STRATEGIC Wealth Advisors

January 2013 | Vol. No. 11 | Newsletter

Risk, Not Volatility, Is the Real Enemy

What would you do if your investments lost 10% in a single day? A) Add more money to my account. B) Hold steady with what I've got. C) Yank my money; I wouldn't be able to stand any more losses.

If investors buy the right investments but sell them at the wrong time because they can't handle the price fluctuations, they may have been better off avoiding those investments in the first place. Most investors are poor judges of their own risk tolerance, feeling more risk-resilient in up markets and more risk-averse after market losses. However, focusing on an investor's response to short-term losses inappropriately confuses risk and volatility. Understanding the difference between the two and focusing on the former is a potential way to make sure you reach your financial goals.

Volatility encompasses the changes in the price of a security, a portfolio, or a market segment, both on the upside and downside, during a short time period like a day, a month, or a year. Risk, by contrast, is the chance that you won't be able to meet your financial goals or that you'll have to recalibrate your goals because your investment comes up short. So how can investors focus on risk while putting volatility in its place? The first step is to know that volatility is inevitable, and if you have a long enough time horizon, you may be able to harness it for your own benefit. Diversifying your portfolio among different asset classes can also help mute the volatility. It helps to articulate your real risks: your financial goals and the possibility of falling short of them. Finally, plan to keep money you need for near-term expenses out of the volatility mix altogether.

Investing in securities always involves risk of loss. Diversification does not eliminate the risk of experiencing investment losses.

What's Happening at SWA

The SWA Team

Info@xpertadvice.com
480-998-1798
www.Xpertadvice.com

It has become commonplace to transact business, pay bills, maintain memberships and subscribe to various services online. With this comes risks (think identity theft) and responsibilities (think passwords). If your spouse or significant other suddenly became incapacitated or passed away, would you have access to manage all of his/her online accounts? Would you be able to access his/her computer? Without knowing the user's IDs and passwords, managing the family's finances can add a tremendous amount of strain to an already difficult situation.

We suggest creating a list (a spreadsheet is useful) containing every website, user ID and password for each family member. Don't forget to document the security questions that periodically pop up. The list should be kept in a location known by at least 1-2 family members. If possible, use a password to access the list (make sure to give it to someone). Make sure to keep the list current and don't wait until something happens to figure things out…plan ahead!

Monthly Market Commentary

The worst of the fiscal cliff crisis was averted as Congress managed to come to a deal at the eleventh hour. As part of the deal, tax rates will go up for high-income earners, and the payroll tax holiday will expire, affecting income earners across the board. The new tax rates may slow the economy, but also decrease some of the uncertainty. Markets reacted positively, with the S&P 500 jumping more than 4% in the first week of January.

GDP: The third and final estimate for third quarter real GDP growth was revised sharply higher to 3.1%, from an initial estimate of 2.0% and also higher compared with the second quarter real GDP growth rate of 1.3%. This makes it the third-best quarter of the 13-quarter recovery. Consumption and import/export figures were revised upwards, while inventories were less of a contributor than previous estimates.

Employment: In December, 155,000 jobs were added, mainly from strong growth in the health-care and construction sectors. More importantly, hours worked and hourly wage rates were also up. Taking into consideration average hours, average wages, and employment, Morningstar economists believe that total private wages grew at a stunning 0.7% in December (8.4% annualized). Given that there was limited inflation in December, these gains may flow almost immediately to consumers. Going into January, with higher taxes, this large income growth will provide consumers with a substantial cushion. The unemployment rate in December inched up slightly to 7.8%.

Housing: Original housing market forecasts for 2012 ranged from more doom and gloom to minuscule improvements. Instead, the U.S. got a year of considerable advancement, with home inventories down significantly, which has led to higher prices across the board. With inventories so low, it is now difficult to buy a home in many markets, especially on the West Coast. Home builders are also constrained by raw material prices going up, as well as a shortage of construction workers. Morningstar economists believe that home price gains of 5% or more for all of 2012 are pretty much certain, but volume-related housing metrics will slow in 2013 given these supply constraints.

Auto: Auto sales in December were at about 15.4 million units, down slightly from the 15.6 million units sold in November, which benefited from required replacements associated with Hurricane Sandy. The auto industry has been a real plus for the U.S. economy. The durable goods sales category (mainly comprised of autos), has been the single largest contributor to the economic recovery so far. While much of Europe is struggling with declining auto sales, the U.S. managed to pull out another year of very impressive growth.

Retail: Holiday sales (essentially November and December) were up 3.1% from a year ago. Sales in December showed a sharp improvement compared with November, which reflected the impact of accounting for layaway sales, Hurricane Sandy, and the timing of Cyber Monday this year. Overall, the holiday season was good, but not great. Consumer headwinds were substantial, ranging from Hurricane Sandy at the beginning of the season to worries about the fiscal cliff at the end of it. Thankfully, improved consumer incomes, falling gasoline prices, cooler temperatures, and more discounting at the end of the season, all helped boost sales.

Year-end insights: Despite odd weather patterns, presidential election jitters, and fiscal cliff concerns, 2012 was filled with much positive news for the U.S. economy. This included higher oil production, an improved auto industry, decreased commodity prices, and a stabilizing housing market. Unfortunately, the same could not be said about Europe, which entered a recession, or China, whose growth slowed dramatically. The relative strength of the U.S. economy also translated into benefits for consumers, who experienced steady employment growth, stable inflation, rising financial assets, and a nicely improving real estate market.

Economic Outlook for 2013

2012 has been far from uneventful: election year in the U.S., ongoing sovereign debt crisis in Europe, potential real estate bubble in China, food and energy prices on the rise and, of course, the fiscal cliff and looming uncertainty ahead for American taxpayers. Fortunately, though, there may be some good things in store for 2013.

U.S. GDP Expected to Grow by about 2% in 2013: Morningstar economists estimate that GDP growth is likely to drop from very close to 3% in the third quarter to a slower 1%–2% in the fourth (mainly because of Hurricane Sandy's devastating effects). The true strength of the U.S. economy is probably an average of these two extremes, or about 2%.

Slower Growth May Keep Inflation in Check and Indicate a Longer, More Durable Recovery: The recovery is now approaching 3.5 years in length, testing consumers' patience but also preventing inflation from rising too fast. Morningstar economists project an overall inflation rate of about 2% for next year. Slow worldwide economic growth and more controlled commodity demand from emerging markets would point to more stable food and energy prices in 2013, potentially driving overall inflation as low as 1.5%. However, food and energy prices are among the most difficult to forecast, and because of them the overall inflation estimate may not be as certain as other projections.

Consumer Spending Stable to Modestly Higher in 2013: The consumer represents about 70% of U.S. economic activity and, as long as inflation remains under about 4%, may continue to power the economy ahead. Good news for the consumer in 2012 included slow but steady employment growth, stable inflation, rising financial assets, and a nicely improving real estate market. Now that a fiscal cliff decision has been reached, Social Security taxes will increase by 2% in 2013 at all income levels, and high-earning individuals (above $400,000) and couples (above $450,000) will face higher taxes on income above these thresholds. For this reason, lower-income and especially middle-income earners may do better than high-income earners in 2013.

Housing, a Big Change Factor in 2013: The recovery growth drivers are likely to change again next year. Although housing clearly began to turn in 2012, the effects were relatively muted. While direct housing investment will be a meaningful contributor in 2013, some of the ancillary goods and services that are housing-related will also finally kick in (for example, mortgage brokers, furniture sales, and remodeling businesses that may take longer to recover than housing itself).

1.8% Employment Growth Possible; Unemployment Rate May Drop to 7.1%: Year-over-year employment averages have been relatively consistent at 1.8% growth for some time. At this rate, all the jobs lost in recession may not be recaptured until sometime toward the end of 2014. However, employment growth of 1.8% can easily support GDP growth in excess of 2% due to higher productivity levels. The net labor market is expected to increase by about 1 million in 2013 (compared with about 1.3 million in 2012), which translates into a drop in the unemployment rate from an estimated 7.8% in 2012 to 7.1% by the end of 2013.

The U.S. Economy Not Drastically Affected by World Economic Slowdown: U.S. economic growth in 2012 was very close to the level experienced in 2011. The U.S. benefited from higher oil production, an improved auto industry, decreased commodity prices, and a turn in the housing market, avenues of growth that were not available in a lot of other countries. At the same time, Europe moved into a recession, and growth in China and other developing markets slowed dramatically (though in many cases, growth rates were at a higher level than in the U.S. before the slowdown). As emerging markets now begin to show signs of stabilization, there may be more room for earnings improvement in 2013. However, Europe could still be problematic, as its fiscal issues remain far from solved.

What the Tax Deal Means for Your Portfolio Plan

The tax deal passed on January 1st, 2013 included something for everyone to revile: Tax hawks decried higher taxes on the wealthy, while many on the left rued that Bush-era tax cuts were made permanent. In any case, the newfound certainty in tax rates makes matters of investment, estate, and tax planning significantly easier.

Higher Rates for High Earners: Higher income, dividend, and capital gains taxes will kick in for those individuals earning more than $400,000 and married filers earning more than $450,000. Starting in 2013, those high earners will pay a top tax rate of 39.6% on ordinary income and 20% on both dividends and long-term capital gains. For individuals in the aforementioned higher income tax bands for 2013 and beyond, many best practices for tax management like maximizing contributions to tax-sheltered accounts (IRAs and 401(k)s) while placing assets with high year-to-year income production in tax-sheltered vehicles may make more sense.

Conversions from Traditional 401(k)s to Roth 401(k)s: The fiscal cliff deal now allows all employees with traditional 401(k) balances to convert them to Roth 401(k)s, provided their 401(k) plan allows for such a conversion and includes a Roth 401(k) feature. Before, the Small Business Jobs and Credit Act of 2010 enabled only a limited subset of individuals (those who have left or retired from their former employers, are age 59 1/2, or are disabled or dead) to do so. Because in-plan conversions allow workers to pay taxes on their balances at today's tax rates in exchange for tax-free withdrawals during retirement, such a maneuver may make the most sense for those who have reason to believe their tax rates will be higher in the future.

Long-Term Care Provision: Originally a component of the landmark 2010 health-care reform law, the Community Living Assistance Services and Supports (CLASS) Act was designed to create a national insurance pool, offered through employers, to help workers pay for long-term care. The recently passed budget agreement finally repealed the CLASS Act. However, there have been dramatic increases in long-term care insurance premiums, owing to both low interest rates and misguided actuarial assumptions. In the face of these headwinds, would-be long-term care insurance purchasers can (1) skinny down long-term care insurance buy, purchasing a policy that provides a baseline of long-term protection but has a longer elimination period (that is, higher deductible) or a lower dollar limit on the amount of benefit, or (2) younger folks might consider delaying their purchases in the hope that higher interest rates will help tamp down premiums in the future. However, this could result in higher premiums as you age, or the possibility of developing a health condition that could make insurance costly.

Alternative Minimum Tax (AMT): With this new deal, Congress put in place an inflation-adjusted exemption amount for the alternative minimum tax. Had Congress failed to take action, an estimated 28 million new taxpayers would have been subject to the AMT for the 2012 tax year, according to IRS estimates. It is important to note that a host of factors affect a taxpayer's vulnerability to the AMT, both on the tax deductions, exemptions, and credits side as well as on the income side of the ledger, and those items change from year to year.

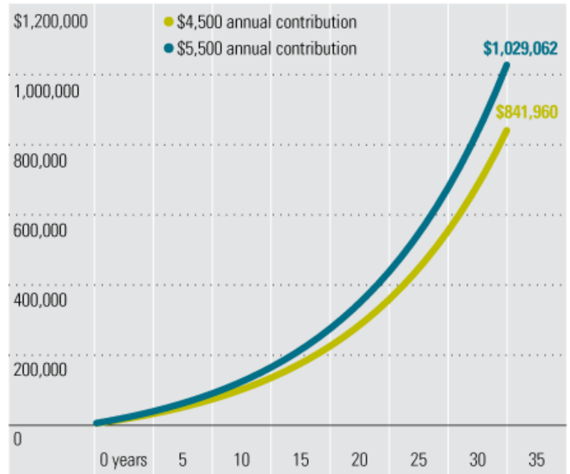
Estate Tax: Although the estate tax exemption was set to drop to $1 million in 2013 and the estate tax was set to rise to 55%, the estate tax exemption will remain $5.12 million per individual, and the top estate tax rate will increase to 40% from 35% in 2013. However, regardless of the status of the estate tax, everyone needs to mind basic estate-planning matters, including properly drafted beneficiary designations, guardianships for minor children, and powers of attorney for financial and health-care matters.

Don’t Forget to Raise Your IRA Contribution

In 2013, contribution limits for both traditional and Roth IRAs (individual retirement accounts) will increase to $5,500 a year for those 49 years of age or younger. If you are 50 or older, the maximum contribution is $6,500. This limit can be split between a traditional and a Roth IRA. These annual contribution limits are imposed by the Federal Government.

The graph shows both a $4,500 and $5,500 annual contribution growing at a hypothetical 8% annual return. Notice the dramatic impact on the ending value of the portfolio. This may be a great time to re-evaluate your financial situation and increase your annual investment to your IRA. Even if you are unable to max out your contribution, any increase you can afford may help you reach your savings goals more easily in the long run.

Hypothetical Growth of Annual IRA Contribution



This is for illustrative purposes only and not indicative of any investment. Funds in a regular IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. Contributions to a Roth IRA are not tax-deductible, but funds grow tax-free as money withdrawn is not taxed. Penalties may apply for withdrawals prior to the age of 59 1/2.

©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.

The SWA Team
8426 E. Shea Blvd.
Scottsdale, Arizona 85260
Info@xpertadvice.com
www.Xpertadvice.com
Tel:480-998-1798