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# SENIORS/BOOMERS NEWSLETTER

"THE RETIREMENT EXPERTS"

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## You Don't Need a Parachute to Skydive. You Only Need One to Skydive Twice!

This month's newsletter focus is on safety inside your portfolio. Right now the economy seems to be firing on all cylinders. As of mid January the S&P 500 was trading at 15.5 times trailing earnings. This is about 15% below its average going all the way back to 1988 when they began capturing that information. So, this tells us that the market is not overpriced.

Both the leading and coincident economic indicators say that the economy is on firm footing and expanding. GDP is increasing and is been led by Consumer Spending (which is the largest component). The *global economy* has doubled between 2000-2010. Consumer Confidence is at its highest level in three years....and the S&P 500 has doubled since its low in March 2009.

A recent article in Zacks.com gave a very bullish outlook for stocks based on four metrics:

1. Corporate Earnings are very strong. In fact corporate balance sheets are at their best levels in many years. The earnings season report just completed for Q4 2010, showed that 3.42 companies reported a positive earnings surprise for every 1 surprise that was negative.
2. Market Valuation. According to their calculations, the forward PE ratio for 2011 is 13.9%. That's very reasonable.
3. End of the Bond Rally. The 30 year rally in bonds ended in October 2010. Inflation looms on the horizon. The equation for this scenario: Higher inflation = higher bond rates = investors losing money in bonds = more money flowing into stocks.

4. Investors getting back into the market. New money coming back into the market will provide the fuel for higher stock prices.

One of my concerns amid all this warm & fuzzy news is INFLATION. It acts as a strong headwind. We see it today at the gas pumps. And, we're seeing it in the grocery store.

An analyst recently ran some numbers that showed that for every 1 cent rise in gasoline prices, it costs Americans an extra \$600 million/year. Gas is up \$0.53 over the past twelve months. The cost to us is a whopping \$31,800,000,000/year. That's a lot of money that's not being spent on consumer goods. Many experts expect us to be paying \$4/gallon of gas in 2011. Do you want to do the math?

On the food side we are seeing a great deal of pressure on food suppliers everywhere in the supply chain. They're saying that they can no longer absorb commodity price increases. They are also telling us to expect to pay more for everything we eat.

The American Institute of Economic Research has begun tracking inflation for seniors as compared to that of the general population. That's because retirees tend to spend a little differently. (Think, suits, ties, transportation, recreation, flat panel TV's).

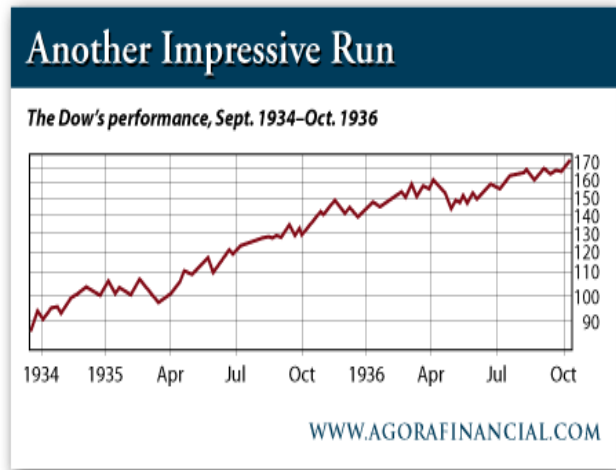
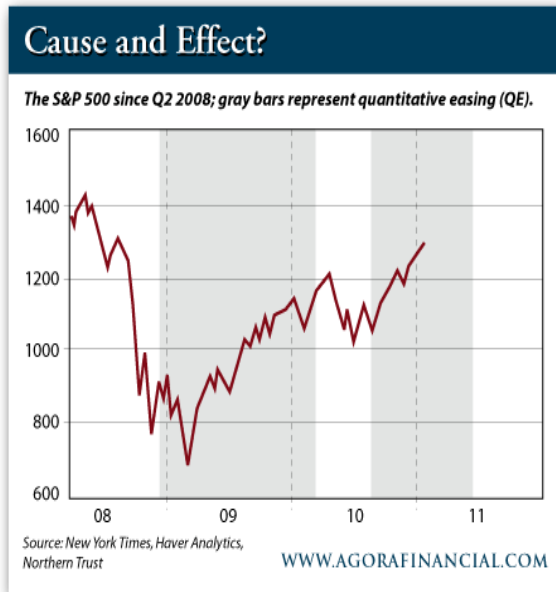
Anyways, a sampling of some price increases for 2010 are:

- \*meats +7.2% (pork +11.2%)
- \*citrus fruits +9.1%
- \*butter + 21.9%
- \*heating oil +16.5%
- \*gasoline +13.8%
- \*inpatient hospital services + 9.2%

Another concern is what happens when the Federal Reserve printing press runs out of ink in June? The chart below provides us with illuminating details of how well the market reacts to Quantitative Easing.

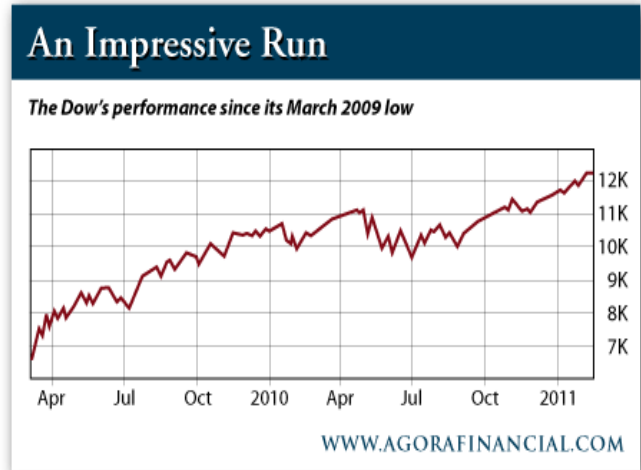
decline in GDP. This kind of sounds a little like déjà-vu.

Here are 3 interesting charts:



When QE 1 ended in the first quarter of 2010, the market tanked 20%. Since QE 2 began, it's back up over 30%. So, the \$600 billion question is: what happens when we don't have any more QE?

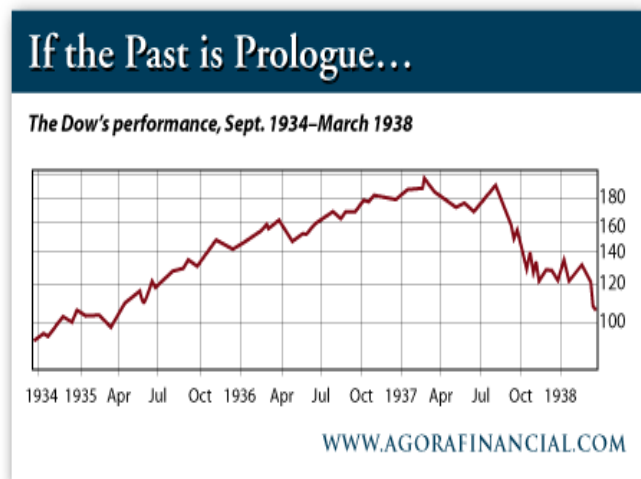
A relatively new issue I have is today's bullishness in the market. Currently, there are 12 bulls for every 1 bear. This, I think, throws off a yellow caution flag. If everyone could be right...everyone could be rich! But, that's not the way the story goes.



As I mentioned earlier, we have seen the S&P 500 double in 23 months. It kind of defies the laws of physics that we should be able to duplicate this feat in the next 23 months. Nothing goes up (in a straight line) forever. Notwithstanding good market fundamentals, at some point investors begin to take profits. If too many take too much, too quickly, it can lead to a rush for the exits.

The other thing (and I'm not superstitious) is that history has an uncanny way of throwing off lessons. As the saying goes it doesn't necessarily repeat itself, but it frequently rhymes.

In the 1930's the country was in a full blown credit crisis. This was accompanied by bank failures, deflation (think housing), severe unemployment and a



It does little good to worry about market direction or timing because no one has ever been able to do it consistently...or for very long. It's more important to

take the necessary steps to protect your portfolio and still remain in the game. Living longer means that your money has to last longer as well. The market has proven to be the most effective way of keeping up with inflation.

### **WHAT TO DO NOW**

- 1) **Follow the global trends. The world needs more food ...more energy ...more commodities Focus on the big picture: Examples,**
  - **China & India's economies are expanding rapidly and they are creating an enormous middle-class & doing a tremendous amount of buying across many spectrums in the process. So, buy what they're buying.**
  - **Our current administration is pushing for more green energy & nuclear power.**
  - **70% of prescriptions were filled with generic drugs in 2009.**
- 2) **Companies can fudge their earnings, but dividends are much more difficult to fudge over the long haul. Not only should you be buying dividend paying stocks, look for those who consistently increase them.**
- 3) **Avoid bond mutual funds. Many have maturities and durations which exceed the safe limit. Buy corporate, investment grade bonds and keep their maturities ultra-short (no more than 5 years).**
- 4) **There's safety in diversification. Try to find uncorrelated investments...meaning that you buy those that don't follow the beat of the same drummer. Your investments should include stocks, bonds, countries, commodities, currencies, precious metals, etc.**
- 5) **Invest in multinationals that get most of their revenue from overseas. This will protect you against a weak dollar.**
- 6) **Pipelines, better known as Master Limited Partnerships, are paying fantastic dividends.**
- 7) **Investment grade preferred shares – ditto -.**

### **Should You Risk Keeping a Highly Appreciated Investment?**

What do you do with an investment that has gone up in value? For some people, the threat of a large tax bill keeps them from selling, even if they know the investment's growth has thrown their portfolio out of balance.

So what's more important: Saving tax dollars or reducing risks in your portfolio? Depending on the investments' value, your other assets, and your time horizon, taking profits and paying taxes now could potentially make more sense than assuming a greater risk of loss down the road.

Here are some questions you should ask if you have a highly appreciated asset or investment that you are considering selling:

#### **Have you *held* the investment for at least one full year?**

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If you have, then the gain will be subject to the lower capital gain taxes. If not, any profits you realize from its sale will be taxed at your ordinary income tax rate.

#### **Will your taxable income decrease in the future?**

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If so, you may fall into a lower tax bracket and qualify for a lower tax rate on long-term capital gains later on. Right now, the tax rates that apply to net capital gain are generally lower than the tax rates that apply to other income. For 2010/2011, the maximum capital gains rate for most people is 15%. For lower-income individuals, the rate may be 0% on some or all of the net capital gain. Special types of net capital gain can be taxed at 25% or 28%.

#### **When do you expect to need the money from the investment?**

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Maybe you don't expect to tap this asset for another 5 or 10 years. The capital gain taxes however, may be a relatively smaller price to pay for the comfort that comes with a properly diversified portfolio. Plus over time, your diversified investments might potentially be able to recover the full amount you paid in capital gain taxes. Although diversification does not guarantee against the risk of loss in a declining market, it can help you to reduce the market volatility risk of your portfolio.

#### **Do you need the investment at all?**

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If you feel you have sufficient funds to last the remainder of your life, you may never need this investment at all. That being the case, you may consider leaving the investment alone and letting it pass to an heir upon your death. Whoever receives the investment might be able to assume a step-up in cost basis, resulting in a smaller capital gain tax bill.

If you have an investment that has grown significantly but you're not sure what to do with it, please call or e-mail my office for an evaluation and tax analysis.

**What follows now is a December 2010 article from Kiplinger's Personal Finance magazine.**

December 2010

## Whose Investment Advice Can You Trust?

The Feds want to level the playing field between brokers and advisers. It may not make a difference.

By Elizabeth Ody, Senior Associate Editor, Kiplinger's Personal Finance

Brokers have never enjoyed the purest of reputations in our popular imagination. From the corruptible Bud Fox of *Wall Street* to the manipulative bond salesman of *Liar's Poker*, the people whose job it is to push investments out the door and into investors' arms have often been depicted as morally elastic. After all, brokers are ultimately salespeople who are generally compensated by commission and whose primary loyalty is to their employers. As a result, regulators have never required brokers to act as fiduciaries -- that is, to act in the undiluted best interest of their customers.

That was all well and good so long as broker-client relationships were largely limited to executing buy and sell orders -- which they were, for much of the 20th century -- and as long as any advice brokers gave to clients was incidental to those duties. But over time, brokers' roles have expanded to overlap those of an entirely different group: registered [investment](#) advisers (RIAs), who are paid to provide investment advice and who, according to federal law, do have a fiduciary responsibility to act in their clients' undivided best interests. Indeed, a growing number of brokers earn their keep in the same way that many advisers do -- by charging clients a percentage of the assets they manage. And many advisers still accept sales commissions for some or all of their compensation.

A 2008 report published by the RAND Institute for Civil Justice said that most investors find brokers "indistinguishable" from RIAs. And a 2010 survey sponsored by several industry groups found that two-thirds of investors surveyed mistakenly believe that brokers are required to put their clients' interests first.

Now federal regulators are considering rewriting the rules to put an end to this confusion. The Securities and Exchange Commission is studying the issue and will announce its conclusions in January. There's a good chance that the SEC will finally decide to impose

a fiduciary standard on brokers, requiring them to place their clients' interests ahead of their own.

### Raising the Bar

At first glance, the idea of a fiduciary duty sounds warm, fuzzy and unassailable. At its core lie both the concept of trust -- a client entrusts an adviser with his or her finances, just as you entrust your health to your doctor -- and the notion that a fiduciary should make his personal interests secondary to those of his clients.

Currently, brokers need only demonstrate that the investments they recommend are "suitable" for their customers. Suggesting penny stocks for an 80-year-old widow would almost certainly flunk the suitability test. So would recommending an investment that locks up money for ten years to a couple who soon plan to buy a house.

To meet the suitability standard, brokers must make reasonable inquiries into the financial situation, tax status and investment objectives of their customers. But brokers are not required to subordinate their own interests -- specifically, how much they're being compensated. "Legally, a fiduciary duty is a higher standard than suitability," says David Tittsworth, executive director of the Investment Adviser Association, a trade group for RIAs.

It sounds like a no-brainer, right? "I don't believe you can go wrong if you're putting the client's interests first," says Kevin Keller, president of the Certified [Financial Planner](#) Board of Standards.

The trouble is, it's difficult to pinpoint specific ways in which a fiduciary standard would improve the advice brokers provide. Some advocates say that if brokers were required to meet the fiduciary standard, they would have to recommend the *best* investments for their clients, rather than merely suitable investments, because they would be required to take their clients' best interests to heart.

That is, at least in theory, the standard to which advisers are currently held. "The vast majority of RIAs -- 99% of them -- are trying to follow the spirit of the law," including the spirit of this "best" standard, says Adam Bold, founder of the Mutual Fund Store, a network of adviser franchises.

But it doesn't seem to be an enforceable standard. "I have never seen any case law defining the difference

between 'suitable' and 'best,'" says Nelson Ebaugh, a Houston-based securities lawyer. He says that if an investor sued his or her adviser, arguing that the adviser recommended a product that was suitable but not the best, "it would be considered frivolous."

Most claims against advisers are settled through private arbitration, the details of which aren't made public. So it's impossible to know for certain whether any investors have ever successfully made such a claim. But Scott Shewan, president of the Public Investors Arbitration Bar Association, an organization of lawyers who represent investors in arbitration cases, agrees that any difference between "best" and "suitable" is so nebulous that it would be impossible to resolve in a legal proceeding. "I don't think you can hold a broker to a 'best' standard," he says.

Ironically, brokers are already subject to an elaborate oversight system, which aims to ensure that they follow both the spirit and the letter of the suitability standard, in addition to the requirement that they "deal fairly" with clients. All broker-dealer firms enforce their own internal oversight systems. Typically, a firm is visited by either the SEC or Finra, the brokerage industry's self-regulatory agency, once every two years. Individual states provide another layer of scrutiny. By comparison, registered investment advisers are regulated by either the SEC or their home state, but not both.

Mischief still happens. Brokerage customers are not permitted to sue brokers; instead, they must go through arbitration. In 2009, customers filed 7,137 arbitration cases against their brokers. As of the end of August, 3,778 cases had been filed so far for 2010. Comparable statistics for advisers aren't available.

A fiduciary standard applied to brokers wouldn't get to the heart of the matter because it wouldn't abolish a broker's ability to charge a sales commission. If the SEC does set a fiduciary standard for brokers, Congress has directed that accepting a commission should not, in itself, count as a violation of a broker's fiduciary duty. And it wouldn't be a violation if his or her firm offers only in-house products with high fees, as long as the broker tells clients that they are being offered a limited range of investments.

That gets us more or less back to where we started. Some brokers could still be pressured to recommend high-fee products that don't really serve

their clients' best interests. Many investors might not be told that they may be better off buying a low-cost index fund than an expensive product managed by the broker's own firm. Nor, in all likelihood, would many customers be told that they shouldn't be investing at all because of their financial circumstances. "As long as customers are dealing with someone who's getting a piece of the transaction, they won't get advice as good as if they were dealing with someone who earns a fee for their service," says Tom Posey, a Houston financial planner.

On balance, however, extending the fiduciary standard would be a plus for investors, if only because brokers would be required to clearly explain conflicts - for example, when they receive a commission from the sale of a product.

If, for instance, a broker has two equally suitable products on hand, but one would earn him a higher commission than the other, he would have to explain as much to the client before making a recommendation. In that situation, "the investor needs to determine whether the financial incentive might be clouding the broker's judgment," says David Cosgrove, a St. Louis-based securities lawyer.

#### Part-Time Fiduciaries

Even this isn't foolproof. Congress has stipulated that any fiduciary standard adopted for brokers will not require them to act in that role round the clock, but only when they are providing [financial advice](#). In other words, a fiduciary duty will be a hat that brokers can don or doff, depending on which service they're performing. Any new rule should ensure that this flexibility doesn't give brokers a pass if they fail to fess up about conflicts of interest, including commissions, at all times, for all products they sell.

Whatever the SEC decides, it doesn't relieve you of the responsibility to do your homework when choosing an adviser (see [6 Steps to Finding a Great Adviser](#)). If you are looking for someone to execute your transactions, using a broker may be just the ticket. But if you're seeking financial advice, you should think carefully about your adviser's incentives. You wouldn't go to a doctor who earns a commission on every prescription he writes. Why treat your finances with any less respect?