Investor Insights & Outlook

September 2012 | Vol. No. 1 | Investment Updates

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

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

	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

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.

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 http://brcapitalinc.com. To subscribe to articles and daily market updates go to http://brcapitalinc.com/subscribe/

Monthly Market Commentary

In early September, the European Central Bank took steps to ease monetary policy and China introduced new infrastructure stimulus measures, as economic news in both regions continued to show signs of slowing. Both these actions have led many to expect the Federal Reserve to do the same with some form of quantitative easing, following poor manufacturing data and a softer-than-expected employment report in August. Morningstar economists believe that lowering rates further may do little to help the economy. Corporations are already awash with cash, while consumers are still finding it difficult to get loans at these low rates. Furthermore, commodities are on the rise again with gold setting a five-month high, and oil prices moving higher.

GDP: Second quarter real GDP was revised upward to 1.7% from 1.5%, which typically means that things were stronger in the last month of the quarter than originally anticipated. Overall, consumer spending was revised up, exports also improved (despite turmoil in Europe), and government spending shrank less than previously estimated. Although the quarter-to-quarter data over the last 2 years continued to be extremely volatile (ranging from 0.1% to 4.1%), the year-over-year data shows GDP growing at a slow but consistent pace (1.6% to 2.8%).

Employment: August saw a disappointing 96,000 jobs being added, down from 163,000 jobs in July. Morningstar economists have highlighted a few inconsistencies over this data: at a time when new and existing home sales were up, the report indicated construction employment did not grow at all. Also, the employment at building material and garden centers was reported to have fallen by almost 10,000 people, which Morningstar economists felt was unlikely, given the better construction market. An unusually large number of employees (380,000) left the workforce in August, which caused the unemployment rate to drop to 8.1% from 8.3%. Morningstar economists believe that this was mainly because of students returning to school from their summer jobs. While seasonal adjustment factors are typically supposed to capture this change, many schools and universities are shifting the start of their school year earlier in August. The high dropout rate could also have come from more employees quitting, or ceasing to look for jobs, to go back to school due to poor economic prospects.

Housing: The housing recovery has continued long enough that both leading indicators (pending home sales) and lagging indicators (Case-Shiller Home Price Index) were moving in the same positive direction. July pending home sales jumped 2.4% compared with June and 12.4% compared with July 2011. It is important to note that pending sales have been higher than closed sales all year, as the failure of homes to appraise at the agreed-upon price and tight lending conditions are holding back closings. In June, the Case-Shiller 20-city index increased 0.5% on a year-over-year basis, which marked the first year-over-year increase in two years. Although the index just broke into positive territory, the improving trend has been in place for six consecutive months. Month-to-month data showed a 2.3% increase, and all 20 cities in the index showed home price improvement.

Manufacturing: U.S. manufacturing in August continued to slow, as new orders fell and inventory levels increased. However, auto sales accelerated to 14.52 million units in August, the best performance since the cash-for-clunkers promotion in 2009. Year-over-year sales growth of over 20% was inflated by a strong recovery from Japanese brands that suffered supply shortages last August because of the tsunami. Pent-up demand and low cost has also resulted in the Detroit Big Three reporting year-over-year gains of more than 10%, mainly from pickup truck sales. Outside the U.S., manufacturing in Europe continued to weaken, including Germany, because of softer orders from China. China's manufacturing sector also underperformed, reporting its lowest level since 2009.

Five Ways to Cut Housing-Related Costs in Retirement

Housing-related costs are often the largest component of retirees' household budgets, so this article will address some of the key ways in which retirees can cut this type of costs.

1. Consider a Cheaper Location: Talk about trade-offs. The decision to relocate is a difficult one, particularly if it means venturing away from kids, grandkids, and longtime friends. It's also worth noting that the highest-cost housing markets also tend to be close to other amenities that may be important to a retiree's quality of life, such as cultural and leisure attractions. But if you reside in a high-cost locale and are assessing how you can make your nest egg last, relocating ought to be high on your list of considerations. By selling your high-priced home and moving to a cheaper location, you may be able to unlock a significant amount of equity while also reducing your housing costs on an ongoing basis.

2. Downsize in the Same Location: If you're not up for relocating, you might still be able to save money by downsizing to a smaller home in your same geographic locale. Like relocation, this decision usually doesn't come without compromise: Many people have a sentimental attachment to the homes in which they raised their families, and after a lifetime of accumulation, a move across town may seem like more trouble than it's worth. And if you stay in the same geographic locale, your non-housing costs (food, entertainment, and the like) will stay the same. But even within a depressed housing market, you may be able to unlock valuable equity by selling your larger home, and your ongoing costs for taxes, maintenance, and utilities are also likely to be a lot lower.

3. Consider Combining Households: Thanks to the economic downturn, there's a well-documented trend toward children remaining with their parents for a much longer time than in the past. But we may also start to see more people combining households later in life—grown children moving in with elderly parents, retired siblings moving in with one another, and so forth. Of course, such setups sound a lot simpler than they are in practice, but consolidating what would've been two households into one can help reduce costs greatly.

4. Don't Pay for Care Until You Need It: Seniors are increasingly gravitating to so-called continuous-care retirement communities, which allow them a great amount of independence as long as their health allows but also provide for ongoing health care and other assistance later in life. Such facilities allow seniors to transition from one life stage to the next with a minimal amount of disruption--a huge attraction given the upheaval that often occurs when seniors move from an independent home to assisted living to a hospital and back again.

As sensible as such arrangements are, however, they carry significant costs. If you've run the numbers and think there's a significant risk you could outlive your assets, a continuous-care retirement community may entail more costs than you can afford to bear, particularly if you don't yet need any help. The decision to move into a continuous-care community is a hugely complicated one that should entail a full cost-benefit analysis.

5. Refinance: One of the best financial steps you can take in the years leading up to retirement is to pay down your debt, because reducing your fixed costs in retirement will reduce the income demands you make on your portfolio. But if you still have a mortgage and are preparing to retire or you're retired already, refinancing ought to be on your radar. Mortgage rates have ticked up in recent weeks, but they're still ultralow relative to long-term averages.

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.

©2012 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. Morningstar Market Commentary originally published by Robert Johnson, CFA, Director of Economic Analysis with Morningstar and has been modified for Morningstar Newsletter Builder.

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