September 2013 | Vol. 3 No. 9 | "Morningstar's Best Client Newsletter" in 2012

How Safe Is Your Life Insurance Policy?

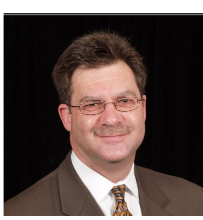
- You purchase life insurance to reduce the financial risk of your passing. Given the long time horizon that policies may run, the financial health of the life insurance company issuing the policy is a key factor to consider.
- Thankfully, each state maintains basic guarantee levels for its residents in case an insurance company becomes insolvent.

So you've finally sat down with your financial advisor and answered important questions, such as do you need life insurance, how big of a policy do you need, and what type makes the most sense for you. One thing you don't want to happen after purchasing your life insurance policy is to find out the company that sold you the policy has run into financial trouble. If your insurer went out of business, not only would you be uninsured, but you would also have to reapply for a new policy at a potentially more expensive rate due to your age and health.

Fortunately, there is a system in place to ensure that policies remain in force even after the issuing companies become insolvent. All 50 states, plus the District of Columbia and Puerto Rico, have life and health insurance guaranty associations that step in to make sure that policyholders aren't left holding the bag if their insurance company becomes insolvent. In nearly all states, the limits of coverage are $300,000 for life insurance death benefits and $100,000 for the net cash value of the policy. Some states even have limits as high as $500,000 for both. Coverage is provided by the guaranty association in the state in which the policyholder resides, even if he or she purchased the policy elsewhere.

For customers who hold policies worth more than their state guaranty limits, one option is to buy multiple policies within those limits from different companies to reach the desired total amount. So, instead of buying a $1 million policy from a single company, you could buy $250,000 policies from four different companies. The downside is that not only is this somewhat inconvenient, but it also might result in paying more than you would for a single policy because of the additional fees involved, not to mention different premium rates. Consult your financial advisor to explore all your options.

2013 FIVE STAR PROFESSIONAL Wealth Manager MULTI-YEAR WINNER



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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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Measuring Fear in the Markets

- The most basic investor emotions are fear and greed. One measure of investor fear is the VIX, as outlined in this article.
- The VIX tends to spike during periods of great uncertainty. During such times, COMPASS believes investors should not allow their emotions to dictate their actions by abandoning their investment strategy and asset allocation.

Fear is a basic emotion that all human beings experience when feeling threatened or uncertain. Fear can be caused by many things, from being afraid of losing a loved one, to being fearful of the ancient Mayan prophecies that predict the end of the world. Interestingly, an investor can also experience (and measure) fear in the stock market.

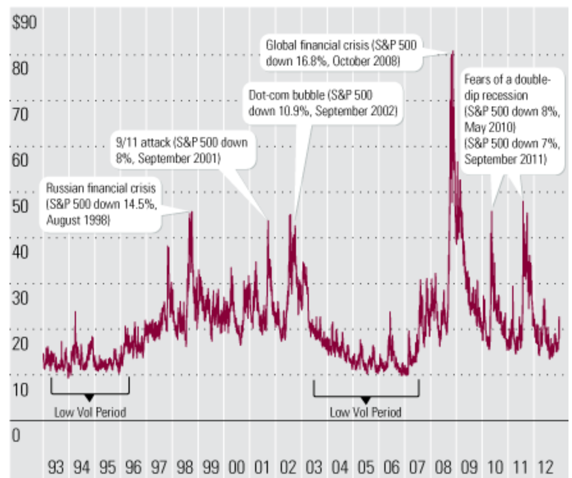
Fear in the market can be measured by the Volatility Index (VIX), also commonly known as the "fear index." The VIX measures the uncertainty that investors feel about short-term market prospects. A period of high fear is characterized by higher uncertainty, higher volatility (stock prices swinging widely), and a higher VIX reading. On the other hand, a lower VIX reading occurs during less stressful periods because of lower uncertainty and lower volatility.

The image highlights the daily closing price of the VIX over the last 15 years. When there were sudden downturns that resulted in steep declines in the market, the VIX spiked sharply to reflect the uncertainties in the market. Examples can be seen during the Russian financial crisis in 1998, the 9/11 attack in 2001, and the dot-com bubble in 2002. More recently, the global financial crisis saw the S&P 500 decline by 16.8% in October 2008, causing the VIX to spike to an all-time high of $80. Concerns regarding a potential double dip recession in 2010 and 2011 also caused the VIX to rise. When times were good and the market grew complacent, the VIX was not as volatile. Instances of this can be seen throughout the 1990s, as well as during the period leading up to the global financial crisis from 2003–2007.

Why is fear so rampant in times of great uncertainty? It's one thing to be afraid of what's happening next in a stable market, but it's a completely different story when you've just seen your portfolio shed 40% of its value and wonder what's next. Investors understand that fundamentals advocate investing for the long haul, and avoiding market-timing pitfalls in the short-term. Yet they can't help but be afraid, thinking about what would happen if they lost another 10% of their savings over the next month, next quarter, or next year. What if markets never recover and they never see that money again?

Investors who are faced with situations where they are fearful of market performance in the near future should take a step back and avoid making irrational investment decisions that may adversely impact their financial goals. Similarly, during calmer times, investors should not be lulled into a false sense of security and expect markets to only continue to rise forever. And for those investors saving for retirement, it is important to remember that short-term fear and volatility should not impact their decisions for the long term.

Daily Closing Price for the VIX



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. The S&P 500 index is an unmanaged group of securities and considered to be representative of the U.S. stock market in general. The VIX is represented by the CBOE volatility index.

Benefits of Staying Invested Through Market Volatility

- While the previous article reviewed a measure of market volatility, this article discusses the benefits of remaining invested during such periods.
- The S&P 500 has advanced a further 16% this year, adding to the returns through December 31, 2012, which are shown in the accompanying line graph.

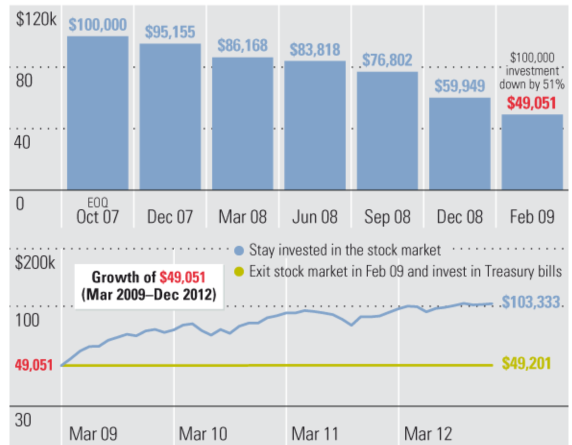
The recent market volatility has investors questioning, “Are stocks still a good investment?” It’s a good question, and one way to address this issue is to look at the recent 2007–2009 market crash. Investors who bailed out of the stock market following the significant decline and moved their money to the safety of cash would be quite disappointed to learn that the stock market, in fact, recovered significantly.

The top image illustrates the value of a $100,000 investment in the stock market at the end of October 2007 (when the downturn began). Over the next several quarters, this $100,000 investment declined significantly, and by February 2009 (the trough date) was down to $49,051, a 51% decline. If an investor panicked and exited the stock market to invest the remainder ($49,051) in Treasury bills (proxy for cash), here’s what would have happened. The bottom graph illustrates the growth of the $49,051 investment in both the stock market and Treasury bills since March 2009. The difference in the ending wealth values of the two investments is considerable. If an investor remained invested in the stock market, the ending value of the investment would be $103,333. If the same investor exited the market at the bottom to invest in Treasury bills, the ending value of the investment would be only $49,201. While exiting the market during a downward spiral may mean avoiding down days, it also means missing days when the market bounces back. While all recoveries may not yield the same results, investors may be well advised to stick with a long-term approach to investing.

The beginning investment time period of October 2007 was chosen to illustrate two concepts: (1) investing right before a significant market downturn and (2) the contrast between exiting the stock market and staying invested during a recovery. The exact timeline of the downturn-recovery is as follows: October 2007 (peak before the downturn), February 2009 (trough), March 2012 (recovery).

Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed. Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. Stocks are not guaranteed and have been more volatile than bonds or cash. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss.

Ending Wealth Values After a Market Decline and Recovery



Monthly Market Commentary

The U.S. stock market dropped by 2.9% in August, heavily weighed down by news out of Syria. Though Syria produces no oil to speak of, there are fears that other Middle Eastern oil producers would be drawn into the conflict, and oil prices would soar.

Federal Reserve news: There are a lot of worries in anticipation of the Fed's September meeting, when tapering seems imminent. An increasing number of Fed governors seem to believe that there has been enough bond buying. Still, some governors continue to believe that the economy is in a fragile state and are more reluctant to make any changes without clear evidence of an accelerating economy. A small tapering might represent an acceptable compromise, unless the near-term economic indicators fall apart.

GDP: The second-quarter GDP estimate was revised sharply to show 2.5% growth, compared with the previous estimate of just 1.7%. Most categories were unchanged, except for the much-anticipated change in net exports, which accounted for almost the entire 0.8% revision in the GDP.

Employment: The economy added 169,000 jobs in August, with most of the growth coming from the retail trade and health-care sectors. However, the June and July numbers were revised downward by a combined total of 74,000 jobs. Based on the new numbers, only 148,000 new jobs were created on average during the past three months. The unemployment rate dropped to 7.3% from 7.4% in July.

Housing: Pending home sales fell 1.3% between June and July, while the year-over-year tally was up 6.7%, its lowest showing in 2013. Unfortunately, pending sales are tracking lower than existing-home sales data, which means that existing-home sales are likely to show slower growth rates in the months ahead. The data also seem to indicate that the big jump in July existing homes was a result of a rush to close mortgages faster (to beat rate increases), and not actual gains in the housing market. Home prices have risen sharply over the last 15 months; however, rising interest rates and declining affordability may keep a lid on prices, at least in the near future. Affordability has slipped from an index of 210 to 166, and that was before rates really started to increase this spring. Overall, the housing market appears to be slowing its growth rate.

Consumer spending: Consumption, which represents 70% of the U.S. economy, has been on a slow drift down during the past year. Given the limited growth in July actual data and lackluster shopping-center data so far in August, Morningstar economists estimate that consumption data will be hard-pressed to grow much faster than 1.5% in the third quarter overall, compared with increases of 2.3% in the first quarter and 1.8% in the second quarter. Given that consumption is the largest component of GDP, the data would seem to indicate a slowing in the overall GDP growth rate in the third quarter.

International: The European economy appeared to move out of recessionary territory in the second quarter as the 17-country eurozone experienced growth for the first time after an 18-month-long double-dip recession. The 2013 second-quarter annualized GDP growth rate of 1.1% was the first positive one since fall 2011. Germany, France, and the United Kingdom were the backbone of the recovery with annualized growth rates of 2.8%, 2.0%, and 2.4%, respectively. Employment data didn't show nearly as much improvement as GDP did, especially in France, but overall, the improved data should make Europe less of a headwind to world growth.

Morningstar economists are still optimistic about the long-term outlook for the U.S. economy, because of the potential of the housing, oil, aerospace, and auto industries. Manufacturing and the banking system also remain strong, and inflation appears under tight control. However, there is no denying that fiscal austerity and higher interest rates are taking at least a short-term toll.

Five Lessons from the Three-Year Market Rally

…now a four-year market rally, but the lessons are still relevant. 1) The turning point is not always obvious. In hindsight, it seems like it should have been dead obvious that stocks were cheap four years ago. But, because of their inability to clearly identify market bottoms, investors may be better off sticking with a strategic asset-allocation plan. 2) Don't let past performance control your portfolio. To the extent that you can, let your strategic asset-allocation framework be a key driver of where you deploy new cash. 3) To help maximize participation, make a little room for the risky stuff. Even though higher-quality stocks tend to hold up better during downturns, the opposite tends to be true during recoveries. Investors may want to maintain exposure to both types of companies: high-quality, wide-moat dividend payers and economically sensitive small- and mid-caps. 4) But there are also chicken ways to play. You don't need to pile on the risk to generate robust gains in absolute terms. Investors who have shorter time horizons or are simply more comfortable with lower-risk stocks can reasonably allocate more toward such stocks without completely ceding their upside potential. 5) There will be bumps (and buying opportunities) along the way. The movement hasn't always been upward since the market bottomed. If your portfolio is light on stocks at the outset of a rally, periodic sell-offs may provide opportunities even at a later time.

Diversification and asset allocation do not eliminate the risk of investment losses. Stocks are not guaranteed and have been more volatile than other asset classes. Small stocks are more volatile than large stocks, are subject to significant price fluctuations and business risks, and are thinly traded. This should not be considered financial planning advice. Please consult a financial professional for advice specific to your individual circumstances.

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