Our Two Cents

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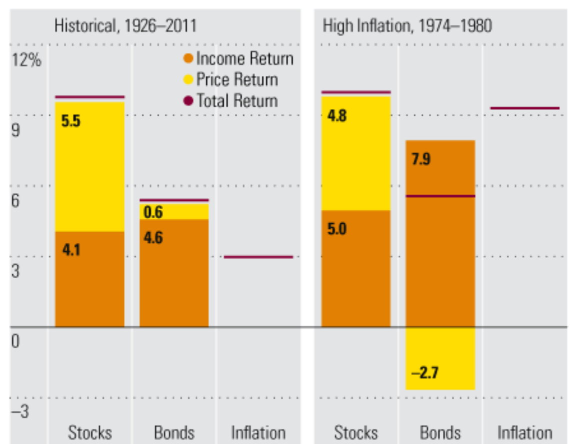
Dividends and Inflation

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% of 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.

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Are we becoming a Nanny State?

- Recent statistics show record number of people on welfare and disability.

- Government involvement from soda pop consumption to steroid use in baseball.

Recent Congress approval ratings have been as low as 9%. So why do we turn to people we don't trust or respect to solve our problems.

America has a long history of perseverance, ingenuity and opportunities. Those traits are not fads, but the framework from which makes this country so sought after by people in other countries.

Here is to making sure that we do not forget what got us here and taking control of our own lives. We reap what we sow. What say you?

How to Cope with Financial Anxiety

No one likes uncertainty. We want to maintain at least the illusion of control. But that's almost impossible to do today, given the volatility of the stock market and employers' belt-tightening. Even the steadiest hand is shaking just a little. It is imperative to avoid letting your emotions get in the way of making smart investment decisions. In times of doubt, it might be in your best interest to follow these steps for re-examining your current financial strategy.

Reassess Your Risk Tolerance: Today's investor is living those “hypothetical” questions that appear on risk-tolerance questionnaires. If you haven't checked your risk tolerance (the degree of uncertainty that you can handle in your investment portfolio) in more than a year, you're most likely due—especially if you're uncomfortable right now. Maybe you've taken on more risk than is prudent. If so, it might be in your best interest to change your asset mix. If you find that you're taking on the appropriate amount of risk for your goals, just sit tight.

If You Have to Do Something, Review Your Expenses: When dealing with uncertainty, some people feel compelled to act. Instead of trying to time the market (which even the professionals can't do with any consistency), focus on things you can control with certainty: expenses. Identify where you can tighten your belt. Try to identify unneeded or underused services. After such cuts, you’ll have some extra cash to invest each month. Expenses also matter in investment accounts. Do you know what you’re paying in expense ratios, 12b-1 fees, front- or back-end loads? Burn up some of your nervous energy by making sure those expenses aren’t eating up what little positive returns you might have.

Create a Shopping List of Investments: Research stocks or funds that would complement your portfolio, then see where they are currently trading. This could be a great opportunity to pick up some of your favorite picks at rock-bottom prices. However, make sure they are trading at historical lows because of investor overreaction and not because they are no longer financially sound.

Win the Psychological Battle: Don't let the financial media scare you into making poor investment decisions. Times of great uncertainty are usually bad times to be making major decisions. What is healthy is knowing how the human mind works and factoring that into your investment decision-making process. Researchers and academics in the field of behavioral finance attempt to better understand and explain how emotions and perceptions influence investors and their decisions. If you are interested in learning more, there are plenty of publications devoted to this relatively new field.

Consider all of the complex financial decisions faced by investors today. Without experience in different market environments or knowledge of market history, how might investors make such decisions? Potentially through their perceptions or based on their emotions. Thus, it is imperative that investors understand and combat the myriad of illusions to which they might be prone.

When the markets are doing well, people tend to think the trend will continue indefinitely. During the recent crisis when the market was struggling, we witnessed overreaction: Investors were running away from the stock market. However, if you think U.S. companies are still fundamentally strong and will profit in the next five to 10 years, then you should still have a stake in the stock market. Just make sure you set your asset allocation policy first, and then stay the course with an appropriate mix of stocks, bonds, and cash. Investing is a long-term proposition—don’t let your emotions overpower your sense of reason.

Stocks are not guaranteed and have been more volatile than bonds. Past performance is no guarantee of future results. Diversification does not eliminate the risk of experiencing investment losses.

Common Investing Mistakes

Almost all of us have made investing mistakes. The key is not to make the same mistake twice. These mistakes can directly affect whether or not you achieve your desired goals. By repeating even just one mistake, individual investors can quickly become their own worst enemy. Below are some common mistakes that many fall prey to and some suggestions on how to sidestep them.

Starting Too Late

The first mistake a large number of investors make is waiting too long to initiate a long-term investment plan. The earlier you can start the investment process, the more likely it is that the plan will succeed. For example, let's consider two investors—Bill and Tim. Bill began investing $5,000 per year 30 years ago. Tim began investing $10,000 per year 20 years ago. Assuming a hypothetical return of 10% per year, Bill's ending wealth value was $822,470 compared to $572,750 for Tim. Thanks to the power of compounding, a small amount of money, wisely invested early on, can turn into a large sum over time. Avoid procrastinating; start investing today.

Lack of Diversification

By investing all of your money into just one asset class, industry, or company, you are placing all of your eggs into one basket—and this can be extremely risky. It is better to combine a variety of investments, such as stocks, bonds, and cash, which are unlikely to move in the same direction. Your risk exposure should be lessened as a result.

Chasing Past Performance

Yesterday's hot stocks or mutual funds may not be today's best investments. A good number of investors purchase assets when they have already reached their peak, only to watch their performance subsequently suffer. It may be a good idea to choose investments with a history of good performance as well as quality management.

Lack of Research

No matter what type of investment you plan to make, be sure to conduct the proper research. It is unwise to allocate your money to an investment you do not understand. There are a number of helpful resources that you can explore—ranging from public information to professional advice. Take advantage of these when possible.

Unrealistic Expectations

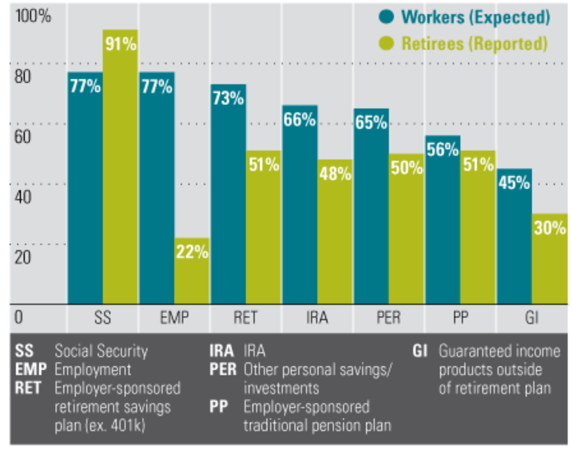
Many investments require time to grow. Investors often become frustrated with the early performance of their investments, decide to sell too quickly, and move the proceeds into other investments. This will result in too much trading, which is not only expensive, but also usually unnecessary. It is important to maintain a long-term view and to not be distracted by short-term results.

Overconfidence

Confidence is a good thing, but overconfidence can cause investors to improperly select investments. Too much assurance in one's knowledge and ability can lead investors to focus on the upside and deemphasize the potential downside of investments. Instead, a solid financial plan constructed by a professional can go a long way.

Retirement Income Sources

Times are Changing:
Sources of Retirement Income are Shifting



Source: Employee Benefit Research Institute, 2011 Retirement Confidence Survey.

Concerns about shortfalls in traditional retirement income sources like Social Security and pension plans have caused people to expect to rely more heavily on personal savings to fund their retirement. The graph illustrates that while only 50% of current retirees utilize their personal savings for retirement income, 65% of current workers anticipate personal savings to play a role during retirement. Further, 73% of workers expect to receive retirement income from an employer-sponsored retirement savings plan, while only 51% of those already retired actually receive income from such a source.

It may be a good idea to plan for a diminished reliance on Social Security or a pension plan. Whatever extra funds you save by taking this more conservative view will make retirement all the more enjoyable.

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