Investor Insights and Outlook

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Dealing With the Risk of Investing

Investment risk comes in many forms, and each can affect how you pursue your financial goals. The key to dealing with investment risk is learning how to manage it. This three-step process will show you how.

Step One: Understand Risk

Fear of losing some money is probably one reason why people may choose conservative investments, even for long-term savings. While investment risk does refer to the general risk of loss, it can be broken down into more specific classifications. Familiarizing yourself with the different kinds of risk is the first step in learning how to manage it within your portfolio.

Risk comes in many forms, including:

Market risk: Also known as systematic risk, market risk is the likelihood that the value of a security will move in tandem with its overall market. For example, if the stock market is experiencing a decline, the stock mutual funds in your portfolio may decline as well. Or if bond prices are rising, the value of your bonds may also go up.

Interest rate risk: Most often associated with fixed-income investments, this is the risk that the price of a bond or the price of a bond fund will fall with rising interest rates.

Inflation risk: This is the risk that the value of your portfolio will be eroded by a decline in the purchasing power of your savings, as a result of inflation.

Credit risk: This type of risk comes into play with bonds and bond funds. It refers to a bond issuer's ability to repay its debt as promised when the bond matures.

International investments also involve additional risks, including the possibility of fluctuating currency values (currency risk) and the risk that political and economic upheavals may affect a country's markets.

Step Two: Diversify

The process of diversification, spreading your money among several different investments and investment classes, is used specifically to help minimize market risk in a portfolio. Because they invest in many different securities, mutual funds may be ideal ways to diversify. Selecting more than one mutual fund for your portfolio can help further reduce risk.

Also consider the potential benefits of selecting investments from more than one asset class: When stocks are particularly hard hit due to changing conditions, bonds may not be affected as dramatically. In part, that may be because bond total returns may be timed more to income (which can cushion a portfolio) than price changes.

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Advisor Corner

Thank you for the opportunity to serve as your advisor.

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8 Financial Resolutions for 2015

By **J. William G. Chettle**
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A new year is an ideal time to take a closer look at the areas of your financial situation that you may have neglected. While saving and investing are crucial to our financial futures, so are often-overlooked items such as getting beneficiary designations right, talking with children and grandchildren about money and establishing a living will.

Working with a financial advisor means you have an experienced partner and advocate who can help you navigate these areas and many more.

And if you already have a solid plan in place, it never hurts to revisit what you've done and see if any changes are needed.

1 Create an emergency fund

Expensive home or car repairs, losing a job, a medical emergency — the unexpected can happen at any time. That is why many experts recommend you have at least three to six months' living expenses readily accessible for any "surprises." If you haven't started a "rainy day" fund yet, you are not alone. More than 56% of Americans have not set any money aside to cover three months of living expenses.[1]

Some experts advocate investing your rainy day fund the way you invest the rest of your portfolio, so that your money has the highest potential for growth. A more conservative approach is to invest in lower risk instruments such as savings accounts, money market funds or fixed income, which offer some potential for growth but with lower volatility. Just don't put it under your mattress.

2 Invest in your child's education (and your own)

According to the College Board, the average cost of tuition and fees for the 2013–2014 school year was $30,094 at private colleges and $8,893 for state residents at public colleges ($22,203 for out-of-state residents). This means the sooner you can start saving and investing for your children's education, the better.

Many families use 529 plans, which can allow the money you contribute to grow on a tax-advantaged basis. But why stop with the kids?

Perhaps you'd like to spend part of your retirement taking art or cooking classes, getting another degree or learning to fly a plane. If you open a 529 plan for yourself now, while you are working, you have the opportunity to invest towards these goals, allowing your money to grow tax free.

You can spend 529 plan funds on tuition, books and fees at any eligible educational institution, including many schools located abroad. And any unused money in the plan can be used to help pay another family member's college costs.

For a list of eligible educational institutions, visit www.savingforcollege.com/eligible_institutions.

529 plan investments are tax deferred and income is federally income tax free, but may be subject to state or local taxes.

3 Talk about finances as a family

Educating children on the essentials, such as checking accounts, saving, and investing, is important, but even more imperative is imparting good values about money.

And if your children are grown up, it is important for them to understand your hopes and plans around your estate. 70% of estates come unglued after transition from one generation to the next.[2] Either the kids sue each other, try to break up the terms of the will, or lose the assets. Most failed estates resulted from insufficient education for the next generation, coupled with an absence of parent/child communications.

A meeting with your children at a neutral site, such as your financial advisor's office, may foster more effective and open family communication. This discussion may be a relief to everyone, as you may have been reluctant to talk about your estate and your children fearful to ask.

4 Get your beneficiary designations in order

More than $14 trillion is held in tax-deferred retirement account assets such as IRAs, 401(k)s, etc.[3] But many Americans don't understand the importance of the beneficiary designation form. When it comes to distributing assets, beneficiary designations trump other estate-planning documents, so it's worthwhile to periodically review them to make sure they're up-to-date. Some common mistakes that occur with beneficiary designation forms include:

- **No beneficiary named —** Believe it or not, this is generally the most common mistake.
- Lack of a contingent beneficiary — If the primary beneficiary dies before the IRA holder and no contingent beneficiary is named, the IRA will be deemed to have no beneficiary.
- **Not naming all children as beneficiaries —** There have been cases where individuals have not named all their children as beneficiaries because there was not enough room on the form and because they thought that since all of the children were named in the will, it didn't matter. Also, if you intend to leave your IRA to multiple children, make sure you define that you want it left in "equal shares."
- **Naming a minor child as a beneficiary —** Since a minor lacks legal capacity, naming a minor child as beneficiary

creates a set of problems. One alternative is to create a trust for the benefit of the child as beneficiary. Another alternative would be to name a custodian under the Uniform Transfers to Minors Act (UTMA) for the benefit of the child. This is a less expensive option than creating a trust, but the potential downside is that the child inherits the IRA outright when he/she turns 21 (depending on your state).

- **Naming an ex-spouse —** This is where things can get ugly. Even if the divorce agreement and property settlement stipulate that one spouse (the wife, let's say) has no claim on her ex-husband's IRA, if the beneficiary designation form isn't updated, the ex-wife would be entitled to the IRA.

Finally, see if your state allows you to add beneficiaries to bank and investment accounts and even your home and car — saving your heirs the hassle and cost of probate on these assets.

5 Update your estate planning documents.

The size of your estate will dictate the types of legal documents you need, but, shockingly, 61% of Americans do not even have a will.4 A will helps ensure that your money, possessions and property go to the people and organizations you care about most.

In addition to a will, a basic estate plan should also address what would happen to your affairs if you are no longer able to act on your own behalf. To this end, you should consider having a living will, a durable power of attorney for health care and possibly a durable power of attorney.

Sometimes called an "advance directive," a living will details how you want to be cared for if you become incapacitated and unable to make decisions about your health care. Your living will can be as specific as you want about the kind of medical care you wish to receive, including life support and other interventions such as feeding tubes and resuscitation.

Via a durable power of attorney for health care, you appoint someone to make all necessary health care decisions for you and ensure that your health care providers act in accordance with your written wishes. This person should be someone you trust who, ideally, lives in close geographic proximity.

A durable power of attorney specifies who will handle your affairs and financial decisions if you are unable to. This person should be detail-oriented and comfortable with financial matters.

6 Review insurance needs

While many of us own car, home and life insurance, we sometimes overlook other types of insurance that could help protect us from the unexpected. For example, many people do not have disability income coverage, but insuring against the loss of earnings can play an important role in your financial planning. Similarly, a long-term healthcare policy can help you pay your expenses in the event of a serious illness or injury. And if you have a high salary or significant net worth, you also may want to consider a personal liability umbrella policy to protect against liability risks. And if you have any valuables — such as collections of art, wine, cars, coins, etc. — be sure to get them appraised and properly insured.

Whatever insurance you own, it's important to regularly review your policies.

7 Make sure you have a smart Social Security strategy

If you are within 5 to 10 years of retirement, you should start planning how and when you will take your Social Security benefits. Delaying the receipt of benefits can actually work in your favor.

There are three basic choices as to when to take benefits:

- Early (age 62)
- Full Retirement Age (Based on year of birth. For those born in 1954, for example, the age is 66)
- Delayed (age 70)

As you would imagine, the earlier one chooses to take benefits, the smaller the benefit will be. For someone taking benefits at age 62, their benefit may be 30% less than it would be if they waited until full retirement age. Conversely, every year benefits are delayed past full retirement age may mean another 8% per year increase in benefits (up to age 70).

Additionally, a married individual is entitled to a spousal benefit of 50% of the spouse's amount, and one spouse can start receiving benefits while the other delays. Your advisor can help you determine what strategy would be optimal for your situation.

8 Give money wisely to your favorite charities

Though many of us simply give cash to charities, this may not be the best strategy for maximizing the tax benefits of charitable giving. When you donate assets that have appreciated in value, you get a triple benefit. Not only do you help the charity, but as long as you've owned the asset for at least a year, you can deduct its fair market value and avoid paying any capital gains.

But before you donate, first make sure your money is going to the right charity. Charity evaluation and watchdog organizations such as charitywatch.org and charitynavigator.org can provide you with detailed information and ratings for your preferred charities.

[1]The Financial Fragility of American Families, FINRA 2013

[2]Trusts and Estates Magazine, "The Future of Estate Planning" by Vic Preisser & Roy Williams (1/6/2010)

[3]www.EBRI.org, "Fast Facts", #203, 6/30/11

[4]2013 Harris Interactive Survey

How to Manage an Inheritance

Over half of American retirees expect to leave an inheritance for their loved ones,. If you have recently received a bequest or are anticipating inheriting sizeable assets, now is the time to plan. Here are some tips to help you manage an inheritance.

Wait and develop a strategy. Start by parking the money in the bank and take an inventory of your financial life. Are you on track for retirement? Do you have adequate insurance? Do you have significant debt? Are you supporting a family?

Pay down your high-interest debt. Near the top of your priority list should be eliminating consumer debt, especially high-rate credit card debt. But think twice about paying off your mortgage, unless owning your home outright is an important goal for you. Your mortgage interest rate is likely low, and the money may be better used elsewhere. The same goes for paying off college loans at low interest rates.

Save, save, save. Next step should be to turn to your savings, which may include funding an emergency fund of about six months' living expenses, putting aside money for retirement, and setting up accounts for your childrens' education and other life expenses.

Don't rush to spend. Ideally, the money should bring you closer to financial independence, but many heirs don't know how to handle a windfall and end up no better off than they were before. Take small steps when making your decisions. Instead of quitting your job right away, consider working part-time. If thinking about purchasing a luxury sports car, try renting one first. The goal is to avoid making irrational decisions you might later regret.

Do your research. If you've inherited a traditional IRA, research the options available before making changes. If you're not a spouse, you can't roll the inherited IRA into your own. Non-spouses are required to take taxable minimum distributions every year based on life expectancy. Instead of treating the distribution as an annual windfall to be spent, plan to integrate it into your long-term strategy.

Find a suitable long-term investment strategy. Constructing a portfolio that generates passive income is the slow-and-steady approach that will lead to financial independence. To achieve stability and income growth, you'll need to mix stocks and fixed-income investments, but don't speculate by sinking it all into volatile equities or go too conservative by keeping it too heavily invested in cash or fixed-income securities. The point is to make the money work for you without unnecessary risk.

Meet with Jim. Managing an inheritance gets easier with professional financial help. Working with your advisor will help you maximize your current plan or help you develop a plan if you don't have one. If you know you'll inherit, you can begin planning ahead of time, but if the inheritance comes as a surprise, we can provide a better idea of your options.

Dealing With the Risk of Investing (continued from page 1)

Step Three: Match Investments to Goals

Before you can decide what types of investments are appropriate from a risk perspective, you need to evaluate your savings goals. Is your goal preservation of principal, generating income for current expenses, or building the value of your principal over and above inflation? How you answer this will enable you to find an appropriate balance between the return you hope to achieve and the risk you are willing to assume.

Examine your time horizon for meeting your goals, and consider how comfortable you may be riding out short-term losses in the value of your investments. Remember, the longer your time horizon, the more volatility you may be able to tolerate in your portfolio. By devoting time to examining your goals, conducting some research, and working with Jim Hallett, you can learn how to manage risk in your portfolio by choosing appropriate investments.

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