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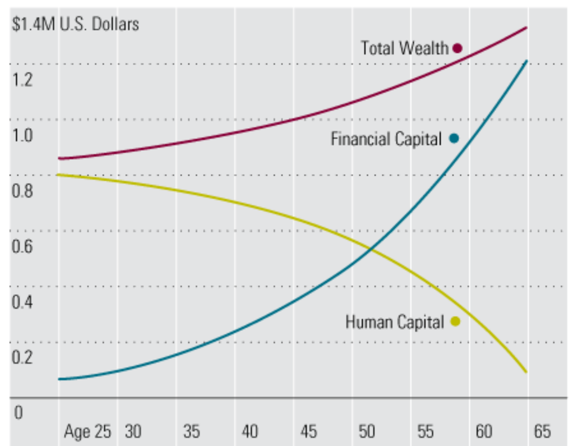
Understanding Financial Capital and Human Capital

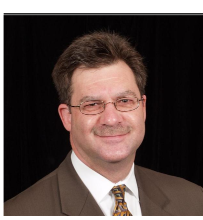
- As this short article reviews, human and financial capital are inextricably linked.
- Early in our careers we expect to rely on our human capital to fund our financial capital needs later in life (e.g., the assets needed for retirement).
- However, the accumulation of our family's financial capital can be at risk if we encounter a challenge to our human capital (e.g., incurring a disability).

When calculating total wealth, it is important to consider not only financial capital, but human capital as well. Financial capital refers to an individual's total saved assets, while human capital refers to the individual's future potential savings from income earned. Looking at financial capital in isolation for retirement planning is incomplete without also considering human capital. Initially, an individual has higher human capital and lower financial capital. Over time, accumulation in savings increases financial capital, while human capital declines as the individual reaches retirement. Certain life events trigger significant changes in financial capital, such as receiving an inheritance, and in human capital, such as going back to school or receiving a promotion at work. Individuals should keep this in mind when planning their financial goals.

Financial Capital, Human Capital, and Total Wealth Over Time



Source: Roger G. Ibbotson, Moshe A. Milevsky, Peng Chen, CFA, Kevin X. Zhu. Lifetime Financial Advice: Human Capital, Asset Allocation, and Insurance, Research Foundation of CFA Institute, 6 April 2007.



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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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Financial Planning for Women

- While men and women share commonalities, there are differences as well.
- In the financial planning realm, many women face additional challenges, including a longer average life span and lower average lifetime earnings.
- COMPASS incorporates these factors in the retirement planning analyses that we create for female clients in order to provide more realistic projections.

Financial planning may present different challenges for women as opposed to men for various reasons. Knowing these challenges, when and if they are likely to occur is crucial for women to successfully manage income, expenses, retirement planning, college planning for children, and any other money matters that need attention.

Challenge 1: Women tend to live longer than men. According to 2009 data from the Centers for Disease Control, remaining life expectancy for a 65-year old woman is 20.3 years, as opposed to only 17.6 years for a 65-year-old man. This may mean that not only do women need to accumulate more assets for retirement, but also that they need to manage these assets much more carefully in retirement in order to make them last for a longer period of time. It is, therefore, paramount for women to begin contributing to a retirement account as soon as possible. According to the Department of Labor's "Women and Retirement Savings" publication, only 45% of the 62 million women (age 21 to 64) working in the United States participate in a retirement plan. This is probably one of the worst financial-planning mistakes you can make. If your workplace offers a 401(k) plan, you should start contributing as soon as you receive your first paycheck, and make sure you're contributing enough to take advantage of the employer match.

Challenge 2: Women are more likely than men to work part-time, which means they may not be eligible for benefits (such as retirement-plan participation). If a 401(k) isn't an option, consider an Individual Retirement Account (IRA) instead. A traditional IRA gives you the benefit of tax deferral, meaning that your assets will be able to grow tax-free until you begin withdrawing in retirement. A Roth IRA is not tax-deferred, but may offer other advantages. Conduct the necessary research and consult a financial advisor to determine which type of retirement account is the best option for you.

Challenge 3: Women, in general, earn less than men. Median income for men was $48,202 in 2011, compared with only $37,118 for women (Current Population Reports: Income, Poverty, and Health Insurance Coverage in the United States, September 2012, U.S. Census Bureau). This also puts women at a significant disadvantage financially, especially if they're single, widowed, or divorced and don't enjoy the security of a dual-income household. Precisely because they earn less, women have to be more disciplined about saving and investing. Make a realistic budget to assess your financial situation. Control your expenses as much as you can, and invest the rest. No matter how tiny it may seem, every little dollar you put aside today counts.

Challenge 4: Women tend to take more breaks from the workplace and have shorter job tenure, since they are most often the primary caregivers for children and also elderly relatives. This makes it difficult to get back into the workforce (and at the same pay level). The most important thing is safeguarding your retirement savings. No matter how tempted you might be, do not cash out your 401(k). If you do, you will not only pay taxes, but you'll also incur early-withdrawal penalties. Instead, consider rolling your 401(k) over into an IRA, and do the necessary research before you begin this process.

401(k) plans are long-term retirement savings vehicles. Withdrawal of pre-tax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty. Funds in a traditional IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. Contributions to a Roth IRA are not tax-deductible, but funds grow tax-free, and can be withdrawn tax free if assets are held for five years. A 10% federal tax penalty may apply for withdrawals prior to age 59 1/2. Please consult with a financial or tax professional for advice specific to your situation. Investing in securities always involves risk of loss, including the risk of losing the entire investment.

Monthly Market Commentary

The market endured yet another month of Fed-watching as investors moved markets upward when more quantitative easing looked possible and downward when it looked like tapering of bond purchases was around the corner. In the past, easing and tightening measures by the Fed have been nearly perfect predictors of stock- and bond-market moves in the short run. At some point, however, bond purchases will inevitably end and rates will move somewhat higher. There is a high probability that bond purchases will end in the next 12 months. (There simply won't be enough bonds left to buy.) And while the positive effect of quantitative easing on markets remains undeniable, gross domestic product growth remains mired in the 2% range.

GDP: The headline third-quarter GDP growth rate of 2.8% came in ahead of the consensus estimate and second-quarter result, which both showed growth of 2.5%. To put this in perspective, the long-term average GDP growth rate is 3.1%. Morningstar economists' year-over-year GDP growth calculation (versus the government's method of annualizing quarter-to-quarter growth) shows a softer 1.6% growth rate.

Despite the powerful rate, the composition of GDP growth was far from optimal. Most of the growth came from net exports and inventory increases. Worse, consumer spending growth rates continued to slump, and businesses' spending for equipment actually decreased for the quarter. The government sector had no net contribution to GDP growth, after three quarters of being a meaningful detractor. Looking ahead, Morningstar economists suspect that GDP growth will drop to 2% or maybe a little less in the fourth quarter, as inventories turn neutral, consumers remain stingy, and net exports make little, if any, contribution to GDP growth.

Employment: Between the furlough and a couple of below-average reports in August and September, everyone braced for the worst with regard to the October jobs report. However, the private sector, expected to increase jobs by only about 130,000, added 212,000 jobs, slightly better than the 196,000 average over the past year. Upward revisions to the prior two months counted an additional 70,000 private-sector jobs. Nevertheless, the report was less than inspiring in aggregate. There was almost no hourly wage growth, and hours worked were flat, which will keep income growth in check. Year-over-year job growth remained stuck around the 2% level, where it has been for some time. Unfortunately, the real strength was again in retail and leisure and entertainment, which are not generally the highest-paying jobs.

Housing: Pending home sales continued to plummet, both month to month and year over year. Weaker existing-home sales have already begun to follow suit, and more deterioration is likely in the short run. The short-term increase in existing-home sales (in July and August), caused by a rush to beat rising rates, could boost GDP growth by 0.2% in the third quarter and subtract a like amount in the fourth quarter, as sales dip back to more sustainable levels. Higher mortgage rates and, more importantly, higher prices, have begun to affect housing affordability in a dramatic way.

Consumer spending: The five-week moving average for weekly shopping center data has been stuck at 2% versus the three-year trend of 2.5%–4.0%, despite lower gasoline prices and the return of furloughed government workers. Retail sales dropped 0.1% in September overall (ex-autos, they increased by 0.4%). Adjusted for inflation, the 2.5% growth rate matched the average of the past 12 months.

One of the few recent pieces of good news was that the federal budget deficit fell dramatically in fiscal year 2013, dropping to $0.7 trillion from $1.1 trillion in just one year, the largest dollar drop in history by a factor of two. Another really good piece of news is that health-care inflation continues to run far, far below long-term projections.

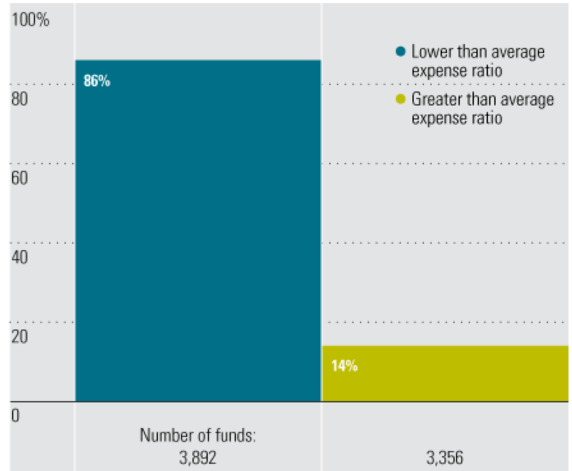
Lighten the Load

- Ceteris paribus (all else being equal) COMPASS prefers to select mutual funds with lower expense ratios as every dollar saved through a lower expense ratio is an additional dollar in your pocket.
- One way COMPASS' clients benefit from our portfolio management is that we can select the institutional share class of mutual funds that offer annual expenses that are 0.25% - 0.40% lower than the same fund's retail share class.

Do mutual fund investors prefer to invest in funds offering low expense ratios? The answer is yes. Expense ratios are an important factor in choosing a mutual fund, because they affect returns. It seems that the market is taking matters into its own hands and putting more assets in low-expense funds. As of October 2013, the average expense ratio for domestic funds was 1.14%. Investors pooled about 86% of net assets in funds with expenses lower than the average, leaving only a small portion to higher expense funds.

You would think that a majority of funds available to investors would have fairly low expenses, but 54% of funds have below-average expenses and 46% have expenses equal to or above the average expense. With more funds available and a variety of added investment choices, investors have clearly chosen the low-cost alternative.

Low Expense Funds Hold Majority of Assets



Source: The average expense ratio was computed for the oldest share class of all domestic funds in Morningstar's open-end database (7,248 funds as of October 2013).

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