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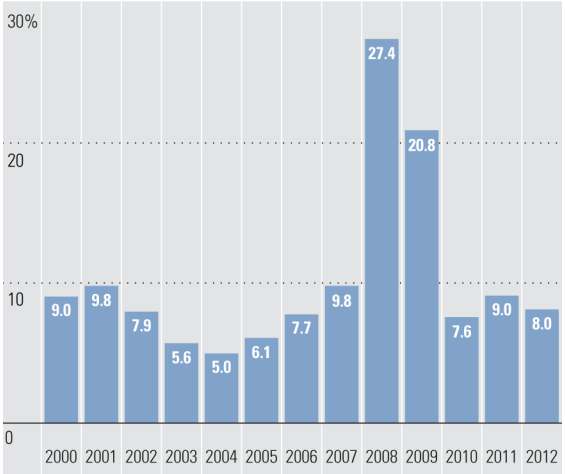
Dividend Income: Not So Fixed

Since interest rates are still relatively low right now, many investors looking for income and yield have begun to assess switching a portion of their investment allocation from bonds into dividend-paying stocks. However, it is important to remember that the interest payment of a bond is a contractual obligation of the company, whereas dividend payments are not. If a bond issuer does not pay either interest or principal on time, the company will be in default, and likely will be placed into bankruptcy. However, dividend payments are not a contractual obligation of a company and can be either cut or raised by its board of directors at will. When times are tough, companies may cut dividends to conserve cash, such as during the 2008 credit crisis. Conversely, when times are good, companies may increase their dividend payments, providing investors with additional upside.

Percentage of Companies That Cut Dividends



Source: Morningstar analysis. This is for illustrative purposes only and not indicative of any investment. Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed, and stocks have been more volatile than bonds. Dividends are not guaranteed and are paid solely at a company's discretion. Percentage of companies that cut dividends is calculated for listed companies on NYSE, NASDAQ, and NYSE AMEX.

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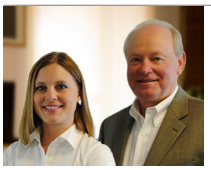

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Chambers Financial Group is a comprehensive financial services firm that was founded in 1984 with the goal of assisting our clientele with a holistic financial view in mind. We integrate many of the financial areas in your life, including investment planning, portfolio management, retirement planning, estate and tax planning.

We are an independent family practice dedicated to providing objective, responsible financial planning assistance to a broad range of clients. Our objective is to help our clients live the life they wish to, both now and in the future. Our clients' success is our success.

We believe in building long-term relationships with our clients. We believe in the value of building trust and confidence with long range plans to achieve your financial goals. We give unbiased, honest advice and believe patience along with discipline is crucial in the achievement of defined investment goals.

In-Retirement Withdrawal Strategies

The standard sequence for a tax-efficient portfolio drawdown is required minimum distributions first. Taxable accounts next, followed by Traditional IRAs and 401(k)s. Roth IRAs and 401(k)s last. The overarching thesis is to be sure to tap those accounts where you'll face a tax penalty for not doing so (RMDs) while hanging on to the benefits of tax-sheltered vehicles for as long as possible. Because Roth assets enjoy the biggest tax benefits--tax-free compounding and withdrawals--and may also be the most advantageous for heirs to receive upon your death, they generally go last in the withdrawal-sequencing queue.

That's a helpful starting point for sequencing retirement-portfolio withdrawals, and it goes without saying that you should always take your RMDs on time. That said it may be a mistake to always follow this strategy. The reason is that your tax picture will change from year to year based on your expenses, your available deductions, your investment performance, and your RMDs.

In order to keep your total tax outlay down during your retirement years, it may be worthwhile to maintain holdings in the three major tax categories throughout retirement: taxable, tax-deferred, and Roth. Armed with exposure to investments with those three types of tax treatment, retirees can consider withdrawal sequencing on a year-by-year basis, staying flexible about where they draw their income bases on their tax picture at large. They can help limit the pain of an otherwise high-tax year by favoring taxable and Roth distributions, for example, while giving preference to tax-deferred distributions in lower-tax years.

For example, in a year in which they have high medical deductions that push them into a lower tax bracket, they might actually give preference to withdrawals from their Traditional IRA accounts, even though they have plenty of taxable assets on hand, too. The reason is that it may be preferable to take the tax hit associated with that distribution when they're paying the lowest possible rate on that distribution. Moreover, aggressively tapping tax-deferred accounts like Traditional IRAs in low-tax years will mean that fewer assets will be left behind to be subject to RMDs.

On the flip side, in a high-tax year--for example, when RMDs are bigger than usual due to market appreciation--a retiree might reasonably turn to her Roth accounts for any additional income needed. Although those Roth assets usually go in the "save for later" column under the standard rules of withdrawal sequencing, those tax-free Roth withdrawals (versus, say, paying capital gains on distributions from a taxable account or paying ordinary income tax on tax-deferred withdrawals) may help the retiree avoid getting pushed into a higher tax bracket than would otherwise be the case.

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.

This article contributed by Christine Benz, Director of Personal Finance with Morningstar.

Four Retirement-Portfolio Withdrawal Mistakes to Avoid

Some errors in retirement-portfolio planning fall into the category of minor infractions rather than major missteps. Did you downplay foreign stocks versus standard asset-allocation advice? It's probably not going to have a big impact on whether your money lasts throughout your retirement years.

But withdrawal rate errors can have more serious repercussions for retirement-portfolios. If you take too much out of your portfolio at the outset of retirement, and that coincides with a difficult market environment --you can deal your portfolio a blow from which it may never recover. Other retirees may take far less than they actually could, all in the name of safety. The risk is that they didn't fully enjoy enough of their money during their lifetimes.

Mistake 1: Not Adjusting With Your Portfolio's Value and Market Conditions. Even though the popular "4% rule" assumes a static annual-dollar-withdrawal amount, adjusted for inflation, retirees would be better off staying flexible with their withdrawals.

What to Do Instead: The simplest way to tether your withdrawal rate to your portfolio's performance is to withdraw a fixed percentage, versus a fixed dollar amount adjusted for inflation, year in and year out. That's intuitively appealing, but this approach may lead to more radical swings in spending than is desirable for many retirees. It's possible to find a more comfortable middle ground by using a fixed percentage rate as a baseline but bounding those withdrawals with a "ceiling" and "floor."

Mistake 2: Not Adjusting With Your Time Horizon. Taking a fixed amount from a portfolio also neglects the fact that, as you age, you can safely take more from your portfolio than you could when you were younger. The original "4%" research assumed a 30-year time horizon, but retirees with shorter time horizons (life expectancies) of 10 to 15 years can reasonably take higher amounts.

What to Do Instead: To help factor in the role of life expectancy retirees can use the IRS' tables for required minimum distributions as a starting point to inform their withdrawal rates. That said, those distribution rates may be too high for people who believe their life expectancy will be longer than average.

Mistake 3: Not Adjusting Based on Your Portfolio Mix. Many retirees take withdrawal-rate guidance, such as the 4% guideline, and run with it, without stopping to assess whether their situations fit with the profile underpinning that guidance. The 4% guideline assumed a retiree had a balanced stock/bond portfolio. But retirees with more-conservative portfolios should use a more-conservative (lower) figure, whereas those with more-aggressive asset allocations might reasonably take a higher amount.

What to Do Instead: Be sure to customize your withdrawal rate based on your own factors, including your portfolio mix.

Mistake 4: Not Factoring In the Role of Taxes. The money you've saved in tax-deferred retirement-savings vehicles might look comfortingly plump. However, it's important to factor in taxes when determining your take-home withdrawals from those accounts. A 4% withdrawal from an $800,000 portfolio is $32,000, but that amount shrivels to just $24,000, assuming a 25% tax hit.

What to Do Instead: It pays to be conservative in your planning assumptions. To be safe it's valuable to assume a higher tax rate than you might actually end up paying.

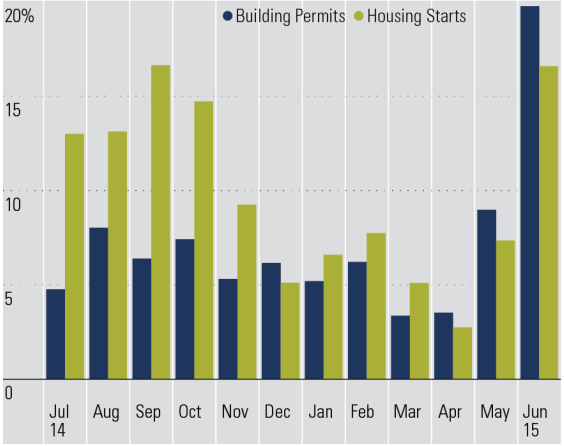
Disclosure: This is for informational purposes only and should not be considered tax or financial planning advice. Please consult with a financial or tax professional for advice specific to your situation.

This article contributed by Christine Benz, Director of Personal Finance with Morningstar.

Housing Construction in Good Shape

The chart depicts the state of the housing construction industry, suggesting that there is still plenty of room to grow in this slow, but steady recovery we've seen so far. The latest starts and permits data from the Census Bureau, however, shows a slightly exaggerated picture, as it is the multi-family category that's been making overall housing construction look better than it is in reality. Both starts and permits picked up in June, as multi-family activity rose sharply amid expiring construction tax incentives for developers in the New York City area. As a result, the housing construction revival is probably not as strong as the numbers seem to currently suggest. Nonetheless, improvements for single-family construction still look healthy, and continue to trend up closer to the 10% rate year over year.

Building Permits Versus Housing Starts
Year-Over-Year Growth, 3-Month Average



Source: Census Bureau, Morningstar.

This article contains certain forward-looking statements which involve known and unknown risks, uncertainties, and other factors that may cause the actual results to differ materially from any future results expressed or implied by those projected statements. Past performance does not guarantee future results.

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