

# Financial Pulse

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Investment Updates

## The New Tax Package and Your Portfolio

On Dec. 16, 2010, Congress approved \$801 billion in tax cuts and \$57 billion for extended unemployment insurance. It includes other tax breaks, such as college tuition credit for some families, an expanded child tax credit, and the earned income tax credit. Here is how some of these changes may impact your portfolio.

**Social Security Tax:** The one-year payroll tax cut would reduce the Social Security tax to 4.2% from 6.2%. Although this was intended to increase consumer spending levels and stimulate the economy, a better option would be to increase your contribution to your 401k plan to match your employer's contribution, at a minimum, if you do not need extra cash in the near future. The contribution limit for 401k plans remains at \$16,500 for those under 50, and \$22,000 for those age 50 or older.

**Dividends/Capital Gains Tax Rates:** Dividend and long-term capital gains taxes will remain at 15% for the next two years. Many had suggested selling securities in your portfolios that were projected to have huge capital gains before the end of 2010, since the capital gains tax rate was projected to increase to 20%. Now, you can sell your securities if your investment strategy dictates.

**Estate Taxes:** The new tax package sets new estate tax parameters with an exemption of \$5 million per person, or \$10 million per couple, and a maximum rate of 35% for the next two years. You should speak to your financial advisor about creating an estate plan that will detail how you would like your assets distributed after you are gone, and who should act on your behalf should you become disabled.

Dividends are not guaranteed and are paid solely at a company's discretion. Please consult with your tax professional for specific tax advice.



**Scott Cline**  
scline@cline-financial.com  
(217)766-9288

### Temperature Check

Many investors believe that "The more you pay, the better the performance". This philosophy works great if you are buying a speed boat, but it does not work when you are investing your money. You could be paying 1.5% to 3% in fees per year, and getting nothing in return. It is important to check your portfolio cost by looking at the internal

management fee, 12b-1 fee, front-end load fee, and back-end load fee of each of your investments. To see what you are really spending you can go to [www.morningstar.com](http://www.morningstar.com), or contact Cline Financial Concepts, LLC for a free one-hour consultation.

# Destination Correlation

## Diversification

- ▶ It has been reported that 95% of your portfolio's performance is based on how well you are diversified.
- ▶ You may want to examine adding some bonds, and commodities to give you a broader diversified portfolio.

"Correlation" and "correlated assets" are mainstay expressions in the jargon of investors and financial professionals, and while the concept of correlation can be confusing to novice investors, a quick explanation can clarify why correlation is a key factor in portfolio construction.

Let's say you or your financial advisor are trying to choose two investments in the construction of a portfolio. Would you prefer investments that are similar (move in the same direction) or investments that are dissimilar? Think about it this way: If you are going on vacation to an unknown island, what type of clothes will you put in your suitcase? If you only take summer clothes and the island nights turn out to be cold, or if you only bring winter clothes and the climate is tropical, your vacation will probably end in tears. It's the same with investing: You're better off diversifying than putting all your money in similar investments.

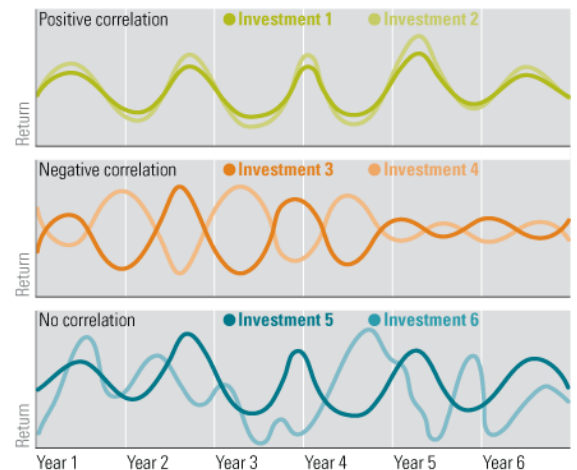
In order to create a truly diversified portfolio, the investments in the portfolio have to compensate for each other's shortcomings. If investment A declines in value, ideally you would want investment B to increase in value, or at least decline less than investment A. In order to achieve this, you need two investments that behave differently, meaning they have a low correlation.

Correlation is a statistical measure designed to quantify the interrelationship of two investments (again, investment A and investment B). By taking into account the characteristics of the two investments, a mathematical formula calculates a number between  $-1.00$  and  $+1.00$ . This number is called the correlation coefficient. If this coefficient is negative (for example,  $-0.81$ ), we say the two asset classes are negatively correlated. This simply means they tend to move in different directions: if asset class A declines in value, asset class B is likely to increase in value, and vice versa. If the correlation coefficient is positive (for example,  $+0.34$ ), the two asset classes tend to move in the same direction: they are positively correlated. A correlation coefficient of zero means

the asset classes are completely uncorrelated; their movements in relation to one another are random.

Adding investments with low correlation to a portfolio can soften the impact of market swings because the investments do not all react to economic and market conditions in the same manner. For example, building a portfolio with large, small and international stocks would probably not be such a good idea because stocks are generally highly correlated to one another—if large stocks go down, the other stock categories will probably go down, too. The same logic applies to a portfolio with only bonds. However, combining stocks and bonds in a portfolio could provide a significant diversification benefit because these two types of investments do not tend to move together (they have a low correlation).

## Various Levels of Correlation



Past performance is no guarantee of future results. Diversification does not eliminate the risk of investment losses. Investment returns shown and correlation numbers mentioned in the text are based on hypothetical data. Government bonds and Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds.

## The Rollover IRA, Taking It With You

### Consolidating Your Accounts

- ▶ Consolidating your retirement accounts to a single brokerage company is a great way to simplify your retirement life.
- ▶ For those of you that move to another job, it may give you the opportunity to roll your retirement money to an IRA where you may be able to get better low cost options.

One of the most convenient and flexible options for dealing with a retirement plan from your ex-employer is to transfer the money to a Rollover Individual Retirement Account. A Rollover IRA is, in essence, a traditional IRA where you can park the cash you're transferring from your old employer's retirement account. The money you invest in a Rollover IRA accumulates tax-free until you take it out in retirement, just as it does in a defined-contribution retirement plan (401k). You can open a Rollover IRA with just about any investment firm, including mutual fund companies, insurance companies, and online brokers. You're allowed to invest the money in stocks, mutual funds, bonds, and other types of investments. That's why the Rollover IRA is your most flexible choice when leaving a job.

You have a number of options after you open your Rollover IRA, too. Of course, you can leave it alone

until you retire. But if you move on to a new job, you may be able to transfer the money you have invested in your Rollover IRA into your new employer's retirement plan (assuming the qualified retirement plan has language permitting such rollovers). And if a Roth IRA is more to your liking, you can convert your Rollover IRA into a Roth IRA, if you meet the criteria.

Keep in mind that you can't take a loan from a Rollover IRA as you can from some employer-sponsored retirement plans. Moreover, Rollover IRAs are also subject to the same withdrawal limits as other tax-deferred retirement accounts. So, if you take any money out before you turn 59½, you'll pay a 10% early withdrawal penalty in addition to taxes.

Returns and principal invested in stocks are not guaranteed. Stocks have been more volatile than bonds.

## Head to Head Competition: Large Growth versus Large Value

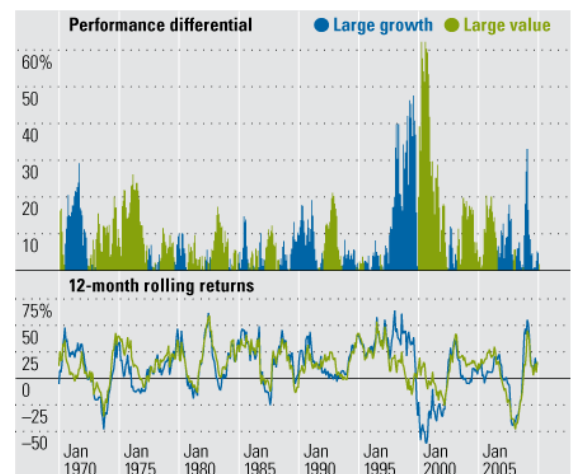
### Passive vs. Active Investing

- ▶ There are also many arguments about which is better: passive versus active investing.
- ▶ It really depends on the amount of historical data that each side is looking at to argue their point.
- ▶ This is the reason why we at Cline Financial Concepts uses a combination of both. We believe that the more diversified you are the better your long-term outlook will be.

The battle between large-cap growth and value investing has been going on for years, with each style trying to seize the spotlight. Although there is an annual frontrunner, history shows that leadership shifts with market conditions. In the bull market of the late 90s, growth stocks offered superior returns. But, since that bubble burst in 2000, value went on quite an impressive run. Growth seems to have captured the spotlight recently and many wonder if the tables have turned yet again.

Determining your allocation between growth and value can be difficult. Which style is more stable, or which will provide higher returns? Unfortunately, there is no definite answer. Focus on finding the option that offers the most upside for your situation: perhaps it's growth, maybe value, or possibly a blend of both.

One-Year Growth and Value Cycles: 1970–2010



Performance differential measures the outperformance of one asset class over the other using 12-month rolling returns. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed.

Source: Large growth and value stocks in this example are represented by the Ibbotson Associates Growth and Value Indexes for 1970–1997 and the Morningstar Style Indexes thereafter. Ibbotson Associates Growth and Value Indexes are calculated based on data from CRSP US Stock Database and CRSP US Indices Database, Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business. Used with permission.

# Retirement Income Sources

## Defined Benefit Plans

- ▶ Did you know that one defined benefit plan disappears every day? This trend was brought on by the Enron scandal when regulations changed the ability for companies to borrow short-term loans from their own pension plans.
- ▶ Did you know that the 401(k) plan was not intended to be our only way to save for retirement in the workplace? It was designed to be a sweetener for companies that offered defined benefit plans.

Concerns about shortfalls in traditional retirement income sources like Social Security and pension plans have caused people to expect to rely more heavily on personal savings to fund their retirement.

The graph illustrates that while only 58% of current retirees utilize their personal savings for retirement income, 78% of current workers anticipate personal savings to play a role during retirement. Further, 75% of workers expect to receive retirement income from an employer-sponsored retirement savings plan, while only 44% of those already retired actually receive income from such a source.

It may be a good idea to plan for a diminished reliance on Social Security or a pension plan. Whatever extra funds you save by taking this more conservative view will make retirement all the more enjoyable.

## Times are Changing: Sources of Retirement Income are Shifting



Source: Employee Benefit Research Institute, 2010 Retirement Confidence Survey.

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Scott Cline

3121 Village Office Place  
Champaign, Illinois 61822

scline@cline-financial.com

Tel: (217) 766-9288