

MONETARY INSIGHTS

July 2012

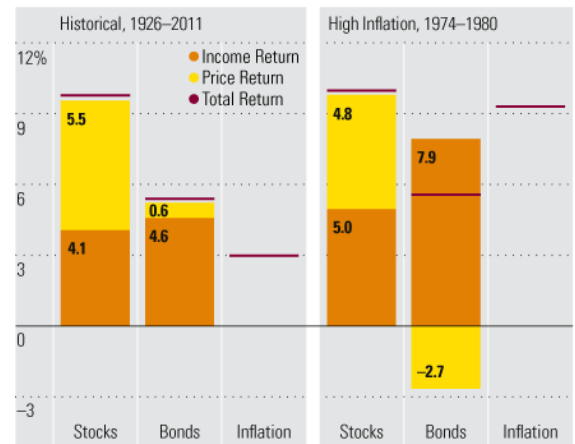
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Investment Updates

Dividends and Inflation

As an investor, you may ask if an allocation to dividend stocks in your retirement portfolio will help keep up with inflation. Examining stock returns during periods of high inflation may answer this question. Dividend-paying stocks may offer benefits such as stability through income return and inflation protection. While stock prices tend to be volatile, dividends may serve as a stable component of total return and may provide better inflation protection compared with bonds. Between 1974 and 1980 (high inflation period), the average rate of inflation was 9.3%, much higher than the historical rate of 3%. During this time, bonds yielded 7.9% from income, but prices declined by 2.7%, resulting in a total return of 5.6%—way short of inflation. On the contrary, stocks returned a total of 10%: 5.0% from dividend income and 4.8% from price return, outpacing inflation for this time period.

Performance of Stocks and Bonds Relative to Inflation



The 1974–1980 time period was chosen as representative of high inflation because it contains multiple consecutive years when inflation was 5% or higher (except 1976). The sum of the price return and income return may not equal the total return due to compounding. Past performance is no guarantee of future results. Dividends are not guaranteed. Diversification does not eliminate the risk of experiencing investment losses. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Government bonds 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 the other asset classes. Stocks are represented by the Standard & 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. Bonds are represented by the 5-year U.S. government bond and inflation by the Consumer Price Index.

Advisor's Corner



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I hope you had a happy 4th of July, and are getting a chance to enjoy the summer. In June we taught a Financial Strategies for Successful Retirement Course™ at Benedictine University. It was great to help people appreciate the complexities and opportunities of a wide variety of financial topics impacting their retirement years. The feedback from the attendees was that it was very helpful to gain an

appreciation for retirement income opportunities, investment allocation methodologies, how annuities work, Medicare options and properly managing social security benefits. We really enjoyed teaching the seminar and are looking forward to our next course. The next educational seminar will be in Naperville at the end of September 2012, more details to follow. Please watch for updates on

<http://www.millingtonfa.com/Seminars.5.htm>. Helping people to best navigate through these difficult and sometimes complex times has been a very rewarding experience. If you or someone you know could benefit from our services please call me at (630) 457-1264.

Retirees: Non-Traditional Investment Risks

Volatile markets pose several challenges for retirees who rely on receiving a livable income stream from their investments. Interest rates are low and likely to stay low for the foreseeable future, making cash and high-quality bonds a safe parking place for now. Amid such a challenging environment, it's hard to blame retired investors for looking beyond traditional investments like stocks, bonds, and cash, or the mutual funds and exchange-traded funds that invest in these securities.

Many investors have flocked to gold and other precious metals, while others have gravitated toward investment types like life settlements, distressed real estate investments, and private mortgage investments. Such non-traditional investments might hold the promise of higher returns compared with traditional asset classes, but there is often a trade-off of higher risks and/or costs. Moreover, investors in non-traditional investments might not benefit from the same liquidity, transparency, and regulatory oversight that investors in traditional assets have. The following three asset types have picked up traction, but it is important to understand the risks before entrusting your hard-earned cash to them.

Life Settlements: A life settlement originates when a life insurance policyholder, often an elderly or terminally ill person, sells his or her interest in the policy to a third party, usually at a level that is well below the policy's stated death benefit. The third party then resells, often by issuing securities, that interest to investors who in turn must keep the policy in effect by paying its premiums. When the originally insured person dies, the owner of the security collects the death benefit. The rate of return on a life-settlement investment will hinge on when the originally insured person dies. If death occurs within his or her estimated life expectancy, the return will be relatively high. But if the original policy owner lives well beyond the expected time frame, a life settlement can be a poor investment. Not only will it take a while to pay off, but the investor will have to fork over premiums on a regular basis.

Distressed Real Estate: Distressed properties typically sell at prices lower than what the owners paid and may

be under foreclosure; their prices may also be low in absolute terms. As with investing in any other security type, seeking low valuations is a key way to bring down your risk, but distressed real estate investing is far from a low-risk endeavor. Distressed properties may require substantial additional investment before they can be rented or resold, and there is no guarantee that a seemingly low-priced property won't fall further still. Finally, real estate can be illiquid, and for smaller investors can be cost-prohibitive to build a diversified portfolio of properties.

Private Mortgages: The troubled housing market has given rise to another real estate-related investment, the private mortgage. In contrast to a loan extended by a bank or financial institution, a private mortgage is funded by individuals, groups of individuals, or a corporation that specializes in making such loans. A private mortgage holder may be able to earn a substantially higher interest rate than he or she can earn on cash or high-quality bond investment. At the same time, the risks of a private mortgage loan are also a lot higher than cash or bonds, even though the loan is secured by the property. Individuals usually turn to the private mortgage market because they can't secure bank financing; thus, they might have poor credit or limited down payments. Those risks can be exacerbated because it can be difficult to diversify in the private mortgage market.

Retirees should exercise caution when investing in non-traditional assets. It is important to understand that investors in these non-traditional assets might have to give up transparency, liquidity, and regulatory oversight.

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.

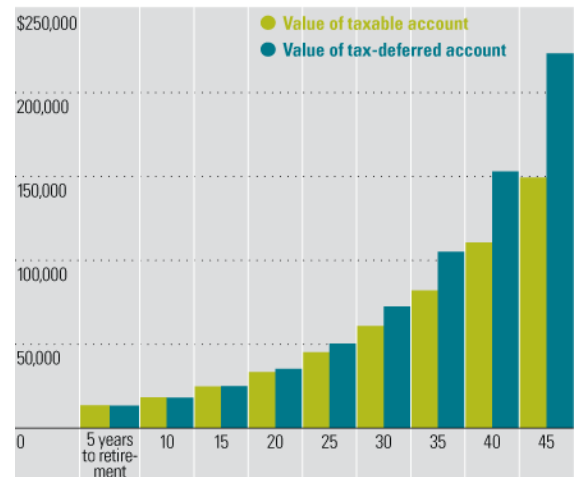
Source: U.S. stocks are represented by the Standard & Poor's 500® index, which is an unmanaged group of securities and considered to be representative of the stock market in general. Emerging markets are represented by the Morgan Stanley Capital International Emerging Markets Index.

Take Advantage of Tax-Deferred Accounts

One of the main reasons why retirement accounts are so beneficial is the power of tax deferral. In a tax-deferred investment vehicle, such as a 401(k) plan or an IRA, your earnings are not taxed until you begin withdrawing money from your account in retirement. Consider the image. A hypothetical value of \$10,000 is invested in both a taxable and a tax-deferred account. The difference in value between the two accounts becomes quite substantial after 20+ years. For investors with a long investment horizon, a tax-deferred portfolio is an excellent choice.

Please keep in mind that once you begin to withdraw money from your retirement account, you will be taxed accordingly. However, since you will most likely earn less in retirement, withdrawals from a deferred portfolio may be taxed at a lower rate.

Benefits of Deferring Taxes



Withdrawals of tax-deferred accumulations are subject to ordinary income taxes. A 10% federal tax penalty may apply to withdrawals made before age 59½. Returns and principal invested in stocks are not guaranteed.

Source: This hypothetical example is for an investor in the 28% bracket using the 2011 tax code (estimated to become the 31% tax bracket in 2013). \$10,000 is invested in stocks at the beginning of year 1 (2012). Assumes an 8% annual total return (6% price return and 2% income return) and a 15% tax rate on capital gains and dividends in year 1 (2012) after which the rates revert to 20% and the investor's marginal tax rate, respectively. The investment is taxed at a 28% marginal tax rate in year 1 (2012) and then reverts to 31%. Taxes are assessed yearly on the taxable account but only at the end of the period on the tax-deferred account. Estimates are not guaranteed.

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