Investing With Integrity

April 2012 | Vol. No. 8 | Investment Updates

Investing in Bond Funds

If you don't want to invest all your assets in the stock market, you may need to consider either cash or bonds for your portfolio. While cash is relatively safe, returns are likely to be less than 1% given the low interest-rate environment. Bond funds are an alternative but most people don't have a good understanding of what to expect. You may want to consider buying a bond fund to give your portfolio stability or help generate income. Unlike individual bonds, bond funds hold a number of fixed-income securities with varying maturities. Therefore, investing in a bond fund provides a diversification benefit. In order to save yourself from making costly mistakes, it helps to thoroughly check up on what a bond fund owns before you buy in. Two basic determinants of bond performance are interest-rate sensitivity and credit quality.

Interest-rate sensitivity is important because an inverse relationship exists between bond prices and yields. If interest rates fall, bond prices rise, and vice versa. The credit quality tells you how risky the bond fund is, which can help determine if the fund fits your risk profile. Consider these factors before you go bond-fund shopping. Just as you wouldn't want to have all of your stocks in one style, you also want to diversify your bond portfolio. A well-rounded bond portfolio should have some exposure to most of the following bond types: Government, mortgage-backed, municipal, corporate, and world bonds. It is important to understand that the right combination of bond funds ultimately depends on your investment goals and risk profile.

Diversification does not ensure a profit or protect against a loss in a declining market.

Advisor's Corner

Integrity Financial Planners
tg@integrity-fp.com
541-469-4080
www.integrity-fp.com

Charles Blozinski, CFP and Thomas Goodwin, CFP, EA offer their clients the advantage of over 35 years of combined experience in financial services. They work as an interactive team to provide independent, unbiased financial advice in a fee-only environment. Integrity Financial Planners is a registered investment advisor in the State of Oregon.

Six Reasons Why Boomers' Retirement Is Different From Their Parents'

Integrity:

- In today's low interest rate environment, diversification among your stock and bond investments have become important. An income producing portfolio needs to provide a balance between interest rate risks and market risks in order to provide a steady income with minimal fluctuation of principal throughout retirement.

1. Much Longer Retirement: Many people in previous generations worked as long as they could and very few were fortunate enough to have a retirement that would be considered "golden" by today's standards. How many spent the last third (or more) of their lives pursuing hobbies and leisure instead of working? Boomers retiring in their 60s can expect to live about 30 years in retirement, which is a lot longer than their parents did.

2. Higher Expectations: Not considering tours of duty in Europe or the Pacific, how much traveling did past generations of retirees do? Boomers' parents were Depression-era babies who practiced frugality and continued to pinch pennies throughout retirement. In stark contrast, boomers want their retirement to include travel, vacation homes, new cars, dining out, etc. This is fine, but it is expensive. Therefore, boomers need to plan for a much more expensive retirement than their parents ever would have expected.

3. Personal Savings Instead of Pensions: The greatest generation might have had a lower per capita income but many also had corporate pensions. Boomers wanted higher salaries, freedom to change employers and the ability to save independently. Corporate pensions were largely phased out, giving way to the 401(k). However, when given the option, most boomers didn't start saving enough or early enough. Today, many boomers haven't amassed enough in personal savings, and most don't have meaningful pensions compared to their parents.

4. Rising Instead of Declining Interest Rates: In the 1980s, when the greatest generation started to retire, interest rates were much higher than they are today. The long decline in interest rates provided a great return to bond investors. The boomers are facing the very opposite situation. Instead of an ever-declining interest rate, they are facing the likelihood of steadily increasing interest rates during their retirement.

5. Exotic Investment Options: The greatest generation had relatively few investment options; mostly ordinary bonds and certificates of deposit. Today's boomers, on the other hand, are being offered an ever-expanding universe of income securities. The investment industry has provided a lot of rope, and a lot of new and exciting ways to lose it all.

6. Deregulations: If they felt like taking risk, the boomers' parents might buy some dividend-paying stocks. At the time, most of the dividend-paying industries, such as finance and utilities, were highly regulated. Decades of deregulation have caused these industries to become less predictable and more risky; hence, the certainty of previously assumed dividends is now extremely uncertain.

What Boomers Really Need: As boomers give up on stock gains, they tend to focus on income investing, and are always on the hunt for higher yields. There is no secret to finding higher yielding securities. In one way or the other, a higher yield just means higher risk: either term risk, credit risk or price risk. Higher-yielding securities always have more risk than lower-yielding securities. And some high-yield securities can even be riskier than a simple basket of stocks, but with a lower expected return. For these reasons, you may want to ask your advisor to establish a sustainable withdrawal rate and build a diversified portfolio focusing on total return rather than focusing on dividend-producing, interest-paying securities.

Diversification does not ensure a profit or protect against a loss in a declining market. The opinions herein are those of Morningstar, Inc. and should not be viewed as investment advice.

Making the Most of Your 401(k)

Integrity:

- Contribute enough to maximize your company's matching contributions.
- Choose a well diversified portfolio of investments. Do not try to predict the next hot investment.
- Rebalance your plan assets annually to keep your investments in line with your risks and goals.
- Change to a more conservative allocation as your retirement date approaches.

Focus on Your Goal: It is very important to have a time frame for your retirement. Whether or not this comes to fruition, you'll want to plan for it. If your retirement is still more than 20 years away, you can probably afford to keep most of your plan in investments with a higher level of risk, such as stocks. While you will undoubtedly experience the ups and downs of the stock market, time is on your side. Just don't panic when the inevitable downs come your way.

On the other hand, if your retirement goal is right around the corner, you will most likely want to work on preserving your portfolio. In this case, it might be in your best interest to take on less risk. If you find yourself in a position to preserve your wealth, don't be afraid to shift more of your portfolio to less risky investments, such as bonds, or even cash.

Contribute Money NOW: Most people, at one time or another, have found themselves saying they just don't have the extra cash to contribute to their retirement. While this may be the case for some, contributing just 1% of your pay is a good place to start. Try your hardest to increase this rate every year, until you max out. Furthermore, if your employer provides any type of match to your contribution, saving becomes even more important. And contributions are made on a pre-tax basis, providing you with a very nice tax benefit by shaving money off your tax bill.

Choose Investment Options Wisely: When it comes to picking which investments will make up your 401(k), this can be quite a challenging task. You absolutely must understand your investment options and choose those that are right for you. Don't swing for the next home-run investment. When it comes to saving for retirement, consistent, positive growth wins. Asset allocation is one of the most important factors in determining both return and risk of an investment portfolio, so you may want to consult a financial advisor for guidance.

Be Careful when Changing Jobs: Most people only change jobs about every four or five years. But if you do switch, don't forget about the 401(k) from your previous employer. More importantly, do not take a cash distribution of your plan's balance. If you do this, you'll be starting from scratch and will have to pay early withdrawal penalties and income tax. You do have options, though. You may be able to keep the money in your prior employer's plan. You can roll the money over into the new plan. Or you can roll the money into an IRA. The important thing is that your savings will continue to grow and you will not have to incur any penalties or pay any taxes.

Resist Borrowing from Your Plan: Borrowing from your retirement account, except for extreme circumstances, is generally a very bad idea. As with taking a cash distribution, you are derailing your savings plan. If you are paying back your loan, it's going to be a lot harder to maintain your current contribution rate. And once again there are tax implications. If you have to borrow, try other alternatives, and preserve your retirement account if at all possible.

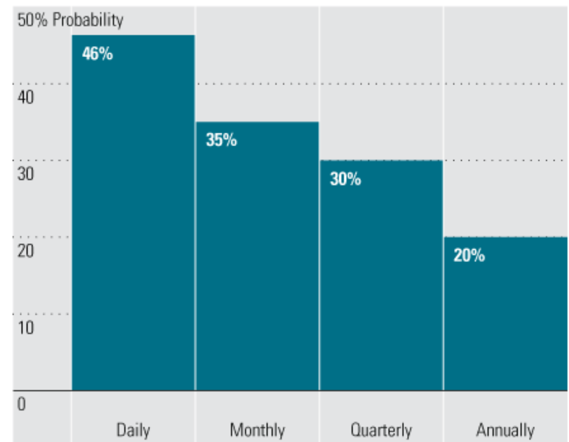
Keep Beneficiary Information Up to Date: Call your human resources representative and ask about your current beneficiary designations. Don't waste all that hard work saving money only to have it go to someone who's no longer a part of your life.

Short-Term Focus: Coping with Near-Term Fluctuations

Integrity:

- A long term focus for your investment portfolio is critical to achieving your goals. As your investment holding period increases beyond one year, the probability of a loss continues to decrease.

Instant access to real-time quotes and media reports can make it difficult for investors with a long-term investment horizon to stay focused on their goals. In reality, these daily market movements may not be as extreme as they seem. As investors look longer term, their perception often changes. Short-term market fluctuations can be quite volatile, and the probability of realizing a loss within any given day is high. However, the likelihood of realizing a loss has historically decreased over longer holding periods. The image illustrates that while the probability of losing money on a daily basis over the past 20 years was 46%, the probability dropped dramatically when analyzing an annual time period—20%. Periodic review of an investment portfolio is necessary, but investors shouldn't let short-term swings affect their view of the future.



Source: Stocks are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. An investment cannot be made directly in an index. Returns and principal invested in stocks are not guaranteed. Probability of loss is calculated as the number of negative periods divided by the number of total periods using the specified frequency of data.

©2012 Morningstar, Inc. All Rights Reserved. The information contained herein (1) is intended solely for informational purposes; (2) is proprietary to Morningstar and/or the content providers; (3) is not warranted to be accurate, complete, or timely; and (4) does not constitute investment advice of any kind. Neither Morningstar nor the content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. "Morningstar" and the Morningstar logo are registered trademarks of Morningstar, Inc. Morningstar Market Commentary originally published by Robert Johnson, CFA, Director of Economic Analysis with Morningstar and has been modified for Morningstar Newsletter Builder.

Integrity Financial Planners
PO Box 4790
Brookings, Oregon 97415
tg@integrity-fp.com
www.integrity-fp.com
Tel:541-469-4080