Investor Insights & Outlook

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Getting Things Done in Washington

If you're among those who believe that nothing can get done within the partisan bickering on Capitol Hill, you should know that both parties came together with remarkable speed recently to pass bipartisan legislation. There was virtually no bickering, posturing or visible hostility as a new modification of the STOCK Act (Stop Trading on Congressional Knowledge) sailed through both houses of Congress.

The original STOCK Act, which became law just a year ago, was designed to discourage top government officials and members of Congress from enriching themselves by buying and selling stocks based on non-public information that they--but not the rest of us--had access to. The law required that Congressional staffers and 28,000 employees of the executive branch of government disclose their portfolios and trades. These financial disclosures were to be posted in an online database open to the public, so researchers could look over the shoulders of our elected officials and their key staffers, and notice any suspicious trades that resulted in mysterious financial windfalls.

The new law eliminated the disclosure laws for Congressional staffers and government employees, leaving them in place only for members of Congress, Congressional candidates and the President and Vice President. Insider trading instantly became much easier in Washington--which appears to be about the only thing Congressional Democrats and Republicans can agree on these days.

Source: http://finance.yahoo.com/news/insider-trading-nations-capital-just-123453723.html

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Advisor Corner

Garner Financial Management, Inc. was founded with one very important and underlying mission – to help improve and enrich the quality of life for you and your family.
Garner Financial Management utilizes global non-proprietary resources in order to design investment portfolios to meet all of your financial needs. We provide a customized and straightforward approach to financial growth, protection and management. Our fee-only structure is specifically designed to avoid conflicts of interest. As an independent advisor we utilize no proprietary investment products, and are free to select from all available investments. This investment process allows us to identify the most appropriate investment strategy and to focus on helping you attain your long-term financial goals. The fiduciary role we assume in every client relationship is paramount. We understand the duty that we serve and hold ourselves to the highest personal and professional standards. It is our mission to grow and protect your wealth through integrity, passion and knowledge.

How Can Grandparents Help with College Costs?

If your grandchildren are fortunate enough to have you chip in with their college costs, there are a few things you need to be aware of before you start writing checks.

The most straightforward way for a nonparent to help a student pay for college is with a cash gift. Gift tax rules in 2013 allow any individual to give another individual up to $14,000 per year ($28,000 from a couple) without the gift counting against the lifetime estate tax exemption. A problem with this approach is that your contribution will be taken into consideration when the student applies for need-based financial aid. Cash given directly to a student the year before he or she applies may be considered student income, reducing need-based aid by as much as 50% of the amount given. Furthermore, money held in the student's name is treated as a student asset, reducing aid by another 20%. Cash given to the parents also counts against financial aid, albeit at a much lower rate of up to 5.64%. To potentially avoid any financial aid impact with a cash gift, keep in mind that the Free Application for Federal Student Aid takes into account income from the prior year in determining need-based aid. Hence, consider giving the money when you know the student will not be applying for aid next year.

Another approach is to offer to help pay back the student's loans. By waiting until the student is done with school, you avoid financial aid concerns and help ease his or her debt burden as the student enters the workforce. This strategy may be particularly useful for students with subsidized loans, which don't begin to accrue interest until after graduation.

Grandparents may also open a 529 college-savings account in the name of a student. One of the advantages of this approach for the account owner (the grandparent) is that many states offer income tax deductions on 529 contributions, though you must typically make the contribution to your home state's plan in order to earn the deduction. Another benefit is that the IRS allows a five-year acceleration of the gift tax exclusion for such contributions, allowing an individual to contribute as much as $70,000 in a single year to a 529 in a student's name. A disadvantage to this approach is that distributions from a 529 owned by someone other than the student or his or her parents are counted as student income and may reduce the amount of need-based financial aid available by $0.50 for every dollar distribution. Waiting to use 529 distributions from a grandparent-owned account until the student's final year is one way to avoid this problem.

One final option that some grandparents might consider is paying tuition directly to the university on the student's behalf. This has special appeal for those who want to give large amounts but who are worried about gift tax consequences. The good news is that payments made directly to the university to cover tuition are exempt from the gift tax, although additional costs such as room and board are not. Unfortunately, direct tuition payments may be counted as either income against the student's financial aid allocation (reducing it by 50%), or as a financial resource available to the student (reducing financial aid dollar-for-dollar). Hence, this only makes sense for students who are not concerned about need-based aid or if the payment is made during the final year of school.

Tax law is ever-changing and can be quite complex. It is highly recommended that you consult with a financial or tax professional with any tax-related questions or concerns. An investor should consider the investment objectives, risks, and charges and expenses associated with municipal fund securities before investing. More information about municipal fund securities is available in the issuer's official statement, and the official statement should be read carefully before investing. 529 plans are tax-deferred college savings vehicles. Any unqualified distribution of earnings will be subject to ordinary income tax and subject to a 10% federal penalty tax.

Modern Portfolio Theory Statistics and What They Mean

After the 2007-2009 financial crisis, investors have become more attuned to the risk characteristics of investments. As volatility in the market continues, investors are paying more attention to the relationship between the potential for reward and the likelihood of experiencing losses. Modern Portfolio Theory (MPT) is used by many investment professionals to help investors make appropriate investing and asset allocation decisions. MPT is rooted in the assertion that there is no free lunch, as investors can only obtain higher returns if they are willing to take on more risk. Knowledge of MPT statistics such as alpha, beta, and R-squared are useful to understanding and quantifying this risk/reward landscape.

Beta: Although alpha precedes beta in the Greek alphabet, beta is a necessary precursor to understanding alpha. Beta can generally be defined as the risk factor of a portfolio to the market, which is usually achieved through asset allocation. A beta number of 1.00 implies that the portfolio will perform exactly how the market performs. A beta number greater than 1.00 implies that the portfolio will perform better than the market when the market is going up, and worse than the market when the market is going down. Conversely, a beta number lower than 1.00 means that the portfolio is expected to perform worse than the market when the market is going up, and better than the market when the market is going down.

Alpha: Alpha, a measure of the excess return generated by a portfolio that goes beyond the benchmark, is the residual (or skill/luck-based) component of active management, allowing financial advisors to display their value. The benchmark is usually a market index that the portfolio can be compared against to assess its performance relative to the market. If alpha is positive, it means that the portfolio returned more than its expected return from the market, whereas a negative alpha indicates that the portfolio returned less.

Should investors be impressed if a financial advisor is generating positive alpha for their retirement portfolio? In general, yes, being able to generate alpha is touted as the holy grail of investing; it's an indication that your financial advisor has been able to generate an above-average return relative to the risk that he or she is taking on. However, before investors put too much stock in the statistic, it's important to know what these statistics mean, and why they are important. Investors should be cognizant of the fact that a higher beta does not necessarily equate to a higher alpha; a portfolio with a high beta may well sport a negative alpha. This is due to the fact that the greater the risk the portfolio assumes, the higher the hurdle the portfolio must overcome in order to outperform the market.

R-squared: The R-squared value is a number that measures the strength of a relationship (correlation), demonstrating how much a portfolio's performance can be explained by the performance of its benchmark. The higher the R-squared value, the more closely the portfolio's performance can be explained by the index it tracks. The lower the R-squared value, the more likely the portfolio doesn't behave much like its index. R-squared values can range from zero, meaning there's no degree of performance correlation between a market benchmark and a given portfolio, to 100, meaning that a portfolio is highly correlated with the index. More importantly, a higher R-squared number validates the relevance of the alpha and beta numbers.

Alpha and beta are the heart of traditional performance (risk and return) analysis, although they do come with their own caveats and limitations. Investors trying to understand or interpret these MPT statistics are best advised to seek professional investment advice to ensure they are allocating risk appropriately. A better understanding of these statistics can go a long way in making better financial planning decisions.

Frontline for Fiduciary Standard

Millions of Americans--and a lot of professional advisors--are talking about the hard-hitting Frontline expose on retirement plans. The PBS special, entitled "Retirement Gamble," tells you a lot of things you already know: that corporations have offloaded the decision-making for retirement portfolios on their (not always financially sophisticated) employees, but provided virtually no guidance. The 2008 market crash wiped out investors who had naively put their entire retirement savings in stocks and then sold out at the bottom in a panic. Just 14% of Americans are confident that they have saved enough to live comfortably in retirement.

The special report includes a few details that are likely to be shocking to many non-experts, including the fact that 401(k) plans are not provided for free, as many participants believe, and some plans were set up by the mutual fund and brokerage companies who (no surprise here) populate it with their own funds and triple-dip, charging fees for managing the account, and more fees for managing the funds, plus commissions for selling the funds to those naive plan participants. We learn what many professionals already know: that some people pay ten times more in fees drained out of their retirement plan than others.

Interestingly, the PBS report doesn't mention that help may be on the way. The U.S. Department of Labor, which sets the regulations for corporate retirement plans, has mandated that all retirement plans disclose, in writing, the various costs and fees that are being charged to plan participants. These disclosures are now starting to show up in performance statements, and some believe that these rays of sunlight will eventually eliminate the self-dealing and high fees that were exposed in prime time.

The DOL is working on proposals that would require those who give investment advice to plan participants to act in the best interests of the future retirees, and the proposal is expected to ban sales commissions. The requirement--known as a fiduciary standard, or putting the client's interest first--would extend to the IRA accounts that receive the rollover funds from 401(k) and other retirement plans.

Nobody should be surprised that the brokerage industry is lobbying furiously against these proposals, which has caused several delays and at least one incident where the Department of Labor shelved a proposal for "further study" to explore the economic impact on brokerage firms and consumers.

Will the new rules ever be enacted? Sales agents failed to stop the disclosure rules from passage, so their lobbying power is not unlimited. And few unbiased parties would argue with the idea that people receiving advice should be given unconflicted advice, and that sales people should openly disclose the fact that they're selling rather than advising. The Frontline special, showing millions of people how much money has been siphoned out of their retirement accounts into the pockets of larger financial services firms, should help the Department of Labor resist the big moneyed opposition to its efforts to do the right thing for retirees.

Sources:
http://www.lifehealthpro.com/2013/01/29/industry-girds-for-dol-fiduciary-rule
http://www.thefiduciarystandard.org/

Monthly Market Barometer

1 Month, ending April 30, 2013. The U.S. Market returned 1.74% (YTD 12.94%).

The Morningstar Market Barometer provides a visualization of the performance of various stock market indexes. The color scale (red for losses and green for gains) allows you to assess which areas of the market performed strongly and which areas showed weakness for the time period analyzed. The nine-square grid represents stocks classified by size (vertical axis) and style (horizontal axis). There are three investment styles for each size category: small, mid and large. Two of the three style categories are “value” and “growth” while the central column represents the core style (neither value nor growth characteristics dominate). Large-caps account for the top 70% of the capitalization; mid-caps represent the next 20%; and small-caps represent the balance.

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