sales saw rapidly accelerating growth in the second quarter, reaching 4.6% on a year-over-year, 5-week average basis.

Shopping Center Versus E-Commerce Sales



Source: Census Bureau, International Council of Shopping Centers.

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