

## Welcome To Our New Quarterly Newsletter

**W**e believe in keeping you informed about what is going on at Integrity. This newsletter is one more way for us to keep you current on important personal financial issues. Stories will focus on timely matters that affect your portfolio, retirement, and family finances.

As a fee-only financial planning firm, our **Certified Financial Planner™** team is proud to offer a philosophy that is exemplified by our mission statement: *"Integrity is our foundation. In partnership with our clients, we provide non-judgmental advice that goes beyond the general perception of financial planning and investments. Together, we create comprehensive, personal financial solutions."*

To bring you this publication, we've hired the services of a veteran personal finance journalist, Andrew Gluck. Andy spent five years covering Wall Street as a staff writer and columnist for *The New York Daily News* and five years as a senior writer for *Worth* magazine. He now writes a monthly column for *Financial Advisor* magazine.

We welcome your input. If there is a topic you would like to see covered in this newsletter, or if you have questions about any of the articles, please do not hesitate to call us.

Sincerely,

*Victoria Marone,*  
Ph.D., MBA, CFP®, CSA  
Chief Executive Officer

## Are Star-Struck Investors Guaranteed Better Returns?

**H**ave you ever gone to a box office hit with consistent "thumbs up" reviews only to walk out wondering what all the hype was about? Investors who flock to four- and five-star-rated mutual funds may also be disappointed by the big picture.

"Star ratings are highly marketable and very seductive," says economist Matt Morey, who led several studies at Pace University on fund ratings. "They've become a *Good Housekeeping* seal of approval. But investors need to recognize that a good rating has minimal predictive power, and should not be the sole criterion for deciding where to invest."

The star rating system, created by Chicago-based Morningstar, Inc., is based on the risk/reward profiles of funds in 48 categories. Funds are measured against their peers in each category and graded on a curve. Ten percent are assigned one star; 22.5% receive two; 35% get three; 22.5% get four, and 10% receive five, the top ranking.

Although Morningstar clearly discloses that ratings reflect only past performance, many investors assume they imply superior future performance—and rush to put dollars into funds when they attain a high rating and pull out money when a rating dips.

But Morey believes that staying put may actually be the key to higher returns. Over time, his studies showed, five-star funds perform no better than those with four or three. And, sticking with the same

three-, four-, or five-star funds over time—regardless of their ratings fluctuations—generally produced better returns than moving money around.

To chase the stars in such a way that you could beat the market indexes would be virtually impossible, unless you have an inordinate amount of time on your hands, Morey adds. You'd have to buy four- and five-star funds, then immediately replace any that fall below four-star status. To keep up, you may have to pay fees on more than 160 transactions per month.

In addition, investors who pour dollars into a highly rated fund may actually contribute to its downfall. It's all about gravity, Morey explains. Funds that rise quickly often fall just as rapidly—and the decline could result in part from the influx of investor cash that comes when a fund gains a top rating.

"Once a fund receives a five-star rating, the inflows increase to the point where the fund becomes unwieldy to manage—having doubled or tripled in size—and cannot perform at the same level as before," he says. A fund that achieves a high rating is likely to receive, on average, 50% more cash during the following six months than it took in during the previous half year, Morey says.

Meanwhile, companies such as Lipper and Value Line also evaluate funds, and do a fine job—yet it's the stars that fund companies tend to

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# A Skeptical View Of Variable Annuities

**V**ariable annuities (VAs) soared from obscurity a decade ago to have \$1.3 trillion in total assets in late 2006, according to the National Association for Variable Annuities. However, many skeptics say VAs are popular not because they're great for investors, but because they're usually great for the people selling them. VAs are often laden with punishing fees that can drain the value of your account.

VAs are not all bad. Indeed, some individuals can benefit from a VA. It provides tax-deferral for investments, just as a 401(k) or IRA does. Unlike an IRA, there's no limit on contributions and no mandatory withdrawals. You can put your money in a wide range of professionally managed subaccounts, very much like mutual funds. And if you happen to lose money and die while the account is down, your beneficiaries could receive a death benefit. In addition, many VAs offer a "living benefit" rider that promises minimum lifetime income regardless of investment performance. With all these benefits, VAs make for a great sales pitch, and that makes it especially important to be aware of the drawbacks.

Bells and whistles can make a VA seem complicated, but the basic structure is simple. An insurance component provides a benefit upon your death and allows a VA its tax-deferred status under

U.S. tax law. You decide how you want your account invested, dividing money among a menu of mutual fund-like subaccounts. Like other tax-deferred accounts, VAs permit penalty-free withdrawals after age 59½. Before that, there's a 10% tax penalty on your policy earnings. All withdrawals of earnings, whenever they're made, are taxed as regular income.



The biggest problem with VAs is that fees tend to be extremely high. They impose insurance and administrative expenses on top of management fees for the subaccounts. Fees can be in excess of 2% of your assets annually. There may also be annual contract charges and sales loads on investment subaccounts.

Meanwhile, the death benefit isn't likely to be much. There are scenarios in which it would be valuable—for example, if you died shortly after making a large investment and the market had dropped sharply. But that just doesn't

happen very often. According to LIMRA International, an insurance research group, only three of every 1,000 VA contracts are surrendered because of death or disability.

Taxes are another shortcoming. When money comes out, it is taxed as income at rates of up to 35%. Compare that with the top rate of 15% on most long-term capital gains and qualified dividends in taxable accounts. Several states also impose additional taxes on VAs. And while the tax advantage for mutual funds may be partially offset by tax-deferred compounding within a VA, it could take many years of tax-deferral for a VA to come out ahead.

There's also the tax treatment of inherited VAs. Heirs, like any other account owner, are subject to tax at income rates on withdrawals. In contrast, the tax basis of an inherited mutual fund is stepped up to its value when it passes to your heirs, so that gains you earned during your lifetime aren't taxed at all.

The final indignity? If you experience buyer's remorse after purchasing a VA, you'll probably have to pay a surrender charge of as much as 7% to get your money back. While VAs may be right in some circumstances, we are here to serve as your trusted advisor in evaluating such sales pitches. ●

## When Your Financial Advisor Accepts The Role Of Fiduciary,

**I**n the world of financial advisors there are myriad labels, certifications, registrations, and other terms that tend to be meaningful only to industry insiders. But one distinction could be crucial: An advisor bound by contract or law to serve as a "fiduciary" is obligated to act solely in your best interest. That's different from others who may seem to work for you but in fact owe primary allegiance to the companies that pay them.

With other professionals, such as lawyers and CPAs, there's typically a fiduciary responsibility that requires them to act in clients' best interests.

But for financial advisors, fiduciary status is not yet standardized or guaranteed. So while you may think your stockbroker offers unbiased advice, he or she is probably receiving a commission for selling you products. To complicate matters, even a fee-based advisor who charges for advice may not be acting solely in your interest.

Not surprisingly, there's widespread confusion among consumers on this point. According to a recent survey by a major financial services firm:

- More than half of the investors interviewed believed both stockbrokers and Registered Investment Advisors

(RIAs) have an obligation to act in the client's best interests.

- Three out of four investors didn't realize that only independent RIAs have a fiduciary duty to their clients.

RIAs must inform clients of potential conflicts of interest, and they're legally obligated to act as a fiduciary. They have a fiduciary duty to act in their clients' interest at all times. Stockbrokers don't have the same obligation. Brokers must make recommendations that are suitable but are not required to adhere to the higher standard of care—to always do what's in your best interest—as a fiduciary.

# Why A Financial Plan Can Make You Happy

**R**emember what it felt like to get that first-ever paycheck? What about the first time you made a tidy profit on a well-chosen stock? Chances are you don't get the same kick today. When you've gotten accustomed to success and having money becomes old hat, it may hinder your happiness and satisfaction, say psychologists and economists. A well-thought-out financial plan can help.

"The key to being happy isn't how much you earn," said George Lowenstein, an economist at Carnegie Mellon University. "Happiness comes from gaining control over your finances and figuring out what to do with your money."

Several studies during the past five years confirm that you can't put a price on happiness:

- The same level of personal happiness was experienced by the very wealthy individuals on the Forbes 400 list and by members of Kenya's Maasai tribe, a herding people without electricity or running water, according to a University of Illinois study.\*

- In a University of Michigan survey, lottery winners and inheritors of sudden wealth had similar experiences. Within a few months or years, all that extra cash lost its ability to boost overall contentment.\*

- In numerous reports, psychologists have found that gains in wealth often

leave us feeling we're getting nowhere—because even though we have more, we're not gaining on our peers.

- Six-figure earners are no happier than those who make \$50,000, according to a survey by economists at the University of Chicago. For those who were surveyed, once basic needs were met, additional assets didn't result in greater contentment. And greater access to luxuries only fueled the need for more and more and heightened peer competition.

Yet even if money can't buy happiness, few of us would turn down the chance to increase our bottom lines. So exactly what are we seeking? "It's physically impossible for a piece of paper like money to make you happy," writes career coach Pamela York Klainer in her book, *How Much Is Enough? Harness the Power of Your Money Story*. "Instead, what makes people happy is the feeling of security money brings."

How secure your wealth makes you feel depends in part on how you use it. Economists at Harvard University have found that income accounts for only 1% of happiness; health, family, and community rank far higher in helping make us happy. Yet when you combine income with those values, income rises on the scale. That's where a financial plan comes in. Ideally, it will help integrate money with values.

To succeed in providing a road map

to happiness, however, a financial plan must do far more than specify asset allocations, explains George Kinder in his book, *The Seven Stages of Money Maturity*. An effective plan should help shape your success according to your short- and long-term goals and personal values. In addition, because it's tailored to your individual needs, a plan can mitigate the extent to which you feel you must measure yourself against your peers.

For example, if you want to travel during retirement and provide your kids with a good education, you can develop a plan structured to maximize college and retirement savings opportunities. Similarly, if you feel strongly about certain causes or institutions in your community, you can put together a carefully structured charitable giving plan. Consider a lottery winner who donates some of his windfall to charity—he or she will likely feel greater long-term satisfaction than someone who uses the entire winnings to finance personal luxuries.

"We're now realizing that we have been too focused on the financial aspects of decision-making rather than the emotional ones," says Stephen Butler, president of Pension Dynamics Corporation, a California-based pension consulting firm. "Understanding emotions may represent a far greater contribution to the well-being of those preparing for, or enjoying, retirement."

Of course, you have worked extraordinarily hard to achieve success and deserve to treat yourself to a spontaneous shopping spree or luxurious vacation every now and then. But when everything happens in the context of a well-considered financial plan, you'll feel better about those special "occasions of consumption," as economists call them—and that can elevate overall contentment and satisfaction.

Come in to talk with us about your hopes and dreams. Together we can create a financial road map to help achieve them so you can enjoy happiness and fulfillment. ●

\*The University studies cited in this article used a similar equation to measure happiness: Happiness = reality – expectation. Generally, respondents were asked to rate satisfaction and success in certain aspects of their lives on a numerical scale.

## You Have A Foundation For Trust

The distinction between an advisor who is a fiduciary and one who is not could be critical when weighing an advisor's recommendations. There may be a hidden agenda—for example, if an advisor is receiving better commissions for selling you one mutual fund instead of another.

Rules recently clarified by the Securities & Exchange Commission permit brokers to give you investment advice on a fee basis and not act as a fiduciary. In these instances, a broker can only give you advice about one or two issues—such as your retirement plan or investing. If a broker wishes to give you comprehensive financial

advice that spans insurance, taxation, college planning and estate planning as well as investing and retirement planning, the broker must accept his or her role as a fiduciary to you. He must disclose that he will begin giving you advice as a fiduciary and then tell you when he has stopped acting as a fiduciary and reverted back to his role as your stockbroker.

Working with someone who is a fiduciary, or will sign an agreement to act as a fiduciary, doesn't guarantee you'll profit from the advisor's recommendations. But it does give you a greater assurance that you're both sitting on the same side of the table. ●

# A Checklist Of Estate Planning Essentials

If you have a will, you're already in better shape than the 57% of Americans who don't, according to a recent survey by legal website FindLaw. But your life isn't static, and major events—marriage, divorce, a new baby, the death of an heir, a significant change in your net worth, a move to another state—could have a major impact on your will and your estate planning documents. So it's important to review your will regularly with your attorney, and update it along with other estate planning records.

There's a long list of possible changes to consider. You may need to add or subtract heirs, adjust individual bequests, insert language relating to new or existing trusts, or revise the will to reflect shifts in federal and state estate tax laws. During the review, make sure you also keep up-to-date records about the following essential items:

- Names and addresses of the guardians you've asked to take responsibility for your minor children.
- Funeral and burial arrangements. Include the location of your cemetery plot, where you keep the deed for the

plot, and whether you've established a pre-need funeral trust.

- Location of safe deposit boxes and details about keys, passwords, or combinations. Indicate whether anyone else has access to the boxes. If you have sole access, ask your executor to inventory box contents immediately after your death.

- Location and number of any post office box, and where you keep the key.

- Account numbers for all checking and savings accounts.

Indicate whether anyone else has the right to withdraw from them, and whether the executor needs to place a stop on withdrawals.

- Names and addresses of any professionals—accountants, attorneys, insurance agents, financial advisors, bank officers, realtors, stockbrokers—who were involved in your affairs and could potentially assist your executor.

- Location and policy numbers of all life insurance policies, including those that have lapsed but could still have cash value.

- A list of credit card accounts and numbers. The executor should immediately cancel credit cards in

your name and take your name off joint accounts.

- Information on outstanding debts, including whether you have insurance that cancels the debt at your death.

- All property and other assets, with the location of deeds and titles.

- Details about brokerage accounts and other investment vehicles, such as limited partnerships or interests in real estate.

- A list of all retirement accounts—401(k)s, IRAs, annuities, pensions—with designated beneficiaries and the location of account statements. Provide a list of former employers; there may be retirement benefits you didn't know about that could go to your heirs.

- Debts owed to you, with any proof that the debt exists.

If you update your will, make sure the executor named in the will has a copy of the latest version, and keep the will in a safe but accessible place. Using a safety deposit box could be problematic, because it could be sealed upon your death. ●

## Star-Struck Investors

*(Continued from page 1)*

crow about in their advertising. Why? The answer may be psychological.

“People are naturally drawn to the same rating systems they use to find hotels, movies, and restaurants,” says Morey, who examined 273 funds for his latest study. In 2004, 97% of the money deposited into mutual funds went to funds that earned four or five stars from Morningstar, according to UBS Investment Research.

Morningstar recognizes the magnetism of its own star image. Stars provide a “quick, easy-to-visualize answer,” admits Russel Kinnel, director of mutual fund research at Morningstar. But they are

also the product of extensive research and analysis. “Because mutual funds are so complex, it makes sense that asset managers seeking to provide a succinct message in a short advertisement ‘reach for the stars,’” Kinnel says.

Morningstar revamped its ratings system in 2002 and fine-tuned it again in March 2005. The company has expanded the system from four very broad fund classes to today's 48 categories. Until 2002, when a particular style of investing was hot—as technology growth stocks were during the late 1990s, or deep-value investing is right now—a disproportionate share of funds within that group received four or five stars, regardless of a particular manager's skill or the

likelihood that a particular fund would continue to fare well when the market shifted. Now, with more clearly defined categories, funds that earn high ratings versus their peers are more likely to sustain performance—their ratings reflect not only market trends but also the fund managers' ability.

But Morey strongly urges investors to do their own research, and look not only at Morningstar, but also at what Lipper and Value Line have to say. Build a well-diversified portfolio of funds ranked favorably across the board, he suggests—and don't rush to act on inevitable ratings fluctuations. If you're a star-chaser by nature, better to channel your tendency toward the movies. ●

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