Investor Insights & Outlook

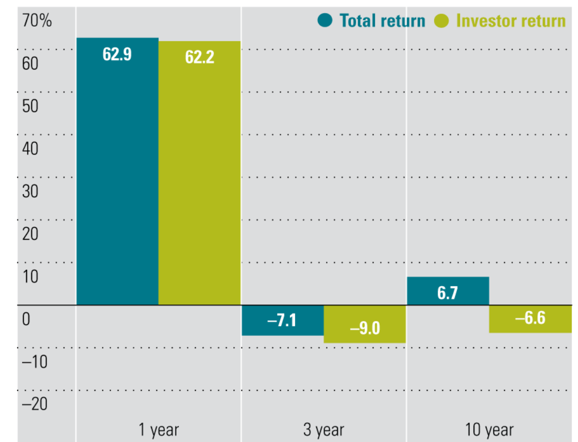
April 2011 | Vol. No. 1 | Investment Updates

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, with the investor return ending slightly lower. 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 February 2010.

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

Advisor Corner

Bill Roller, CFA, CFP®
President
billroller@brcapitalinc.com
(360) 735-1900
www.brcapitalinc.com

Bill Roller is experienced in financial planning and investment analysis. He focuses his consulting practice on estate, retirement, and financial planning for businesses and individuals. Bill started BR Capital Inc. in 2003. Before that he worked for a large Wall Street firm for over nine years. He served for seven years as a U.S. Army officer in Infantry and Special Forces (Green Beret) units. Bill is a Chartered Financial Analyst as well as a Certified Financial Planner. He is the VP of the Estate Planning Council of Southwest Washington. He earned a Bachelor of Science degree from the United States Military Academy at West Point in 1982, and a MBA from the Wharton School of Business in 1991. He provides the morning and afternoon market reports and financial commentary for AM 1360 KUIK. A link to Bill's articles and interviews is available at www.brcapitalinc.com/newsletter.

Tax Law Changes for 2011

A good mantra, for investing and for the rest of your life, is “Focus on what you can control.” While most people are inclined to put taxes into the "out of my control" bucket, that doesn't have to be the case. Where taxes are concerned, it is always a good idea to consult with a tax professional. This article is intended only as a starting point to help you become informed about tax-law changes; it does not constitute tax advice. Some of these changes have an impact only on those in very high tax brackets, while others affect individuals of all income levels.

Social Security Payroll Tax Holiday: Social Security payroll taxes have dropped from 6.2% to 4.2% for 2011, giving an effective boost in pay to all workers. (As in the past, you won't pay Social Security tax on any earnings over a certain level--currently $106,800.) This provision is designed to get people out there spending, but a better idea, assuming you can afford it, is to divert that money to another retirement fund: your own. Increase your 401(k) plan contribution as close as you can to the annual limit; in 2011, that limit remains $16,500 for those under 50 and $22,000 to those over 50. And if you're already funding your 401(k), 403(b), or 457 plan to the max—or if you would rather save outside the confines of your company plan—you can direct that money to an IRA instead. IRA contribution limits are also unchanged from 2010: $5,000 for individuals under 50 and $6,000 for those over 50.

Alternative Minimum Tax: Toward the end of 2010, Congress put in place a so-called patch to keep a new group of taxpayers from having to pay the alternative minimum tax, a parallel tax system that disallows many of the credits and deductions that taxpayers are entitled to under the conventional tax system. That's good news, but if you've fallen into the AMT zone in the past, the latest patch isn't likely to keep you out of it. However, by taking steps to control your AMT-subject income and managing your deductions, you may be able to reduce your AMT tax hit. Some key strategies that you can employ include carefully managing the exercise of stock options (a well-versed tax advisor should be able to help with this) and watching out for private-activity municipal bond funds, which aren't taxable under the conventional tax system but are for the purposes of AMT.

Dividend Tax: Through 2012, the tax on qualified dividends remains at zero for taxpayers in the 10% and 15% tax brackets, and is 15% for all other taxpayers.

Long-Term Capital Gains Tax: Through 2012, taxpayers in the 10% and 15% brackets will not owe capital gains tax on the sale of assets they've owned for more than one year. Long-term capital gains tax rates remain at 15% for all other taxpayers. Short-term capital gains are taxed as ordinary income.

Estate Tax: Although the federal estate tax was set to jump to 55% for estates of more than $1 million in 2011, last-minute Congressional maneuvering resulted in a much less onerous rate for people who die with a lot of assets. The top estate tax rate is 35% for 2011 and 2012, and it only affects those who have amassed estates of more than $5 million. Those who inherit assets will also once again receive a step-up in the cost basis of those assets, meaning that the inherited assets are valued at their fair market value as of the decedent's death.

Given the more generous estate-tax limits, you may be assuming that a visit to your estate-planning attorney isn't necessary, but even if you don't anticipate that you will ever amass $5 million in assets, there's more to creating an estate plan than sidestepping taxes. A properly crafted estate plan will detail how you would like your assets distributed after you are gone. Gift Tax: The annual gift-tax exclusion stays the same as it was in 2010: $13,000. That means you can gift $13,000 apiece to an unlimited number of people this year without having to worry about a gift tax or even fill out the gift-tax paperwork.

The Many Faces of Inflation

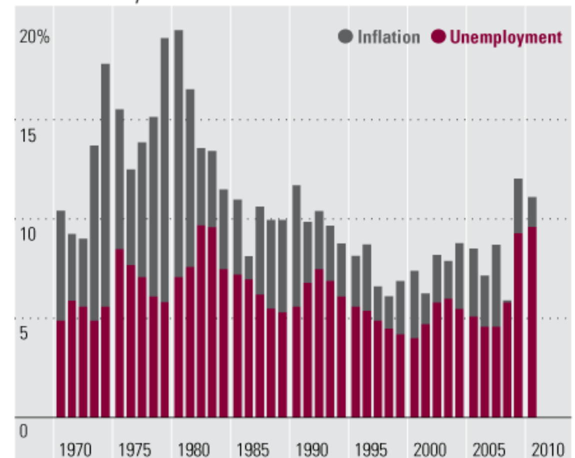
During the recent 2007–2009 recession, it seems all we've seen and heard about the economy was bad news: the housing market collapsing, 401(k)s suddenly being worth much less than before, a lifetime of savings almost disappearing in a few months, rising unemployment, and fluctuating prices. Now that the recession has officially ended in June 2009 and we're on the road to recovery, inflation may become a concern once again. In this uncertain economic climate, it may be helpful to learn about the different types of inflation and their immediate effects.

Inflation: Inflation is defined as a continuing rise in the general prices of goods and services. Simply put, if prices, on average, are going up in an economy, then you've got inflation. With a set amount of money in an inflationary environment, consumers are able to buy less and less over time. High rates of inflation can generate uncertainty, lower productivity and discourage investment. The leading measure of inflation in the United States is the Consumer Price Index (CPI). The government can change its monetary policy to control the money supply and keep inflation in check, although this is not the only variable affecting inflation. In November 2010, the Federal Reserve announced it would buy back long-term Treasuries in order to inject money into the economy, a policy called quantitative easing, which can trigger higher inflation.

Hyperinflation: Hyperinflation is extremely high, out of control inflation, caused by a steep increase in the money supply without a corresponding increase in the output of goods and services. Well-known examples include the German hyperinflation after World War I and the hyperinflation in Hungary after World War II. It appears that such an extreme phenomenon occurs mainly as a result of radical changes and prolonged economic instability.

Deflation: Deflation is the opposite case: a general decline in the prices of goods and services. In the U.S., deflation occurred as recently as 2008 and 2009: The change in CPI was negative in the third and fourth quarters of 2008 and in the fourth quarter of 2009, a clear indicator of deflation. The obvious positive effect here is lower prices—many argue that deflationary periods are good times to buy. The problem with deflation, though, is that consumers reduce spending and businesses stop growing, which is not good for the economy.

Stagflation: This is the worst-case scenario: high inflation and slow growth simultaneously. Normally, there is an inverse relationship between inflation and unemployment; if the economy is able to tolerate a higher rate of inflation, lower unemployment can be achieved, and vice versa. But during a stagflation period, both inflation and unemployment go up. An interesting measure for stagflation is the misery index, which, as illustrated in the image, combines the unemployment and inflation rates. The U.S. experienced severe stagflation in the 1970s, when unemployment and inflation reached a combined high of almost 20%. There has been talk of stagflation during the recent crisis as well, but the potentially encouraging news is that the misery index is not nearly as high now as it has been in the past.



Source: Inflation is represented by the Consumer Price Index, and unemployment by the national unemployment rate, not seasonally adjusted, from the Bureau of Labor Statistics.

Four Steps to Debt Reduction

Easy access to credit can contribute to a lifestyle that starts out with debt and gets worse as spending pressures increase. If you've accumulated debt, how can you dig yourself out?

Calculate Exactly What You Owe: List your debts and minimum monthly payments, due dates and interest rates. Rank debts from highest rate to lowest. Decide if any debt is worth keeping. Consider mortgages and college loans since interest on most mortgages is tax deductible and many college loan rates are reasonable.

Set Up a Budget and Start Eliminating Your Debt: A budget helps you decide how much extra cash you can devote to paying debt. It also helps you identify expenses that you can cut back on, which leads to more cash to further reduce your debt.

Lower Your Borrowing Costs: Compare what rates credit card firms are offering. Then get your current credit card company to match the attractive rate you discover. Or, transfer your current higher interest-rate balance to a company offering a lower rate. However, make sure you find out how long this lower rate will last and what the regular ongoing rate will be. Also, be on the lookout for balance transfer fees.

Cash Is King: Try to stick to cash and/or use a debit card. Unless you have developed a disciplined approach to pay off the balance, do all you can to avoid using a credit card. Find one card with a low rate for situations that may require one, like Internet purchases, but be sure to pay it off every month.

©2011 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.

BR Capital inc.

Bill Roller, CFA, CFP®
President

BR Capital, Inc.
4400 NE 77th Avenue, Suite 275
Vancouver, Washington
98662-6857

billroller@brcapitalinc.com
www.brcapitalinc.com

Tel:(360) 735-1900
Fax:(360) 838-1597