Investor Insights and Outlook

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U.S. Election Results – Similar Configuration, Same Challenges

- U.S. election results kept the current balance of power largely intact. We believe market volatility in the ensuing days may have more to do with renewed tension in Europe.
- The challenges facing the U.S. government have been clear for some time, but how effectively they are dealt with remains to be seen.
- Market volatility could be elevated while negotiations over the U.S. "fiscal cliff" unfold. However, we do not anticipate any significant changes to wealth management plans.

The immediate political challenges facing the country – most notably the "fiscal cliff," a package of federal tax hikes and spending cuts scheduled to occur early in 2013 – have been apparent for over a year. The divided government must address long-term budget concerns without derailing a multi-year but still-fragile economic recovery. How effectively the President and current or subsequent Congress deal with these challenges remains to be seen.

America's fiscal cliff is the most immediate hurdle for the global economy and politicians from both parties have been giving it lip service post-election. Since the election did not meaningfully change the government's existing configuration, investors can only hope that the political tenor in Washington, D.C. will become more constructive than it has been in recent years.

Feel free to call our office if you would like to talk about how your personal portfolio may be effected by the recent election results.

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Advisor Corner

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The Best Investments for Your IRA

Stocks or Bonds: Which Are Better?

Conventional wisdom holds that investors should hold bonds in tax-protected vehicles like IRAs and stocks in their taxable accounts. Intuitively, that makes sense. After all, bonds throw off a lot of taxable income, which is taxed at rates as high as 35%. Meanwhile, stocks typically generate much less income, and that dividend income is taxed at a much lower rate—generally 15%. (Long-term capital gains from stocks enjoy the same rate.)

In this instance, however, the conventional wisdom has limitations. Stocks generally produce higher returns than bonds, and thanks to the magic of compounding, the differences in performance really add up over time. That's why the return from stocks can generate a much higher tax burden than bonds over the long haul. If you're a long way from retirement, it might make more sense to hold stocks in your IRA (and bonds if you are close to retiring).

Not All Investments Are Equal

So you've got a while until you retire, and you've decided that stocks are the right choice for your IRA. That decision only gets you so far. For an IRA, not all stock investments are created equal. For example, index funds' popularity has soared over the past decade, thanks in no small part to these offerings' often rock-bottom costs as well as the fact that so many active stock-pickers routinely lag their benchmarks. Such funds may also have the benefit of very good tax efficiency, because managers of large-cap index funds tend to buy and sell infrequently. In the same vein, actively-managed funds with very low turnover often don't generate a lot of taxable gains, either. Either fund type would work well as an IRA holding. However, to the extent that you own funds that do generate a lot of taxable capital gains, it makes sense to hold them in an IRA or other tax-sheltered account. In so doing, you take maximum advantage of the IRA's key attribute: tax-deferred (traditional IRA) or tax-free (Roth IRA) compounding.

As for bonds, municipal bonds don't belong in an IRA; such funds generate income that's exempt from federal and in some cases state income tax, and their yields are generally lower than taxable bonds as a result. Meanwhile, high-yield bonds could be contenders—they generate income, but IRA investors don't have to pay tax on those distributions. Alternative asset classes could also fund an IRA. REIT funds, for example, pay out heaps of income from their underlying real-estate holdings, and none of it is tax-advantaged; thus, to the extent that you own such an offering, might want to stash it in an IRA or other tax-sheltered vehicle.

Keep the Big Picture in Mind

How you split your portfolio between stocks and bonds should be based on your risk tolerance and time horizon, not what makes sense from a tax perspective. Your goal isn't necessarily to avoid taxes, but to maximize after-tax returns. Be sure to consult with a financial advisor or tax professional for the latest rules and regulations.

Past performance is no guarantee of future results. Stocks and REITs are not guaranteed and have been more volatile than bonds. REITs typically provide high dividends plus the potential for moderate, long-term capital appreciation. A REIT must distribute at least 90% of its taxable income to shareholders annually. Real estate investment options are subject to certain risks, such as risks associated with general and local economic conditions, interest rate fluctuation, credit risks, liquidity risks and corporate structure. High-yield corporate bonds exhibit significantly more risk of default than investment grade corporate bonds. Municipal bonds may be subject to the alternative minimum tax (AMT) and state and local taxes, and federal taxes would apply to any capital gains distributions.

How Safe Is Your Cash?

Investors often ask the question, “Are money-market funds FDIC insured like certificates of deposit and savings accounts?” The short answer is no, money market fund holders don't have the same guarantees that holders of CDs, money-market deposit accounts, and checking and savings accounts have. However, money-market fund investors were accorded extra protections when the financial crisis happened in 2008. At that time, a large money-market mutual fund, the Reserve Primary Fund, "broke the buck," meaning its holdings dropped in price, which in turn caused the fund's net asset value to drop lower than $1. That event created panic selling among some holders of money-market funds, prompting the Treasury Department to start a new program, similar to FDIC insurance, for money-market funds. Under the Treasury's program, investors who owned money market funds before Sept. 19, 2008 (the date that the Treasury introduced the program) were guaranteed to be "made whole" if their funds' net asset values dropped below $1. The Treasury's program expired a year later, however, meaning that the Treasury, FDIC, or any other entity do not currently insure assets in money-market mutual funds.

That said, the fact that money-market funds aren't insured doesn't mean you should automatically eschew them. Yields on nearly all cash-like vehicles are low across the board right now, but at other points in time, money-market mutual funds might provide better yields than you'd obtain with other cash products. In addition, money-market funds also offer daily access to your money, which is not an option for CD holders. Finally, there's the convenience factor: If you frequently move money into your long-term investments from your cash accounts, holding a money -market fund with your investment provider can make these transfers seamless.

Since the introduction of the first money-market fund 40 years ago, there have been a very small number of funds that have broken the buck; all the rest have maintained stable net asset values. And following the financial crisis, the Securities and Exchange Commission, which regulates money-market funds, imposed more stringent standards, instituting new requirements for liquidity, credit quality, and maturity. If you do opt for a money-market fund for your cash holdings, take a common-sense approach to ensure that you don't get stuck with an outlier. As with all investments, be on high alert if a money-market fund offers an appreciably higher yield than competing funds and does not have ultralow expenses; that can be a red flag that it's taking more risks than its peers.

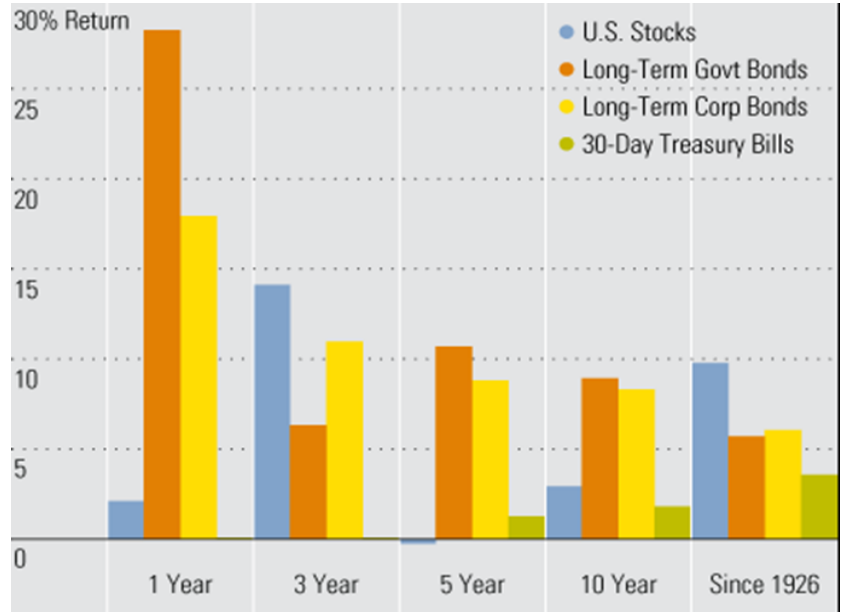
It can also make sense to stick with money funds offered by very large providers with extensive operations outside of the money-market fund business. Thus, in a worst-case scenario in which a money market fund's NAV falls below $1, the provider could contribute the cash to make investors "whole." Finally, if you have a lot of cash on the sidelines, it may be worthwhile to spread your positions among multiple providers for diversification purposes; you might also consider splitting your cash assets among accounts that offer FDIC protection as well as those that do not.

An investment in a money-market vehicle is not insured or guaranteed by the FDIC or any other government agency. The current yield quotation reflects the current earnings of the money market more closely than the total return quotation. Although money markets seek to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in them. Before investing in a money-market fund, you should carefully read all of the fund’s available information, including its prospectus and its most recent shareholder report.

Recent Bond Performance Explained

For investors, it comes as a surprise that bonds have recently outperformed stocks. Investors often assume that stocks offer higher returns compared with bonds. Recent market conditions, however, have proved otherwise. The image shows that while stocks have outperformed other asset classes from a return perspective since 1926, they have struggled over the last 10 years. Don't be surprised at the higher bond returns in the past 1-, 5-, and 10-years. Besides the dot-com bubble and sub-prime mortgage crisis in the past decade, several unique events in 2011, such as the Arab Spring, U.S. credit downgrade and the sovereign debt crisis, led to a flight to safety into government bonds. Under these circumstances, investors are advised to stick with their long-term investing strategy and be aware that asset class characteristics may deviate in the short term based on current market conditions.

Unusual Stock and Bond Behavior 1926-2011



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. U.S. stocks are represented by the Standard and Poor's 90 index from 1926 through February 1957 and the S&P 500 index thereafter, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general, long-term government bonds by the 20-year U.S. government bond, long-term corporate bonds by the Ibbotson® Long-Term corporate Bond Index, and 30-day Treasury bills by the 30-day U.S. Treasury bill. Government bonds and Treasury bills 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 other asset classes. With corporate bonds and investor is a creditor of the corporation an the bond is subject to default risk. Corporate bonds are not guaranteed. Returns are compound annual returns.

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