MILLINGTON FINANCIAL ADVISORS

MONETARY INSIGHTS

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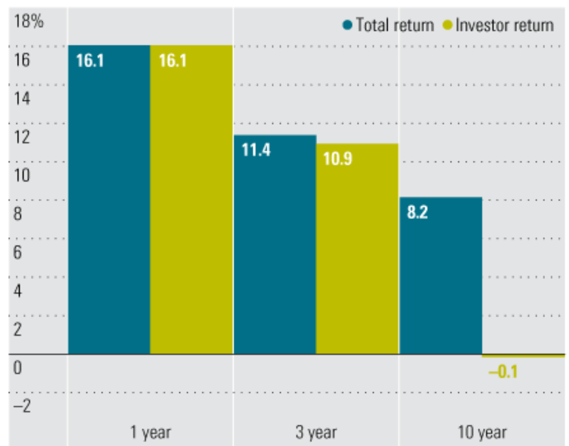
Chasing Performance

Investors often endure poor timing and planning as many chase past performance. They buy into funds that are performing well and initiate a selling spree following a decline. This becomes evident when evaluating a fund's total return compared with the investor return. Overall, the investor return translates to the average investor's experience as measured by the timing decisions of all investors in the fund.

The image illustrates the investor return relative to the total return for a given fund. Over the short term, both the total and investor returns were positive and relatively similar. Over a 10-year period, however, total return greatly exceeded investor return. Investors who attempted to time the market ran the risk of missing periods of exceptional returns.

Comparison of a Fund's Return Performance Over Time



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. Returns and principal invested in stocks are not guaranteed. Morningstar investor returns measure how the typical investor in that fund fared over time, incorporating the impact of cash inflows and outflows from purchases and sales. It is not one specific investor's experience, but rather a measure of the return earned collectively by all the investors in the fund. Total return measures the percentage change in price for a fund, assuming the investor buys and holds the fund over the time period, reinvests distributions, and does not make any additional purchases or sales. Investor returns are not a substitute for total returns but can be used in combination with them. Data as of October 2012.

Source: The fund illustrated in this example was selected from Morningstar's open-end database.

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Assessing the Student Loan Landscape

These days, borrowing to pay for college has become a lot more defensive. Not only may student-loan terms be less attractive than they were in the past, but new graduates may also get squeezed if they have to begin repaying their loans before they land a job. Owing in no small part to the still-anemic economic recovery, the student loan default rate has been on the rise, according to the U.S. Department of Education (September 2012).

As with mortgage borrowers, student-loan shoppers face a bewildering array of options that carry varying interest rates, fees, and terms. In all, it pays to do your homework and investigate other alternatives before signing on the dotted line for a student loan.

Determine Your Need: The first step in the college-funding process is to determine how much of your child's education expenses your family will likely be on the hook for. Submitting the Free Application for Federal Student Aid (FAFSA) is the way to officially check on financial aid eligibility, and your specific package will vary by school.

Discuss the Payoff: If it looks like you and/or your child will have to borrow a sizable sum to cover the cost of college, it's wise to begin discussing those numbers in the context of your child's expected career path. If your child will graduate with $100,000 in student-loan debt but plans to venture into a field where starting salaries are in the $25,000 per year range, it doesn't take a math major to see that it will take many years to retire that debt, and doing so could impede your child's ability to reach other financial goals.

Know the Different Types: College loans come in a number of different varieties, but there are a few key categories to be aware of. The first choices for most students seeking additional funding are those extended by the federal government. Perkins loans are available exclusively to low-income students. Stafford loans come in two key varieties. With subsidized Stafford loans, students aren't on the hook for interest until after graduation, but with unsubsidized Stafford loans, interest begins accruing immediately. Students applying for subsidized Stafford loans must demonstrate financial need, whereas students needn't demonstrate financial need to qualify for unsubsidized Stafford loans. The second key category is federal loans made directly to parents, usually called PLUS loans. On the positive side, parents can typically borrow much more than students. However, interest begins accruing immediately and payments must also begin immediately. The final student-loan category is a private loan extended by a bank. In general, the cost of a private student loan can be much higher than that of a federal loan.

Don't Overestimate the Value of the Interest Deduction: You may have heard that you'll be eligible to deduct the interest on student loan debt. That's true, but don't overestimate the value of that deduction. In 2012, you can only deduct $2,500 in student loan interest per year; single parents earning more than $75,000 and married couples filing jointly who earn more than $150,000 per year cannot deduct the interest at all.

Consider Additional Options: Rather than assuming student loans are the only way to cover the cost of college, it's important to take a step back. Fully exploring financial aid packages, scholarships, and work-study programs can help reduce the strain that such loans can impose on families and new graduates; some grandparents may also have the wherewithal to help defray college costs. Parents may also contemplate tapping home equity lines of credit or using their own savings plans to fund college.

Please consult with a financial or tax professional for advice specific to your situation.

Understanding the U.S. Unemployment Rate

One of the most widely recognized economic indicators is the unemployment rate. There exists a relationship between unemployment rates and recessionary periods, which finally links to stock prices. Institutions and individual investors alike pay special attention to this number to get a bearing on current market conditions that may help them with their investment decisions.

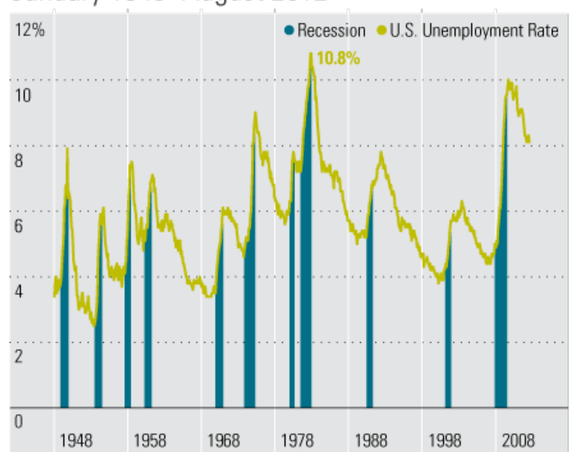
The unemployment rate, as shown in the image, is typically higher during a recession. Over the past 65 years, the U.S. economy has experienced 11 recessions and has seen unemployment rates skyrocket 11 times, peaking at 10.8% back in November 1982. The unemployment rate, a lagging indicator, typically peaks towards the end of a recession and gradually declines as the economy recovers.

The unemployment rate is published by the U.S. Bureau of Labor Statistics once a month through an extensive survey of select households. People are classified as unemployed if they do not have a job, are currently available for work, and have actively looked/are looking for work. The unemployment rate is the number of unemployed people as a percentage of the labor force, with the labor force defined as the total number of employed and unemployed people. The labor force automatically excludes young people (anyone under the age of 16), people in the military, and institutionalized individuals (in prisons, mental institutions, and nursing homes). However, there are other groups of people that voluntarily choose to be excluded from the labor force, including homemakers, students, retirees, and discouraged workers who have stopped seeking employment.

When interpreting the monthly unemployment numbers and how they have changed since the last month, it is important to see if the variation was brought about because of a change in the number of unemployed people, a change in the size of the labor force, or both. For example, if the unemployment rate dropped because the number of unemployed people decreased, that's a good sign and indicates that the economy improved. If the unemployment rate dropped because a sizable number of discouraged workers stopped actively looking for work and simply dropped out of the labor force, that's a bad sign. The lower unemployment rate in the latter case gives the illusion of an improving economy, when in actuality the economy hasn't improved.

Investors should stay informed on current market conditions as they may help explain why portfolio values have changed (for better or for worse) and how they can continue to stay the course. A worsening unemployment trend means more individuals are looking for work and people may have less disposable income to spend, which will negatively affect sales. Poor sales result in lower company profits, putting downward selling pressure on the company's stock price.

U.S. Unemployment Rate
January 1948–August 2012



Source: U.S. unemployment data is from the Bureau of Labor Statistics, U.S. Department of Labor. The monthly unemployment rates are seasonally adjusted. The start date of 1948 was chosen because of data availability. Recession data is from the National Bureau of Economic Research (NBER). The National Bureau of Economic Research (NBER) does not define a recession in terms of two consecutive quarters of decline in real GDP. Rather, a recession is a recurring period of decline in total output, income, employment, and trade usually lasting from six months to a year and marked by widespread contractions in many sectors of the economy. Investing in securities always involves risk of loss, including the risk of losing the entire principal.

Risk, Not Volatility, Is the Real Enemy

What would you do if your investments lost 10% in a single day? A) Add more money to my account. B) Hold steady with what I've got. C) Yank my money; I wouldn't be able to stand any more losses.

If investors buy the right investments but sell them at the wrong time because they can't handle the price fluctuations, they may have been better off avoiding those investments in the first place. Most investors are poor judges of their own risk tolerance, feeling more risk-resilient in up markets and more risk-averse after market losses. However, focusing on an investor's response to short-term losses inappropriately confuses risk and volatility. Understanding the difference between the two and focusing on the former is a potential way to make sure you reach your financial goals.

Volatility encompasses the changes in the price of a security, a portfolio, or a market segment, both on the upside and downside, during a short time period like a day, a month, or a year. Risk, by contrast, is the chance that you won't be able to meet your financial goals or that you'll have to recalibrate your goals because your investment comes up short. So how can investors focus on risk while putting volatility in its place? The first step is to know that volatility is inevitable, and if you have a long enough time horizon, you may be able to harness it for your own benefit. Diversifying your portfolio among different asset classes can also help mute the volatility. It helps to articulate your real risks: your financial goals and the possibility of falling short of them. Finally, plan to keep money you need for near-term expenses out of the volatility mix altogether.

Investing in securities always involves risk of loss. Diversification does not eliminate the risk of experiencing investment losses.

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