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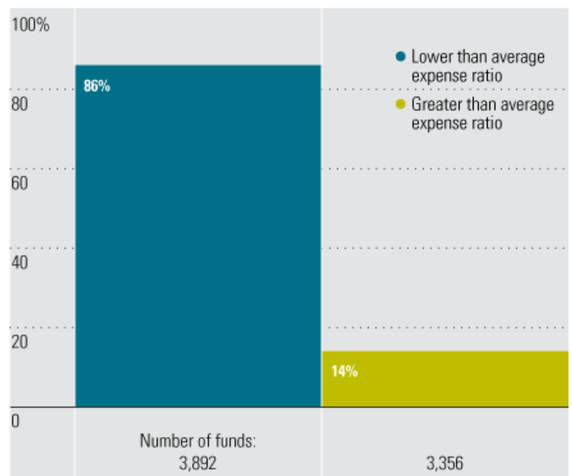
Lighten the Load

Do mutual fund investors prefer to invest in funds offering low expense ratios? The answer is yes. Expense ratios are an important factor in choosing a mutual fund, because they affect returns. It seems that the market is taking matters into its own hands and putting more assets in low-expense funds. As of October 2013, the average expense ratio for domestic funds was 1.14%. Investors pooled about 86% of net assets in funds with expenses lower than the average, leaving only a small portion to higher expense funds.

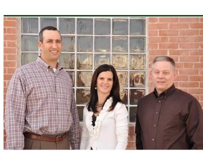
You would think that a majority of funds available to investors would have fairly low expenses, but 54% of funds have below-average expenses and 46% have expenses equal to or above the average expense. With more funds available and a variety of added investment choices, investors have clearly chosen the low-cost alternative.

Low Expense Funds Hold Majority of Assets



Source: The average expense ratio was computed for the oldest share class of all domestic funds in Morningstar's open-end database (7,248 funds as of October 2013).

What's Happening at SWA



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As we approach the holidays and year end, you may be contemplating making a charitable contribution. Donating appreciated securities from a taxable account can be a great way to make the contribution and receive tax benefits as well. Donating securities that are worth more than you paid for them gives you a charitable deduction for the full fair market value of the securities (if you itemize deductions) and avoids long-term capital gains taxes on the donated shares. The tax savings from this strategy can be especially appealing for larger gifts ($1,000 or more). Contact us or your tax advisor for additional information.

Monthly Market Commentary

The market endured yet another month of Fed-watching as investors moved markets upward when more quantitative easing looked possible and downward when it looked like tapering of bond purchases was around the corner. In the past, easing and tightening measures by the Fed have been nearly perfect predictors of stock- and bond-market moves in the short run. At some point, however, bond purchases will inevitably end and rates will move somewhat higher. There is a high probability that bond purchases will end in the next 12 months. (There simply won't be enough bonds left to buy.) And while the positive effect of quantitative easing on markets remains undeniable, gross domestic product growth remains mired in the 2% range.

GDP: The headline third-quarter GDP growth rate of 2.8% came in ahead of the consensus estimate and second-quarter result, which both showed growth of 2.5%. To put this in perspective, the long-term average GDP growth rate is 3.1%. Morningstar economists' year-over-year GDP growth calculation (versus the government's method of annualizing quarter-to-quarter growth) shows a softer 1.6% growth rate.

Despite the powerful rate, the composition of GDP growth was far from optimal. Most of the growth came from net exports and inventory increases. Worse, consumer spending growth rates continued to slump, and businesses' spending for equipment actually decreased for the quarter. The government sector had no net contribution to GDP growth, after three quarters of being a meaningful detractor. Looking ahead, Morningstar economists suspect that GDP growth will drop to 2% or maybe a little less in the fourth quarter, as inventories turn neutral, consumers remain stingy, and net exports make little, if any, contribution to GDP growth.

Employment: Between the furlough and a couple of below-average reports in August and September, everyone braced for the worst with regard to the October jobs report. However, the private sector, expected to increase jobs by only about 130,000, added 212,000 jobs, slightly better than the 196,000 average over the past year. Upward revisions to the prior two months counted an additional 70,000 private-sector jobs. Nevertheless, the report was less than inspiring in aggregate. There was almost no hourly wage growth, and hours worked were flat, which will keep income growth in check. Year-over-year job growth remained stuck around the 2% level, where it has been for some time. Unfortunately, the real strength was again in retail and leisure and entertainment, which are not generally the highest-paying jobs.

Housing: Pending home sales continued to plummet, both month to month and year over year. Weaker existing-home sales have already begun to follow suit, and more deterioration is likely in the short run. The short-term increase in existing-home sales (in July and August), caused by a rush to beat rising rates, could boost GDP growth by 0.2% in the third quarter and subtract a like amount in the fourth quarter, as sales dip back to more sustainable levels. Higher mortgage rates and, more importantly, higher prices, have begun to affect housing affordability in a dramatic way.

Consumer spending: The five-week moving average for weekly shopping center data has been stuck at 2% versus the three-year trend of 2.5%–4.0%, despite lower gasoline prices and the return of furloughed government workers. Retail sales dropped 0.1% in September overall (ex-autos, they increased by 0.4%). Adjusted for inflation, the 2.5% growth rate matched the average of the past 12 months.

One of the few recent pieces of good news was that the federal budget deficit fell dramatically in fiscal year 2013, dropping to $0.7 trillion from $1.1 trillion in just one year, the largest dollar drop in history by a factor of two. Another really good piece of news is that health-care inflation continues to run far, far below long-term projections.

Financial Planning for Women

Financial planning may present different challenges for women as opposed to men for various reasons. Knowing these challenges, when and if they are likely to occur is crucial for women to successfully manage income, expenses, retirement planning, college planning for children, and any other money matters that need attention.

Challenge 1: Women tend to live longer than men. According to 2009 data from the Centers for Disease Control, remaining life expectancy for a 65-year old woman is 20.3 years, as opposed to only 17.6 years for a 65-year-old man. This may mean that not only do women need to accumulate more assets for retirement, but also that they need to manage these assets much more carefully in retirement in order to make them last for a longer period of time. It is, therefore, paramount for women to begin contributing to a retirement account as soon as possible. According to the Department of Labor's "Women and Retirement Savings" publication, only 45% of the 62 million women (age 21 to 64) working in the United States participate in a retirement plan. This is probably one of the worst financial-planning mistakes you can make. If your workplace offers a 401(k) plan, you should start contributing as soon as you receive your first paycheck, and make sure you're contributing enough to take advantage of the employer match.

Challenge 2: Women are more likely than men to work part-time, which means they may not be eligible for benefits (such as retirement-plan participation). If a 401(k) isn't an option, consider an Individual Retirement Account (IRA) instead. A traditional IRA gives you the benefit of tax deferral, meaning that your assets will be able to grow tax-free until you begin withdrawing in retirement. A Roth IRA is not tax-deferred, but may offer other advantages. Conduct the necessary research and consult a financial advisor to determine which type of retirement account is the best option for you.

Challenge 3: Women, in general, earn less than men. Median income for men was $48,202 in 2011, compared with only $37,118 for women (Current Population Reports: Income, Poverty, and Health Insurance Coverage in the United States, September 2012, U.S. Census Bureau). This also puts women at a significant disadvantage financially, especially if they're single, widowed, or divorced and don't enjoy the security of a dual-income household. Precisely because they earn less, women have to be more disciplined about saving and investing. Make a realistic budget to assess your financial situation. Control your expenses as much as you can, and invest the rest. No matter how tiny it may seem, every little dollar you put aside today counts.

Challenge 4: Women tend to take more breaks from the workplace and have shorter job tenure, since they are most often the primary caregivers for children and also elderly relatives. This makes it difficult to get back into the workforce (and at the same pay level). The most important thing is safeguarding your retirement savings. No matter how tempted you might be, do not cash out your 401(k). If you do, you will not only pay taxes, but you'll also incur early-withdrawal penalties. Instead, consider rolling your 401(k) over into an IRA, and do the necessary research before you begin this process.

401(k) plans are long-term retirement savings vehicles. Withdrawal of pre-tax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty. Funds in a traditional 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, and can be withdrawn tax free if assets are held for five years. A 10% federal tax penalty may apply for withdrawals prior to age 59 1/2. Please consult with a financial or tax professional for advice specific to your situation. Investing in securities always involves risk of loss, including the risk of losing the entire investment.

Do You Have a Job-Loss Safety Net?

“What are the chances that I'll lose my job?” Unless you're a retiree, a tenured college professor, or the owner of a business, that question has probably passed through your mind at least a few times over the recent years. Even if you're confident about the security of your current position, it never hurts to put in place a good safety net. Some of the primary steps are outlined below.

1) Build Up Your Emergency Fund

Having an emergency fund in place can help if you suddenly find yourself unemployed. Moreover, an emergency fund can also be helpful for unexpected and unreimbursed medical expenses, big-ticket auto and home repairs, etc. Conventional financial-planning wisdom has long held that you should keep three to six months' worth of living expenses in highly liquid accounts like checking or savings accounts, certificates of deposit (CDs), money market accounts or money-market mutual funds, but the recent financial crisis illustrates that figure is probably too low. Wouldn't you like to have more than three months to find a new job if you lost yours?

2) Consider a Roth IRA for Retirement Savings

You can't put your life—and your long-term financial goals—on hold just because you're worried about job loss. But you can be strategic about what you sink your money into, and that means focusing on those investments with the fewest strings attached in case you need to make a withdrawal. Rather than saving within the confines of your company retirement plan or a traditional IRA, where you'll pay taxes and penalties if you need to withdraw your assets prematurely, consider deploying fresh retirement dollars into a Roth IRA instead. With a Roth IRA you can withdraw your contributions tax-free at any time (the early withdrawal penalty, however, may still apply). And because you're contributing aftertax dollars, you won't have to pay taxes on your earnings from year to year or upon withdrawal during retirement. Please keep in mind that income limits do apply—talk to your financial advisor to see if you're eligible.

3) Pay Down Costly Forms of Debt

If you already have expensive types of debt such as credit cards and are concerned about job security, the first thing to do is to reduce that burden as soon as you possibly can. Credit card companies are the last folks you want to mess around with if you find yourself in a financial bind, as they're able to raise your rates if you're late on a payment.

4) Be a Commitment-Phobe

While service providers—particularly purveyors of cable TV, Internet, and telephone service—will offer you a lower rate if you sign a contract of a year or more, be sure to weigh those lower rates against the risk that you'll lose your job. If you're concerned about job security, read the fine print on any contracts to see what it would cost you to get out of the agreement in a pinch.

5) Contemplate Refinancing

If you haven't refinanced your primary mortgage to take advantage of currently low rates, it's time to have someone run the numbers. As with any type of financing, it's better to shop for a mortgage while you're employed than when you are not.

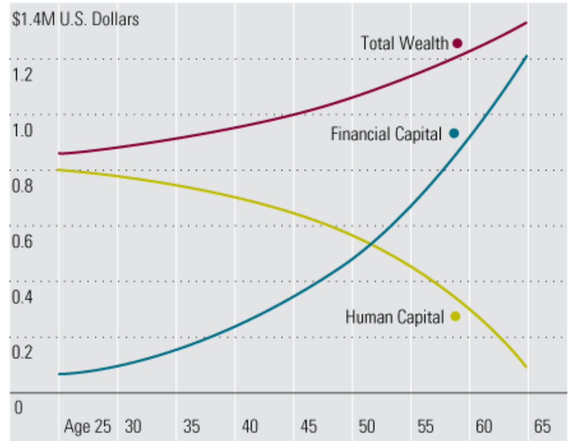
6) Take Advantage of the Perks You Have

Have you had a physical lately? Do you need new glasses or contacts? Are you overdue for a visit to the dentist? If so, it's time to make some appointments. Chances are you're paying decent-sized premiums for the insurance you have through your employer, so it pays to take advantage of all your perks while you still have them.

Understanding Financial Capital and Human Capital

When calculating total wealth, it is important to consider not only financial capital, but human capital as well. Financial capital refers to an individual's total saved assets, while human capital refers to the individual's future potential savings from income earned. Looking at financial capital in isolation for retirement planning is incomplete without also considering human capital. Initially, an individual has higher human capital and lower financial capital. Over time, accumulation in savings increases financial capital, while human capital declines as the individual reaches retirement. Certain life events trigger significant changes in financial capital, such as receiving an inheritance, and in human capital, such as going back to school or receiving a promotion at work. Individuals should keep this in mind when planning their financial goals.

Financial Capital, Human Capital, and Total Wealth Over Time



Source: Roger G. Ibbotson, Moshe A. Milevsky, Peng Chen, CFA, Kevin X. Zhu. Lifetime Financial Advice: Human Capital, Asset Allocation, and Insurance, Research Foundation of CFA Institute, 6 April 2007.

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