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Morningstar's Best Client Newsletter

By Louis E. Conrad II, CFA

This newsletter, The COMPASS Chronicle, was recently named as "Morningstar's Best Client Newsletter." As you may know, Morningstar is an independent provider of investment and financial educational material, as well as the creator of the popular Morningstar "Star Rating" system used by many to evaluate mutual funds, stocks, and other financial products. COMPASS adopted Morningstar's newsletter product beginning in January 2011 to leverage COMPASS-written, original articles with Morningstar's database of financial planning articles to inform clients and prospects of important wealth management topics.

In making its announcement, Morningstar stated that the top three finishers "were chosen based on their visual appeal, creative customization, and overall execution." Specific to first place winner The COMPASS Chronicle, Morningstar said "…your newsletter stood out to our team, winning the majority of our votes by a wide margin. Your use of an eye-catching custom masthead, helpful and informative sidebar comments, the addition of your custom article and thoughtful selection of content were what really set you apart from the competition."

The COMPASS Chronicle won first place out of the approximately 500 advisors who use Morningstar's newsletter product. If you do not already receive The COMPASS Chronicle on a monthly basis via e-mail, and you would like to, please send an e-mail to lconrad@compassinvest.com and ask to be added to our newsletter e-mail distribution list. Alternatively, you could visit the Library page of our web site at www.compassinvest.com and enter your e-mail address where indicated in the lower left-hand corner of the page.

Advisor Corner

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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 2012 FIVE STAR Wealth Manager award, please visit our web site.

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Selecting a Financial Advisor

By Louis E. Conrad II, CFA

- Selecting a financial advisor who is both ethical and competent may seem like a daunting task, especially with the recent convictions of Ponzi scheme operators Bernie Madoff and Allen Stanford.
- However, you can protect yourself by following this outline of important factors to consider in selecting a financial advisor.

Financial advisors have long played an integral role in providing guidance to individuals and families in the areas of investments, retirement planning, education funding, and similar financial planning needs. You may benefit from the counsel of a financial advisor, but what factors should you consider when evaluating a financial advisor?

Factors to Consider

Honesty is the first critical hurdle that an advisor must clear.

* Integrity/Trust: An advisor's integrity is essential in order to have faith in their recommendations. An effective advisory relationship cannot exist without integrity and trust. Use your initial interactions with a financial advisor to determine their level of integrity. I had one prospect tell me part way through our first consultation that I had passed her "smell test." While this may be a gut response, it is also an accurate reflection of what you are attempting to determine: Is this person a crook or are they honest?

* Compliance: You may investigate the background of an advisor and their firm via one of two resources on the Internet. For a registered investment advisor (RIA) or their firm, visit www.adviserinfo.sec.gov, whereas if an advisor operates as a broker (more on this later), you will want to access www.finra.org/brokercheck. These sites list any infractions that are known to regulators and can provide you with insight as to the compliance record of a firm and its principals.

Once you have evaluated an advisor's integrity, you still must determine whether they are competent.

* Credentials: Dozens of credentials exist in the financial advisory field, but most should carry little weight with individuals looking to hire a financial advisor. The most relevant designations to a financial advisory practice are Chartered Financial Analyst (CFA®), Certified Financial Planner (CFP®), Certified Public Accountant/Personal Financial Specialist (CPA/PFS®), and Chartered Financial Consultant (ChFC®). In addition to these credentials, advisors may also hold one or more securities licenses, though these are more prevalent among brokers. Note that these credentials and securities licenses provide only a foundation of knowledge in the financial advisory field and are not a substitute for experience.

* Experience: Another differentiating factor between financial advisors is their depth and breadth of relevant experience. Scrutinize their background. Many financial advisors have not advised clients through several market cycles because they are either too inexperienced or were employed in an unrelated field earlier in their career.

Once you believe you have found an honest and competent person to dispense financial advice to you, consider the business model that they operate within.

* RIA versus Broker: Under current law, an RIA has a legal, fiduciary duty to act in a client's best interests. A broker, on the other hand, is held to a lower standard, one of suitability. As such, an advisor who is a broker is required to recommend products that are appropriate for their client, but may not be in the client's best interests.

* Compensation: A financial advisor's compensation usually follows one of three models: fee-only, fee-based, or commission-based. Fee-only attempts to align an advisor's interests with a client's by charging based on the amount of investment assets overseen or on an hourly or fixed fee basis. A fee-only practice tends to be more advice oriented, whereas a commission-based practice tends to be more product driven with the advisor receiving commissions based on selling investments or financial products. Fee-based is a compensation arrangement that can include fees or commissions.

Keeping It Real

- Inflation reduces your purchasing power and while a 3.1% long-term average may not appear to be meaningful, the impact over time can be substantial.
- Historical inflation rates for medical services and college education have been even higher, significantly reducing the inflation-adjusted dollars that are available to meet these needs.

Inflation has averaged 3.1% over the last 30 years. This might not seem like much, but this reported figure only tracks total goods and services purchased by the typical consumer. This is a good measure for the economy at large, but it may not be representative for individuals whose lifestyles and buying habits differ from the typical consumer.

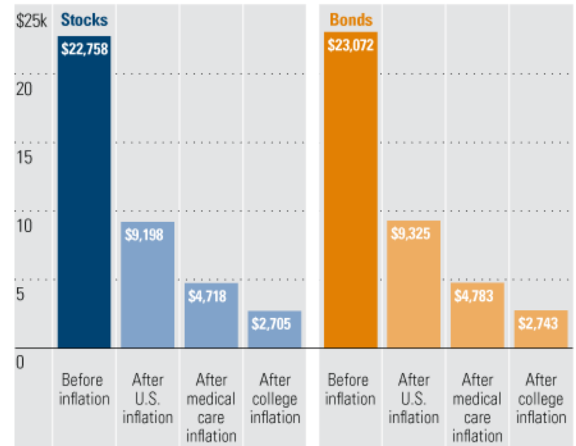
Goal-based investors may experience higher inflation. People who need to focus on savings for college or medical care may be left short, as the cost for such items often tends to rise at a faster rate than the average cost of living. Those investors might not be able to keep pace with rising costs if they do not take their real inflation rate into account when planning their investment goals.

The image illustrates the effect of three types of inflation on an investment of $1,000 in stocks and bonds: overall U.S. inflation, medical-care inflation, and college inflation. After 30 years, inflation has considerably reduced the wealth of the original investment. For example, the $1,000 invested in stocks and bonds only grew to $9,198 and $9,325, respectively, after adjusting for U.S. inflation. Alas, even more bad news for a family with children or a baby boomer nearing retirement.

Further, of the two asset classes considered, bonds provided more growth after inflation, which is unusual. Investors wishing to keep pace with inflation would typically consider a larger allocation to stocks or explore other investments that protect against inflation. However, due to the two major crises and associated stock market declines experienced during the "lost decade," stocks performed more weakly than bonds.

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. 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. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss. The rates used in the analysis and their corresponding compound annual growth rates are the consumer price index for: all urban consumers (CPI-U) (3.1%), medical care (5.4%), and college tuition and fees (7.4%).

Investment of $1,000 in Stocks and Bonds Before and After Inflation Rates, 1982–2011



Source: Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and is considered to be representative of the U.S. stock market in general; Bonds—20-year U.S. government bond; Historical inflation—Consumer Price Index; Growth rates of CPI categories—non-seasonally adjusted U.S. city averages from the Bureau of Labor Statistics.

Monthly Market Commentary

In early September, the European Central Bank took steps to ease monetary policy and China introduced new infrastructure stimulus measures, as economic news in both regions continued to show signs of slowing. Both these actions have led many to expect the Federal Reserve to do the same with some form of quantitative easing, following poor manufacturing data and a softer-than-expected employment report in August. Morningstar economists believe that lowering rates further may do little to help the economy. Corporations are already awash with cash, while consumers are still finding it difficult to get loans at these low rates. Furthermore, commodities are on the rise again with gold setting a five-month high, and oil prices moving higher.

GDP: Second quarter real GDP was revised upward to 1.7% from 1.5%, which typically means that things were stronger in the last month of the quarter than originally anticipated. Overall, consumer spending was revised up, exports also improved (despite turmoil in Europe), and government spending shrank less than previously estimated. Although the quarter-to-quarter data over the last 2 years continued to be extremely volatile (ranging from 0.1% to 4.1%), the year-over-year data shows GDP growing at a slow but consistent pace (1.6% to 2.8%).

Employment: August saw a disappointing 96,000 jobs being added, down from 163,000 jobs in July. Morningstar economists have highlighted a few inconsistencies over this data: at a time when new and existing home sales were up, the report indicated construction employment did not grow at all. Also, the employment at building material and garden centers was reported to have fallen by almost 10,000 people, which Morningstar economists felt was unlikely, given the better construction market. An unusually large number of employees (380,000) left the workforce in August, which caused the unemployment rate to drop to 8.1% from 8.3%. Morningstar economists believe that this was mainly because of students returning to school from their summer jobs. While seasonal adjustment factors are typically supposed to capture this change, many schools and universities are shifting the start of their school year earlier in August. The high dropout rate could also have come from more employees quitting, or ceasing to look for jobs, to go back to school due to poor economic prospects.

Housing: The housing recovery has continued long enough that both leading indicators (pending home sales) and lagging indicators (Case-Shiller Home Price Index) were moving in the same positive direction. July pending home sales jumped 2.4% compared with June and 12.4% compared with July 2011. It is important to note that pending sales have been higher than closed sales all year, as the failure of homes to appraise at the agreed-upon price and tight lending conditions are holding back closings. In June, the Case-Shiller 20-city index increased 0.5% on a year-over-year basis, which marked the first year-over-year increase in two years. Although the index just broke into positive territory, the improving trend has been in place for six consecutive months. Month-to-month data showed a 2.3% increase, and all 20 cities in the index showed home price improvement.

Manufacturing: U.S. manufacturing in August continued to slow, as new orders fell and inventory levels increased. However, auto sales accelerated to 14.52 million units in August, the best performance since the cash-for-clunkers promotion in 2009. Year-over-year sales growth of over 20% was inflated by a strong recovery from Japanese brands that suffered supply shortages last August because of the tsunami. Pent-up demand and low cost has also resulted in the Detroit Big Three reporting year-over-year gains of more than 10%, mainly from pickup truck sales. Outside the U.S., manufacturing in Europe continued to weaken, including Germany, because of softer orders from China. China's manufacturing sector also underperformed, reporting its lowest level since 2009.

COMPASS 2012 - 2013 Economic Forecast

By Louis E. Conrad II, CFA

- Though the U.S. stock market did not suffer from a summer decline this year as it did in both 2010 and 2011, our capital markets still have plenty to worry about.
- While COMPASS is mindful of the economic challenges facing the U.S. and the world, we do see the greatest opportunities currently in U.S. stocks and the emerging markets.

While the U.S. economy continues to slowly recover from the Great Recession of 2008–2009, many risks remain, which leads to a difficult forecasting environment. The European debt crisis, a deceleration of economic growth in the emerging markets, and the economic and political challenges facing the U.S., including our own looming debt crisis and "fiscal cliff," are some of the causes for this challenging environment.

COMPASS Wealth Management expects that U.S. economic growth will stabilize near the second quarter's rate of 1.7% in real (inflation-adjusted) terms, before accelerating slightly to 2.0% - 2.5% in 2013. This assumes that the "fiscal cliff," or the broad -based tax increases and spending cuts scheduled for 2013, is avoided. Inflation is expected to remain at recent levels, though oil and food prices could push inflation higher in 2013. Employment growth may improve slightly if economic growth accelerates as expected in 2013 and, if so, the unemployment rate may finally dip below 8%.

Consumer spending will continue to help drive economic activity, though the housing and construction market may have finally turned the corner, aiding economic growth as well. Government spending will remain under pressure and will partially offset the benefits of better consumer spending and an improving housing and construction market.

From a portfolio perspective, COMPASS continues to favor large U.S.-based companies over European-based companies, but we especially like emerging market stocks and bonds given the better growth rates and financial condition of these countries. In regard to U.S. bonds, COMPASS is managing the interest rate risk of client portfolios by favoring short- and intermediate-term corporate bonds over U.S. Treasuries due to our concern for higher rates.

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