Insights & Outlook

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Wealth by Numbers

America has long been known as the land of opportunity and the promise of a better life to people from all over the world. Recently, however, many Americans feel robbed of opportunities and better lives by the top 1% of their own. This growing income inequality has led to problems and civil unrest, as demonstrated by the "Occupy Wall Street" movement.

The table presents household income distribution data from the U.S. Census Bureau. Given that the poverty threshold for a two-member household is around $14,000, it appears that approximately 13.7% of Americans are poor. At the other end of the income spectrum, 3.9% are rich, with household incomes higher than $200,000.

Household Income Distribution in 2010

Income	Share
Under $5,000	3.5%
$5,000 to $9,999	4.3%
$10,000 to $14,999	5.9%
$15,000 to $19,999	6.1%
$20,000 to $29,999	11.5%
$30,000 to $39,999	10.2%
$40,000 to $49,999	8.9%
$50,000 to $74,999	17.7%
$75,000 to $99,999	11.4%
$100,000 to $149,999	12.1%
$150,000 to $199,999	4.5%
$200,000 and over	3.9%

Source: U.S. Census Bureau, Current Population Survey, 2011 Annual Social and Economic Supplement. Poverty threshold also from the U.S. Census Bureau.

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Advisor Biography

John has been in the tax and financial services industry since 1976 and is a member of The Institute of Certified Financial Planners, The NJ CPA Society and his local chapter of The Lions Club International, where he currently serves as their treasurer.
He has been a Certified Public Accountant (CPA) since 1978 and a Certified Financial Planner (CFP®) since 1990.

John specializes in developing financial strategies for physicians, business owners and high net worth individuals. He is also an expert on Income Tax savings strategies for physicians.
John has received numerous awards such as: Finalist in the Individual Investor of the Year Challenge, The National Quality Award; The Oppenheimer President's Council.

Community Service: He currently serves as treasurer of his church and the local chapter of the Lions club where he earned the "Lion of the Year" award for his service.

Personal: He has 3 children two of whom are CPAs, and 6 grandchildren.

Potential Pitfalls of Bond Investing

Bonds present investors with a number of potential benefits. In general, bonds have provided investors with growth and less risk than stocks historically. Economic events that tend to decrease stock prices have sometimes increased bond prices, and vice versa. Because of this relationship, adding bonds to a portfolio might provide significant diversification benefits. Lastly, bond investors normally receive income at fixed intervals, helping to meet certain cash-flow needs. However, as with any other investment, there are some risks that investors need to be aware of when adding bonds to an investment portfolio.

Interest-Rate Risk: Bonds and interest rates have an inverse relationship—bonds tend to rise in value when interest rates fall and fall in value when interest rates rise. Suppose an investor purchases a 20-year $1,000 bond with a yield of 8% and interest payable annually at year-end. One year later, interest rates rise to 10%. Anybody in the market for a bond can now buy one with a yield of 10%. If the investor tried to sell the bond with an 8% yield for $1,000, nobody would buy it—the same amount of money could purchase a bond yielding 10%. In order to find a buyer, the investor would need to discount the bond price to compensate the buyer for the lower coupon payments.

Inflation Risk: This is also known as purchasing-power risk. Inflation is a rise in the general level of prices for goods and services. If investments do not keep up with inflation, an investor's money will purchase less in the future than it did in the past. At their best, bonds have experienced very modest inflation-adjusted returns. Long-term government bonds returned 2.6% on an inflation-adjusted basis from 1926 to 2011, and long-term corporate bonds produced an inflation-adjusted return of 3.0%. Stocks, on the other hand, returned 6.6% inflation-adjusted.

Credit Risk: This is the risk of a company that is selling bonds not being able to make timely payments of principal and interest. The value of a bond might also decrease because of financial difficulties or the declining creditworthiness of the issuer. It is important to keep in mind that corporate bonds aren't guaranteed by the full faith and credit of the U.S. government but are solely dependent on the company's ability to repay the money that it has borrowed.

Liquidity Risk: Some investments might not be widely held by the public and can be difficult to sell (are not very liquid) if prices drop dramatically. Government bonds are usually very liquid investments; corporate bonds, however, might be difficult to sell quickly in certain situations.

Call/Reinvestment Risk: As interest rates fall, bonds with call provisions might be called (redeemed) by the issuer prior to maturity. While a premium is usually paid to the bond owner when the bond is called, this could leave the investor with the problem of reinvesting the principal at a lower interest rate.

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 and corporate bonds are not guaranteed. Stocks have been more volatile than the other asset classes. An investment cannot be made directly in an index. Diversification does not eliminate the risk of experiencing investment losses. Past performance is no guarantee of future results.

Source: Stocks in this example are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Corporate bonds are represented by the Ibbotson Associates long-term corporate bond index, government bonds by the 20-year U.S. government bond, and inflation by the Consumer Price Index.

Three-Step Checklist for Turbulent Markets

When the stock market experiences extreme volatility, an investor’s best bet is to focus his/her energy on factors that can be controlled. Unfortunately, many investors panic-sell and lose their money. When the market rebounds, many investors are left wondering if it’s the right time to get back in.

Your best bet during turbulent markets is an investment of time. You want to invest in time to see where you stand now, and, if you determine changes are in order, thoroughly research your options. Here is a three-step checklist to manage your investments during turbulent markets.

Step 1: Check adequacy of cash reserves.

The best way to manage your portfolio during volatile markets is to make sure you have adequate cash on hand to cover your near-term needs. This way, your long-term stock investments can ride out the market ups and downs, but you can take comfort in knowing that they won’t affect your ability to fund short-term cash needs.

Step 2: Check your long-term positioning.

Once you've done the liquidity check, the next step is to check the asset allocation of your long-term assets. Market sell-offs can be alarming for retirees and people getting close to retirement simply because they typically have more money invested, compared with their younger counterparts. Checking your long-term positioning helps you put things into perspective so that you can make sound investment decisions for your future.

Step 3: Initiate defensive hedges with care.

During turbulent markets, investors may initiate defensive strategies like selling out of stocks and buying into the so-called “safe” investments like gold. Gold and treasuries can serve as a legitimate defensive role in a portfolio; however, these investments may have already enjoyed a sizable run-up. If you're moving into either, do so with caution, and only after you've checked your existing exposure to those asset classes.

Treasuries are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest. Debt securities are subject to credit/default risk and interest-rate risk (they have varying levels of sensitivity to changes in interest rates). In general, the price of a debt security tends to fall when interest rates rise and rise when interest rates fall. Securities with longer maturities and mortgage securities can be more sensitive to interest rate changes.

Gold/commodity investments will be subject to the risks of investing in physical commodities, including regulatory, economic and political developments, weather events, natural disasters, and market disruptions. Exposure to the commodities markets may subject the investment to greater volatility than investments in more traditional securities, such as stocks and bonds.

Reducing the IRS' Bite with Tax-Efficient Funds

Handing over a portion of your investment earnings to the IRS is never pleasant. Fortunately, a specific category of mutual funds, called tax-efficient funds, might help you keep the amount you send to Uncle Sam to a minimum. Here's how tax-efficient funds work. Mutual funds must pay you almost all of the money they make from interest, dividends, or capital gains (money made from selling stock) in a year. That's called a taxable distribution (since you must pay taxes on that money). Tax-efficient funds keep their taxable distributions as small as possible, thus lowering the amount you have to pay in taxes. Tax-efficient funds can use several strategies to keep distributions low. They avoid stocks that pay dividends. They don't sell their stocks very often. When they do sell stocks, they might also try to sell some that have lost money to offset those that have made money. They could also hold stocks for more than one year before selling, since the profits are taxed at a lower long-term capital gains rate than short-term transactions. These methods, as well as some others, keep your tax bill lower.

While tax-efficient funds seem extremely attractive, there are a few drawbacks to note. First, there are only a handful of these funds available from which to choose (relative to other categories). Second, of the funds that do exist, few have long-term investment records that you can analyze. Finally, most tax-efficient funds stick mainly with large-company stocks and tax-free (municipal) bonds. That means you might have to look at non-tax-efficient funds to get exposure to other types of investments in an effort to build a diversified portfolio.

Diversification does not eliminate the risk of experiencing investment losses. Past performance is no guarantee of future results.

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