Investor Insights & Outlook

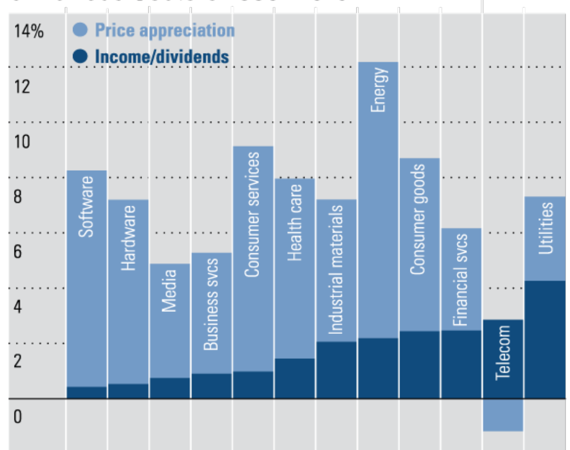
November 2011 | Vol. No. 1 | Investment Updates

Breaking Down Sector Returns

Owning individual stocks can be risky. Buying into sector funds allows investors to participate in ever-changing business and economic cycles while reducing company-specific risk.

Just as equity and fixed-income investments play different roles in investors' portfolios, so do sector investments. Some sectors generate greater income-return potential like bonds, while others focus on price appreciation. The chart shows the income and price appreciation of various sectors over the most recent 15-year period. The right side of the chart highlights sectors that historically provided a good level of income relative to the sectors on the left side of the chart, which have focused on growth. Certain sectors, like energy and utilities, combined the best of both worlds and became appealing to diverse investors.

Price Appreciation and Income Return of Various Sectors 1996–2010



Advisor Corner

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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.

Another Option for Early-Retirement Withdrawals

The recent recession has hit older workers disproportionately. Older workers generally spend a longer time looking for jobs once they've lost them. The sad result is that individuals are tapping retirement accounts to stay in their homes and fund other living expenses, as well as to pay for major life changes such as relocation or further education.

IRA-withdrawal rules are particularly complicated, so this article will focus on one aspect of them in-depth: withdrawals based on the so-called 72(t) exception. Although it's almost never ideal to raid your retirement accounts prematurely, this type of withdrawal may be useful for people who need additional cash to carry them through a specific period in their lives--before they're eligible for a pension or Social Security, for example.

In a nutshell, the 72(t) exception allows individuals who are younger than age 59 1/2 to avoid the 10% early-withdrawal penalty for premature IRA distributions. (It does not help you circumvent any taxes owed on the IRA, however; just the 10% penalty.) To take advantage of 72(t), individuals must receive their IRA assets in what the IRS calls "substantially equal period payments" for a period of at least five years. The payments must continue until the age of 59 1/2 or until five years have elapsed, whichever is longer.

The net effect of that rule is that everyone using this exception will need to take withdrawals for at least five years, and younger folks will have to take distributions over many years. A 50-year-old woman, for example, would have to spread her distributions over 9 1/2 years, until she's 59 1/2. Meanwhile, a 57-year-old man who initiates 72(t) distributions would need to take the distributions for five years until he turns 62, well after he'd already hit the 59 1/2-year mark. If you've begun taking 72(t) distributions but later determine you want to stop, you'll owe the IRS the 10% penalties for early IRA distributions, plus interest. For that reason, it's crucial to be sure that substantially equal periodic payments will work for you.

You don't have to liquidate all of your IRA assets to take advantage of 72(t); if you have separate IRA accounts, you can withdraw from some and leave others alone. It's also possible to reposition your assets in advance of a 72(t) distribution--that is, leave some money in an IRA to compound and grow while repositioning other assets in short-term securities for 72(t) distributions. Furthermore, though the majority of people using this distribution method are doing so with traditional IRA assets, it's also possible to apply this distribution method to Roth assets. (This won't often be desirable, however.)

In general, 72(t) withdrawals will tend to make the most sense for people who need income during a certain period of time. And at the risk of stating the obvious, they'll also be best for folks who have an alternate source of retirement funding besides the amount that they're paying themselves through 72(t).

On the flip side, using this withdrawal method can be complicated and paperwork intensive. It won't make sense for those who need a lump sum to start a business or buy a vacation home because the whole point of 72(t) is that you're receiving payments during a period of at least five years. Nor will 72(t) usually make sense for Roth IRA holders, who have a lot more flexibility in taking withdrawals than do traditional IRA holders. Finally, those who leave their former employers at age 55 or after and have assets in their old 401(k)s can take penalty-free withdrawals directly from their accounts; rolling the assets into an IRA in order to facilitate 72(t) distributions wouldn't be necessary.

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A Quick Guide to Leading Economic Indicators

Turn on CNBC on any given day and you are bound to hear about various economic indicators and how they might affect the markets. Although we believe in investing with a long-term horizon, investors should learn what the key economic indicators mean and how they could potentially affect one's portfolio.

Leading indicators are economic indicators that anticipate a change in the direction of the economy and are useful as short-term predictors. Some of these include the returns on the S&P 500 Index, consumer sentiment and expectations, changes in the employment rate, and production levels in the manufacturing sectors.

The unemployment rate represents the percentage of the working population that does not have a job, have actively looked for work in the prior four weeks, or are waiting to be rehired to a job from which they had been temporarily laid off. This figure is seasonally adjusted to reflect the impact of predictable seasonable patterns. In addition to the overall unemployment figure that is often quoted in the media, data on sector-specific unemployment figures can be obtained from the U.S. Bureau of Labor Statistics. For example, in December 2010, there were gains of 12,000 retail jobs while the construction sector lost 16,000 jobs. These figures can be important for investors who wish to invest in sector-specific ETFs, or are looking to increase their portfolio exposure to a specific sector.

Average workweek hours looks at the productivity of the workforce. In the past few quarters, statistics have shown that companies have been cutting costs by getting their existing employees to work longer hours, instead of rehiring laid off workers. In addition, the U.S. Bureau of Labor Statistics provides quarterly statistics on output per hour and productivity. Typically, in an economic recovery, real wages increase first, followed by hours worked, and finally employment. Given that there are only so many techniques that companies can use to increase productivity out of workers, further increases in production will eventually result in an increase in employment. This indicator is a good gauge for overall business confidence sentiment.

The University of Michigan Consumer Sentiment Index is created using results from approximately 500 telephone interviews conducted each month. The index is used to forecast spending behavior and economic expectations of consumers, and consumer attitudes on savings, spending, and the business climate. It is frequently cited that consumer spending accounts for about 70% of the GDP in the United States and thus, is an important indicator especially if you are heavily invested in the consumer cyclical sector, in areas like the restaurant, retail, and travel industry.

Both the Chicago Purchasing Managers Index (PMI) and the Institute for Supply Management Index (ISM) look at economic activity in the manufacturing sector based on factors such as production, inventories, new orders, and exports and imports. These statistics are particularly important to investors who wish to seek exposure to the industrials or basic material sectors. However, investors should also take note that manufacturing activity increases because of increased consumer demand, and has been a shrinking portion of our GDP, as compared to the services sector.

The returns on the S&P 500 Index are also regarded as a leading economic indicator. This index includes 500 of the largest publicly listed companies in the U.S., comprising 75% of all U.S. equities. It is considered a leading indicator because changes in stock prices might reflect investor's expectations for the future of the economy.

Past performance is not indicative of future results. Returns and principal invested in stocks are not guaranteed. Sector investments are narrowly focused investments that typically exhibit higher volatility than the market in general.

TIPS to Inflation Proof Your Portfolio

When signs of inflation creep into the economy, investors seek to protect their portfolios by turning to defensive market sectors (utilities, health care). But certain fixed-income investments, like Treasury inflation-protected securities, or TIPS, can be just as useful.

The interest rate does not change over the life of TIPS, but the underlying principal rises and falls with changes in the inflation rate. So the amount an investor will receive as income also changes. At maturity, you either receive the adjusted principal or the original principal, whichever is larger. The table singles out those years since 1990 when inflation was 3.0% (its long-term average) or higher and shows how TIPS fared. Out of the seven years illustrated in the table, TIPS outperformed inflation in five of them—and by a considerable margin.

TIPS Performance During Inflationary Periods: 1990–2010

Year	Inflation	TIPS
1990	6.1	23.9
1991	3.1	–13.7
1996	3.3	7.2
2000	3.4	13.2
2004	3.3	8.5
2005	3.4	2.9
2007	4.1	11.8

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