The COMPASS Chronicle

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The Importance of Saving for Women

- As this article articulates, women tend to save a greater proportion of their income for retirement than men.
- However, in a traditional family, wives have tended to take the lead from their husbands in financial matters. COMPASS encourages its married female clients to take an active role in financial decision making throughout their lives. Such involvement can be especially helpful later in life should they outlive their partner.

Women face a different set of financial-planning challenges than men because they tend to live longer, earn less, and take more breaks from the work force. Women may also experience more difficulties if they are widowed or divorced. The good news is that women tend to save more. According to Vanguard's "How America Saves 2012" report, women saved at rates about 5% to 10% higher than those of men across every income group. However, even though their savings rates were higher, women's balances in savings accounts tended to be lower than those of men because women, on average, had lower incomes. This illustrates the extreme importance that saving (and starting to do so early) has for women. It's not always easy, but managing debt, controlling expenses, and contributing to a retirement plan can make a world of a difference down the road.

Average Deferral Rates by Income and Gender 2011

Vanguard defined contribution plans permitting employee-elective deferrals

	Female	Male	All
<$30,000	5.1%	4.5%	4.8%
$30,000–$49,999	5.9	5.6	5.8
$50,000–$74,999	7.4	6.9	7.1
$75,000–$99,999	8.9	8.0	8.3
$100,000+	8.8	8.0	8.2

Source: Vanguard, 2012

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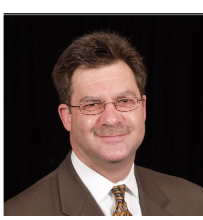

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COMPASS Wealth Management, LLC is a client-focused wealth management firm dedicated to providing superior advice to individuals, families, and corporate retirement plans.

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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Return, Risk, and Taxes

By Louis E. Conrad II, CFA

- One of the guiding priciples of investing is to establish an appropriate asset allocation, or the mix of stocks, bonds, cash, and perhaps alternative investments, for your portfolio. The asset allocation decision establishes your expected return and risk.
- However, the asset location decision, commonly overlooked, dictates how much in taxes you are likely to pay (or avoid).

A rational and knowledgeable investor seeks the highest after-tax return for a given level of risk. Two investment concepts are critical here: asset allocation drives the return versus risk outcome, while asset location helps dictate the taxes an investor pays. These two concepts are reviewed in this article.

Asset Allocation

Asset allocation is an easy investment concept to understand, but it is also a key determinant on where the investor's portfolio lies on the return versus risk continuum. Asset allocation is the proportion of different assets used in a portfolio. In a traditional sense, asset allocation is the mix of stocks, bonds, and cash. Generally speaking, to structure a portfolio for greater return potential, but also greater risk, an investor needs to increase the proportion of stocks in their portfolio. To reduce risk and therefore the potential for returns, the proportion of bonds should be increased.

In a broader sense, other assets can be included as well, including real estate, commodities, and other alternative investments.

Several factors are often examined to determine an appropriate asset allocation for an investor, though the asset allocation decision is admittedly part science and part art. These factors include the investor's financial goals and objectives, investment time horizon, risk tolerance, and risk capacity. Many mutual fund and brokerage firms offer on-line questionnaires that can assist in gauging an investor's risk tolerance and, ultimately, a recommended asset allocation. However, without a complete profile of the investor, such on-line questionnaires should be used cautiously.

The asset allocation decision is not static. For example, as time passes, an investor's time horizon shortens. In response, their asset allocation should become more conservative (in the traditional asset allocation scenario, a greater allocation to bonds and a lesser allocation to stocks) because they will have less time to live through the highs and lows of the stock market.

Asset Location

While asset allocation drives the return versus risk outcome, asset location impacts the taxes you pay as an investor. Asset location is too often ignored to the detriment of the investor's pocketbook. Wisely locating which type of investment is located in which type of account can provide a tax-minimizing strategy.

Once an asset allocation is established, the tax-wise investor will place their income-producing, less tax-efficient investments in their retirement accounts. When taxable bonds and real estate investment trusts (also known as REITs) are placed in retirement accounts, their income is sheltered from taxes. However, if those same investments are placed in an individual or joint brokerage account, or a trust account, that same income is taxable.

Consequently, the extent to which an investor can place their income-producing investments in their retirement accounts is dependent on their asset allocation target and the dollar amounts invested in retirement versus non-retirement accounts.

Summary

In order to structure a portfolio designed to generate the best returns for an appropriate level of risk, as well as minimize the taxes paid, COMPASS Wealth Management, LLC finds that the asset allocation and asset location decisions are critical. Each decision is based on the specific circumstances of the individual client. Failure to follow these principles could lead to a suboptimal outcome, such as lower returns, higher risk, and/or more taxes paid than is necessary.

Monthly Market Commentary

As May saw spring slowly roll into summer, bond markets were sent into a tailspin by strong consumer confidence reports and real estate price data. Stocks managed to do better than bonds, but were still a little off as Germany and the rest of Europe decided to ease up on some of their austerity measures.

Employment: The U.S. economy added 175,000 jobs in May, just a little better than 149,000 in April, and the consensus forecast of 169,000. That's not far off the average for the previous 12 months, which is 179,000 jobs. Year-over-year average data has shown steady growth of around 1.9%–2.0% for almost two years, which is consistent with GDP growth of 2.1%–2.3%. Equity markets reacted positively to the employment numbers, but commodity and bond markets were not as thrilled. The jobs report was high enough to convince investors that the next recession wasn't around the corner, and just weak enough that Fed bond-buying programs are not likely to be eliminated in the very near future. The unemployment rate climbed to 7.6% in May from 7.5% in April.

Housing: Pending home sales showed a modest uptick in April, which should bode well for existing home sales in the months ahead. The Case-Shiller Home Price Index posted a 10.5% increase for April (calculated in year-over-year, 3-month average terms), indicating that the 6%–8% price appreciation seen in 2012 could be followed by a potential 8%–10% move in 2013. However, the Case-Shiller 20 is still about 28% below its all-time high, affordability remains near record-high levels, and not every geographic market is participating uniformly in the large increases. Also, low inventories and still-tight lending conditions are two major factors currently holding back the housing market.

Consumer Spending: The most important thing to remember when measuring this type of economic indicator is that month-to-month numbers fluctuate a lot and are not nearly as significant as long-term trends. Year-over-year data has been exceptionally stable and telling a story of slow and steady improvement. However, there is a sizable gap between income and spending. Spending itself remains stuck in the same 2% annual growth trajectory it has been on for more than two years. Meanwhile, income growth remains considerably below that level, which suggests that even if the consumer is optimistic, the fuel necessary for more spending is running a little low. Consumers in the top income quartile (who are big savers) really need to step it up spending-wise, and weather and gas prices need to cooperate to keep the U.S. economy from settling back a little in the second quarter and in the second half of 2013.

Trade: The U.S. trade deficit as a percentage of GDP has continued to shrink from 5.7% in 2005 to 2.9% in 2012 and 2.85% in the first quarter of 2013. The deficit has remained steady the last several years, even as the U.S. economy has entered a recovery (the trade deficit generally increases in a recovery and decreases in a recession). Continuing good news on the U.S. oil and gas front could improve the deficit even further. A smaller trade deficit points to a smaller need to borrow money from outside the U.S. and also generally means a stronger currency, which in turn helps control inflation.

Overall, Morningstar economists believe that 2013 may still turn out OK, with 2.0%–2.25% GDP growth, inflation well below 2%, and employment growth of about 1.8%. Real estate and consumer spending (especially on housing-related items) remain the bedrock to forecasts for the rest of the year. Government, business spending on structures and technology, and exports are likely to provide a headwind for most of 2013. The Affordable Care Act could be either a headwind or a tailwind. To get GDP growth much in excess of 2% now will require a few lucky breaks in weather, inflation, and Europe. All possible, but it's hard to take that to the bank. In fact, just a couple of bad breaks and the Fed's next move might be more loosening, not tightening.

The Flavors of Investing

It is tempting to jump on the investment bandwagon when certain parts of the market soar based on a trend or analyst report. While great potential exists, sector investing can also come with great risk.

As seen in the image, what is hot one year isn't always hot the next. Interested investors should be willing to follow a sector's ups and downs, as timing the market is difficult. Investing in specific sectors can add volatility to a portfolio, but exposure to the right sectors can contribute to improved financial performance. Keep in mind that while sector investing can fill a gap or serve as a speculative play, a balanced asset allocation should be the core of any portfolio.

10-Year Sector Winners and Losers

- Basic Mat.
- Comm. Ser.
- Cons. Cyclical
- Cons. Def.
- Energy
- Financial
- Health Care
- Industrials
- Real Estate
- Technology
- Utilities

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Highest return	50.3	38.1	40.8	39.4	32.9	–16.1	61.9	30.5	18.5	32.5
	41.0	32.1	14.8	36.2	27.5	–23.3	53.6	27.4	13.4	29.1
	37.6	23.3	12.2	21.8	17.2	–28.1	50.2	24.9	11.9	24.6
	37.3	19.2	8.1	19.7	16.6	–38.2	35.6	24.2	6.9	19.3
	34.8	17.9	6.0	17.6	12.6	–38.4	34.0	23.4	5.1	18.6
	32.1	15.4	6.0	15.4	12.0	–39.4	29.3	23.2	4.1	16.5
	26.1	14.4	5.2	15.1	8.0	–39.8	24.0	14.5	0.6	15.3
	24.7	12.5	3.7	15.0	0.2	–41.2	21.0	13.4	–0.4	13.3
	19.8	10.1	3.0	11.9	–8.7	–42.0	15.6	11.8	–0.7	10.1
	18.9	3.5	–1.4	10.9	–17.9	–48.1	14.5	7.3	–14.1	4.3
Lowest return	17.4	0.8	–6.0	6.7	–18.3	–51.3	11.8	5.1	–16.5	2.2

This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Past performance is no guarantee of future results. Sector investments are narrowly-focused investments that typically exhibit higher volatility than the market in general. Sector investments will fluctuate with current market conditions and may be worth more or less than the original cost upon liquidation. Returns and principal invested in stocks are not guaranteed.

Source: Sectors in this example are represented by the Morningstar Sector Indexes.

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