The COMPASS Chronicle

March 2014 | Vol. 4 No. 3 | "Morningstar's Best Client Newsletter"

Protect your Credit and Cash

By Louis E. Conrad II, CFA

- Too often we hear stories of data breaches that place our credit information at risk.
- This article outlines steps you can take to protect your existing credit and debit card accounts, as well as foil attempts by others to fraudulently open new credit accounts in your name.

Late last year, Target announced that approximately 40 million of its customers' credit and debit card information had been compromised. It later divulged that 70 million of its customers had their name, address, phone number, and e-mail address hacked as well, though there was believed to be some overlap between these two groups of customers. In light of this and other data breaches, what steps can you take to protect your credit and cash?

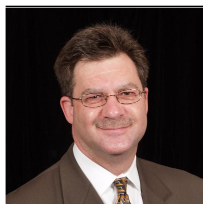
What You Should Do

Contact your credit or debit card issuer—If you believe your credit or debit card may have been used fraudulently, immediately contact your credit or debit card issuer and inform it of your concerns. The sooner you contact the issuer, the less potential liability you have.

For example, under the Fair Credit Billing Act, your maximum liability for unauthorized use of your credit card is $50, but if you report the loss of a credit card before it is used, your liability is $0. If your credit card is not stolen, but your credit card number is used fraudulently, you liability is $0. While it may be inconvenient, especially if you use your credit card for automatic payments, you should ask for a new card and PIN.

With an ATM or debit card, you have no liability as long as you have notified the issuer before any unauthorized transactions occur, according to the Electronic Fund Transfer Act. If you report your card is lost or stolen within two business days after you learn about its loss or theft, then your maximum liability is $50, but it can be as much as $500 if you wait up to sixty calendar days after your account statement (that lists any fraudulent charges) is sent to you.

[Continued on next page.]



Louis E. Conrad II, CFA
President

lconrad@compassinvest.com
(978) 254-7040
www.compassinvest.com

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.

If you would prefer NOT to receive future editions of The COMPASS Chronicle, please send an e-mail with "UNSUBSCRIBE" in the subject line and you will be removed from the distribution list.

Protect your Credit and Cash, continued

However, after the sixty day period, you are fully liable for any money taken from your account if you have not previously notified the card issuer. Note that if your debit card is not lost, but an unauthorized transaction is made with your debit card number, then you will not be liable for any transactions as long as you contact the card issuer within 60 days of the initial statement being sent.

Review your statements—Check your account statements for any unauthorized charges and report them to your credit or debit card issuer. Note that sometimes credit thieves place small charges on a credit card account to determine whether the account is still active.

Monitor your credit report—Actively monitor your credit report or sign up with a credit monitoring service. Under federal law, you are entitled to one free credit report from each of the three credit reporting agencies each year. Consequently, this allows you to check your own credit without cost every four months. Access your free credit report on line at www.annualcreditreport.com.

Two additional options are available to you in order to protect your credit: establishing a fraud alert or credit freeze on your credit file. While these options can reduce the likelihood that new credit will be established in your name without your consent, neither will prevent the unauthorized use of your existing credit or debit cards.

Fraud Alert

You may place an initial fraud alert on your credit file, which provides some protection for 90 days and may be renewed in 90-day increments indefinitely. To place a fraud alert, you need to contact only one of the three credit bureaus (Equifax, Experian, or TransUnion), which in turn will notify the other two.

Usually a fraud alert is used when you believe you have become or could become the victim of identity theft (for example, you see suspicious activity on a credit card statement). Once you establish a fraud alert, lenders are obligated to take additional precautions to verify your identity before granting credit in your name.

If you are an identity theft victim, you can obtain an extended fraud alert on your credit file, which will last 7 years. For the extended alert, you need to provide one of the credit bureaus with a copy of the police report or other record verifying your victimization.

Credit Freeze

While helpful, fraud alerts are not infallible. For extra protection, you can establish a credit freeze (also known as a “security freeze”) on your credit file. A credit freeze prevents lenders from accessing your credit report and score unless you specifically grant them access. Consequently, identity thieves are unable to establish new credit in your name even if they have your personal information.

Note that even with a credit freeze, your current creditors, as well as collection agencies, may still access your credit file. In addition, if you apply for credit you have the option of (1) allowing a specific lender access to your credit file or (2) opening your credit file for access to all potential creditors for a certain period of time.

Unlike a fraud alert, to establish a credit freeze you must contact all three credit bureaus. Each credit bureau will provide you with a password that you can use to open your credit file at your discretion. Depending on your state residency, the cost to place a credit freeze is either $5 or $10 with each credit bureau, plus a similar fee each time you lift the freeze temporarily. If you or your spouse has been a victim of identity theft, these fees are waived as long as you have provided the credit bureaus with a police report. Your credit score is not affected by a credit freeze and the freeze will remain in place until you remove it.

Tips for Preparing Your Taxes

- This article provides some helpful reminders for taxpayers, whether you prepare your own tax returns or hire a qualified tax preparer.
- It also touches on a couple of tax-wise strategies pursued by COMPASS on behalf of our clients: tax-loss harvesting and long-term holding periods.
- For example, during the painful 2008 - early 2009 period, we realized losses for clients with taxable holdings so that we could later use those losses to offset gains and up to $3,000 of income annually.
- Similarly, when we need to withdraw cash from taxable accounts, we attempt to trim only long-term holdings to benefit from their lower tax treatment.

It's that time of year again. While many people cannot say they enjoy preparing their income-tax returns, you'll like it even less if you make mistakes and pay more tax, penalties, and interest than you need to. Here are some things to watch out for as you prepare this year's return or ready your tax documents for your accountant.

Qualified Dividends versus Nonqualified Dividends: Nothing can be more frustrating than receiving a corrected 1099 from your brokerage company. The 1099 is used to report various types of income other than wages, salaries, and tips. If you receive one after you had already filed your taxes, you might have to amend your return.

The problem is that mutual fund companies are required to submit tax information by the end of January, and in some cases they might not have the correct breakdown of qualified and nonqualified dividends by then. Because the tax treatment of qualified dividends might result in you paying less income tax, a revised 1099 might be to your advantage (although in many cases, only by a small amount). So it might pay to wait a bit before filing your tax return if you expect to receive a 1099.

Capital Gains and Losses: When you sell an investment for less than you paid for it, you realize a capital loss. The bright side is that capital losses can help you save on taxes. You can use capital losses to offset capital gains in your portfolio. You'll need to know if your gains and losses are short term or long term. If you held an investment a year or less, it will be a short-term gain or loss. If you held an investment longer than a year, it will be a long-term gain or loss.

In 2014, short-term capital gains are taxed at ordinary income-tax rates from 10% to 39.6%. Long-term capital gains, meanwhile, are taxed at lower, preferential tax rates from 0% to 20%.

Municipal Bond Income: If you own municipal bonds, interest income you receive is exempt from federal income tax. That income may or may not be exempt from state income tax. If the bonds are issued in your state of residence, you usually won't have to pay state and local taxes on the interest. You can find out for sure by contacting your state or the brokerage company at which you hold your securities.

Does that mean all money you receive from municipal bonds isn't subject to taxes? Not necessarily. If you own a municipal-bond fund that paid out capital gains, that money is taxable on your federal and most state returns. In addition, if you own municipals that are classified as "private-activity" bonds, you may be subject to the Alternative Minimum Tax. You may want to consult an accountant about this type of bond. To see if you have both interest income as well as capital gains distributions, check the 1099 forms you received.

Exclude Interest from U.S. Government Securities: Don't forget to exclude the interest from government securities on your state income tax return. You can exclude all income from "direct" government securities (for example, Treasuries). Some states also allow you to exclude income from "indirect" securities (for example, agency bonds like GNMA and FNMA securities). To know for sure, contact your state or the brokerage firm at which you hold your bonds.

Some mutual fund companies can be very good about sending information on the percentage of your funds that are invested in government securities. But there have also been situations where the fund company will only provide this information if you ask.

If you didn't obtain this type of breakdown when you received your 1099 statements, visit your fund company's website to find the information, or call the fund's customer-service line.

Monthly Market Commentary

The jobs report for February and initial unemployment claims were much better than expected, as weather effects began to diminish. That very same jobs report also dashed all hope that just maybe the U.S. Federal Reserve would temporarily halt its tapering program. The 10-year U.S. Treasury bond yield jumped to 2.79% on March 7, with some bond funds beginning to show losses.

Auto sales remained soft, but didn't collapse. Personal income and consumption both looked better than expected, but that was largely because of estimated effects of the Affordable Care Act and massive spending increases on utility bills. Excluding these special factors, consumption would have been down and income gains more muted.

Employment: The employment report for February came in better than expected, with the economy adding 175,000 jobs, up from 86,000 in December and 129,000 in January. This was above expectations of 140,000, but still below the 189,000 average of the prior 12 months. The year-over-year trends showed that weather appeared to have a minimal impact, with only a modest decline in the year-over-year total employment growth rate. Nonfarm payrolls are growing about 1.7% year over year, modestly trailing the 1.9% GDP growth rate reported for 2013. That almost always happens because of productivity growth. Government job losses held back the statistics as the private sector, approximately 84% of all jobs, grew a more robust 2.0%. The very encouraging news is that, at current trend rates, the U.S. economy is just about to recover all the jobs lost during the most recent recession.

GDP: The fourth-quarter 2013 GDP growth rate was downgraded to 2.4% from the previous reading of 3.2%. The news could have been worse, but business spending turned out to be better than expected, offsetting some of the downward revisions in consumer spending. The markets took the news in stride, as the drop was widely anticipated. It also potentially meant that interest rates could stay at low levels for a little longer.

Trade: The trade number for January wasn't terribly exciting, with the deficit basically flat from the previous month at $39 billion and following January trade deficits of $51 billion and $42 billion in 2012 and 2013, respectively. Taking a longer view, the year-over-year averaged data for both import and export showed some signs of softening despite all the excitement about an improving world economy. Both import and export growth rates slowed to their lowest levels since September. Trading partners counting on great sales to the United States might be disappointed, as trade is definitely not as robust as it was in the fall. The Ukrainian situation and continued slow growth in China won't help.

Consumer Spending: Month-to-month growth in consumer incomes and consumption came in stronger than expected because of the Affordable Care Act. Income grew by an acceptable 0.3% (0.2% after inflation) and consumption by an impressive 0.4% (0.3% after inflation). Spending on gas and electricity went up a stunning 11%, even after adjusting for inflation.

Housing: New home sales showed a surprising jump and pending home sales of existing homes finally started showing signs of stabilization. Home price growth also continued to cool, but not enough to create a lot of worries. In fact, low prices might be better for the economy and stimulate more demand. Recent data suggests that home prices are likely to grow at a more sustainable 5% rate in 2014 versus rates of between 8% and 13% in 2013, depending on the index used.

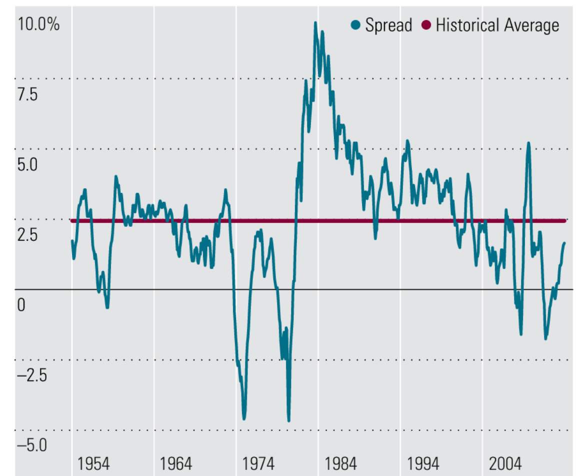
Overall, the economic data remained weak, as it has for the past three months. It is now clear that the problems probably stretch beyond the weather. Morningstar economists' analysis suggests that the economy will bounce back this spring, but without any fireworks to the upside. GDP growth forecasts for 2014 range between 2.0% and 2.5%, not much different from 2013.

Fed Policy, Inflation, and Interest-Rate Risk

- Based on the relationships outlined here, the 10-year Treasury would be yielding about 4% presently instead of its 2.65% yield at the beginning of March.
- As the Fed tapers and the U.S. economy improves, yields can be expected to increase, which would negatively impact bond prices and therefore, bond returns.
- However, COMPASS has already positioned client portfolios so that the deleterious impact from such an environment is limited.

With interest rates still relatively low, the question today is by how much they are likely to rise. Historically, the 10-year Treasury bond has yielded, on average, about 2.5% over the inflation rate. With inflation at 1.5%, the 10-year Treasury bond typically would yield about 4.0%. In an attempt to support economic and job growth, the Federal Reserve has been purchasing long-term Treasury and mortgage-backed bonds to artificially keep interest rates low. As long as the Fed kept this asset purchase program up, 10-year Treasury yields remained relatively low. However, the Fed has begun tapering, and interest rates are likely to rise significantly in the near future. Both investors and advisors should be aware of the implications of rising interest rates.

Spread of 10-Year Treasury Over Inflation



Treasury bonds are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest.

Source: 10-year Treasury yield data from the Federal Reserve. Inflation is represented by the Consumer Price Index, three-month rolling average, and data from the Federal Reserve. The time period displayed in the chart is January 1954 to December 2013.

©2013 Morningstar, Inc. All Rights Reserved. The information contained herein (1) is intended solely for informational purposes; (2) is proprietary to Morningstar and/or the content providers; (3) is not warranted to be accurate, complete, or timely; and (4) does not constitute investment advice of any kind. Neither Morningstar nor the content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. "Morningstar" and the Morningstar logo are registered trademarks of Morningstar, Inc. Morningstar Market Commentary originally published by Robert Johnson, CFA, Director of Economic Analysis with Morningstar and has been modified for Morningstar Newsletter Builder.

Louis E. Conrad II, CFA
President

COMPASS Wealth Management
290 Baker Avenue, Suite N101
Concord, Massachusetts 01742

lconrad@compassinvest.com
www.compassinvest.com

Tel:(978) 254-7040
Fax:(978) 254-7039

© COMPASS Wealth Management, LLC, as well as Morningstar. While the information contained in this newsletter relies on sources believed to be reliable, accuracy cannot be guaranteed. Unless otherwise noted, all information and opinions are as of the date of transmittal, and are subject to change without notice. This newsletter is intended for general informational purposes only and it does not discuss all aspects that may apply to your situation. Please consult with a qualified professional. COMPASS Wealth Management, LLC is a registered investment advisor with the appropriate regulatory authorities. For additional details on the services that COMPASS offers, we encourage you to also review Parts 2A and 2B of our Form ADV, which is provided on request. For details on the selection criteria used to determine the recipients of the FIVE STAR Wealth Manager award, please visit our web site (www.compassinvest.com). The criteria used to determine "Morningstar's Best Client Newsletter", which was awarded to COMPASS in 2012, can be reviewed in The COMPASS Chronicle's September 2012 edition, which is also available on our web site.