MILLINGTON FINANCIAL ADVISORS

MONETARY INSIGHTS

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The Flavors of Investing

It is tempting to jump on the investment bandwagon when certain parts of the market soar based on a trend or analyst report. While great potential exists, sector investing can also come with great risk.

As seen in the image, what is hot one year isn't always hot the next. Interested investors should be willing to follow a sector's ups and downs, as timing the market is difficult. Investing in specific sectors can add volatility to a portfolio, but exposure to the right sectors can contribute to improved financial performance. Keep in mind that while sector investing can fill a gap or serve as a speculative play, a balanced asset allocation should be the core of any portfolio.

10-Year Sector Winners and Losers

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Highest return	4.3	50.3	38.1	40.8	39.4	32.9	–16.1	61.9	30.5	18.5
	–6.3	41.0	32.1	14.8	36.2	27.5	–23.3	53.6	27.4	13.4
	–6.6	37.6	23.3	12.2	21.8	17.2	–28.1	50.2	24.9	11.9
	–9.1	37.3	19.2	8.1	19.7	16.6	–38.2	35.6	24.2	6.9
	–13.1	34.8	17.9	6.0	17.6	12.6	–38.4	34.0	23.4	5.1
	–21.1	32.1	15.4	6.0	15.4	12.0	–39.4	29.3	23.2	4.1
	–23.6	26.1	14.4	5.2	15.1	8.0	–39.8	24.0	14.5	0.6
	–23.8	24.7	12.5	3.7	15.0	0.2	–41.2	21.0	13.4	–0.4
	–23.8	19.8	10.1	3.0	11.9	–8.7	–42.0	15.6	11.8	–0.7
	–37.3	18.9	3.5	–1.4	10.9	–17.9	–48.1	14.5	7.3	–14.1
Lowest return	–38.3	17.4	0.8	–6.0	6.7	–18.3	–51.3	11.8	5.1	–16.5

Basic Mat.
Comm. Ser.
Cons. Cyclical
Cons. Def.
Energy
Financial
Health Care
Industrials
Real Estate
Technology
Utilities

This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Past performance is no guarantee of future results. Sector investments are narrowly-focused investments that typically exhibit higher volatility than the market in general. Sector investments will fluctuate with current market conditions and may be worth more or less than the original cost upon liquidation. Returns and principal invested in stocks are not guaranteed.

Source: Sectors in this example are represented by the Morningstar Sector Indexes.

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Advisor's Corner

We hope everyone enjoyed the Labor Day weekend. August was a busy month for us. We held three successful dinner seminars focused on Investing During Uncertain Times. The feedback received said it was very eye opening to understand how impactful tactical management can be on your portfolio's performance. A tactical management style seeks to create value by underweighting certain asset classes in perceived times of risk and overweighting certain asset classes when opportunities appear present. Incorporating a diversified management approach can be just as significant to your portfolio as traditional asset class diversification. Tactical management can be a lower risk way to participate in asset classes with a greater potential for returns when stated yields are not sufficient to meet your investment objectives. The portfolios we build include diversified management styles and asset classes, positioned to handle these uncertain times. Please let us know if you or someone you know would be interested in meeting with us to learn more.

Know Your Own Inflation Rate

The Consumer Price Index (CPI), a measure of inflation, is a monthly statistic representing the change in prices paid by urban consumers for a representative basket of goods and services. While this measure serves more as an official gauge, a lot of consumers (especially retired consumers and investors) seem to have a different sense of inflation. The question often arises: Why is it that the official rate seems to be lower than what we're actually feeling out there?

Our inflation rate may vary depending on our individual expenditures. This means that some people may experience higher inflation relative to others. For a senior, food and energy costs are a very high proportion of their total household outlay. The location where you live can also impact your personal inflation rate. If you have a fixed-rate mortgage, or if you're retired and your home is paid for, you won't experience fluctuating housing costs as a result of having an adjustable-rate mortgage or paying rent. But you may see housing costs vary from one region of the country to another. Another big swing factor in your personal inflation rate is health-care cost. If you have purchased a long-term care policy with an inflation rider, you can insulate yourself against rising nursing-home and other long-term care costs.

Anyone who has Social Security has a buffer against higher prices because Social Security includes a cost-of-living adjustment. If a Social Security paycheck is a big proportion of your total income needs, you're likely in good shape as far as inflation is concerned. If it's just a tiny portion of your total income needs, you're not in as good a shape. If you're receiving a pension with an inflation adjustment it can help you stave off inflation, and the same goes for folks who have an annuity with an inflation rider; they will have some protection against inflation. What about folks who are still in employment? If you're still working, either full-time or part-time, you may potentially be able to get a cost-of-living adjustment in your paycheck. If you're not working and not eligible for those cost-of-living adjustments, you'll need to plan for inflation accordingly.

Finally, it's also important to gauge whether your portfolio is built to withstand your personal rate of inflation. Portfolio composition is the key here. Investments such as short-term bonds and cash may not safeguard against the threat of inflation. If a high proportion of your portfolio consists of cash or short-term bonds without any inflation protection built in, you may see a large percentage of your return eaten away by inflation. Next up is your portfolio time horizon. Seniors who are quite far into their retirement and don't anticipate having a long time horizon for their investment assets probably need to be less concerned about the toll that inflation will take over time. However, if you're just starting out in retirement, you may need to plan for inflation-proofing your portfolio, because over time, even a seemingly benign inflation rate of 3% may take a bite out of your portfolio return.

Diversification does not eliminate the risk of experiencing investment losses. Government bonds and Treasury bills are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than other asset classes. Annuities are suitable for long-term investing, particularly retirement savings. Annuity risks include market risk, liquidity risk, annuitization risk, tax risk, estate risk, interest-rate risk, inflation risk, death and survivorship risk, and company failure risk. Withdrawal of earnings will be subject to ordinary income tax and, if taken prior to age 59½, may be subject to a 10% federal tax penalty. Additional fees and investment restrictions may apply for living-benefit options. Violating the terms and conditions of the annuity contract may void guarantees. Consult a financial advisor and tax advisor before purchasing an annuity.

Investing in Emerging Markets

Emerging-market economies offer tempting rewards and are becoming more standard among investors willing to take on additional risk. Commonly called developing-market economies, they are in transition but are beginning to see a substantial increase in living standards and income, rapid economic growth and a relatively stable currency. They can be small or large economies and can be found all over the globe. Examples include China, India, Korea, Malaysia, Indonesia, Taiwan, Philippines, and Thailand in Asia; Poland, Hungary, Czech Republic, Egypt, Turkey, and Morocco in Europe and the Middle East; and Brazil, Chile, Columbia, Peru, and Mexico in Latin America, as well as Russia and South Africa. As of December 2011, MSCI Barra identified 21 emerging countries worldwide.

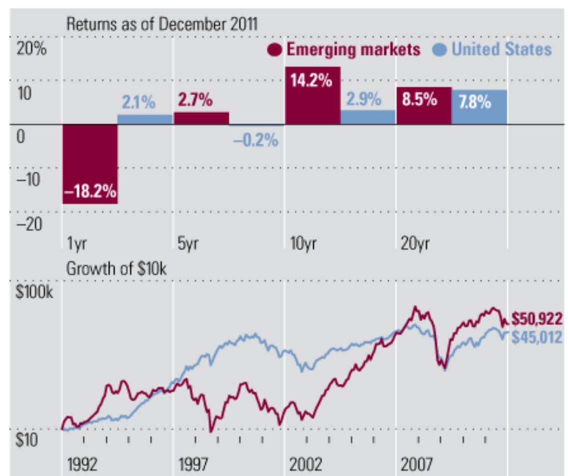
Since these economies are still developing, the risk of an emerging-market investment is higher when compared with that of a developed market. Some of these risks include currency fluctuations, foreign taxation and political, social, and economic upheaval. However, such added risk comes with the potential for higher returns.

Perhaps the easiest way to include emerging markets in a portfolio is to buy an emerging-markets mutual fund. This is a mutual fund that holds various investments in emerging countries, bringing you the added benefit of diversification. Make sure to read the mutual fund's prospectus very carefully before investing or sending any money. Another way to invest in emerging markets would be to buy stocks of foreign companies directly—much more difficult and risky to do on your own. You may also hear the term ADR connected with international investing. It stands for American Depositary Receipt, and it is an instrument allowing the stock of a foreign company to trade on a U.S. exchange.

The graph illustrates the historical short- and long-term performance of emerging markets compared with U.S. markets. Emerging markets posted respectable returns, beating those of the U.S. market over longer time periods. However, these returns came with additional risk, as shown by the volatility of the line graph. A hypothetical $10,000 invested in emerging markets would have grown to $50,922 over the 20-year time frame, compared with $45,012 for domestic investments.

While the emerging markets' ending wealth value surpassed that of the U.S. investment, it accumulated over a rather long time horizon. Note that emerging markets can experience a much greater upside and often a deeper downside in any particular year. Emerging markets took a serious hit in 2011, ending with a large loss due to an uncertain world economic climate following events such as the Arab revolution, the tsunami in Japan, and the European sovereign debt crisis. Consequently, this type of investment is more appropriate for long-term investors who can handle potentially large fluctuations in returns.

Undeveloped Opportunities: 1992–2011



International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, and differences in accounting and financial standards. Emerging-market investments are riskier than developed-market investments. Liquidity is typically lower in emerging markets than in developed markets. An investment cannot be made directly in an index. Returns and principal invested in stocks are not guaranteed.

Source: U.S. stocks are represented by the Standard & Poor's 500® index, which is an unmanaged group of securities and considered to be representative of the stock market in general. Emerging markets are represented by the Morgan Stanley Capital International Emerging Markets Index.

The Art of Asset Location

Asset location is a part of the investing strategy that involves deciding which investments to hold in which accounts, and taxes play an important role in this decision. Here are a few basic guidelines.

Hold in Your Tax-Sheltered Accounts: Assets With High Tax Costs. In general, government or corporate bonds and bond funds may be a better fit for tax-sheltered accounts (like IRAs and 401(k)s) than for taxable accounts because their payouts are taxed at an investor's ordinary income tax rate. If you need to hold bonds in your taxable accounts, a municipal bond or municipal bond fund might offer you a better after-tax yield than a taxable bond investment, because income from munis is exempt of federal income taxes.

Hold in Your Taxable Accounts: Assets With Low Tax Costs. By contrast, stocks and stock funds may generally be a better bet for taxable accounts. Long-term capital gains, which is what you have when you sell a stock that you've held for at least a year, are taxed at a much lower rate than bond income (however, these favorable tax rates are set to expire at the end of 2012).

Stocks are not guaranteed and have been more volatile than the other asset classes. Dividends are not guaranteed. Bonds are subject to credit/default risk and interest-rate risk. Municipal bonds may be subject to the alternative minimum tax (AMT) and state and local taxes, and federal taxes apply to any capital gains distributions. Retirement accounts are tax-deferred vehicles designed for retirement savings. Any withdrawals of earnings will be subject to ordinary income tax and, if taken prior to age 59½, may be subject to a 10% federal tax penalty. This should not be considered tax or financial planning advice. Please consult a tax and/or financial professional for advice specific to your individual circumstances.

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