Investment Accumulation and Preservation

Questions and Concerns:

- How do I build and manage my investments?
- I am concerned with a concentrated investment position.
- There are tax or inflation concerns regarding my investments.
- Am I holding an investment which I would not purchase today?

How do I build and manage my investments?

Investments are simply excess savings. Simply put, these are moneys above savings set aside to cover expenses from mundane home and auto maintenance to taking vacations. Depending on your situation, a recommended saving amount can range between 3-18 months of your monthly income. Such savings can have several purposes such as riding out a slow business cycle, saving for retirement, education or endless other reasons to save. Once you are satisfied with your savings commitments, then investing for the long-term becomes an extraordinary step. You are now moving toward wealth management.

For most individuals, investing is a gradual occurrence and for others it might be a property sale, a salary bonus or other reasons. Typically, the younger you are the more risk you can take. Thousands of investment books have been written on this topic and it is beyond the scope of this brief to cover this broad subject. It is basically understanding you, what you have, what your want and when you want it. Then you should look at how you can get there. Investments discussed in this brief will be using diversified asset allocation programs for individuals who are not inclined to manage their own investments. An investment asset allocation can have representation in various bonds, common stock, real estate and specialty investments also known as alternative investments. Each of these categories can be broken down into more sub-categories. Investments in asset allocation programs can be done in the following ways:

Asset Allocation Mutual Funds – This is generally a fund of funds representing a diversified asset allocation strategy from a fund family. It is an effective way to begin investments for balances less than $50,000. Often there are four to six asset allocation risk strategies ranging from conservative to aggressive. Often they have an investment objective such as: preservation, income, balanced, growth, and maximum growth. They usually have a pie chart to represent the percentage in each category. It is helpful to use Morningstar ratings to select a suitable fund suitable. In addition, avoid funds with management fees greater than 1.5%. If you require a broker to assist you, there will be a load fee as this is how they are compensated. A reputable broker will compare various funds and fees. Class A shares that have an upfront load usually have a lower annual management fee. If there are 12b-1 fees, (on-going sales charges to further compensate the broker) find out its impact on the total management fee. Sometimes this compensation is justified to cover additional financial services.

Asset Allocation Models – This is very similar to the above with the exception that the investment manager or the firm will select the funds in the model. These models usually are open well beyond a mutual fund family and may include exchange traded funds (ETFs). The minimum balances can be from $50,000 and above. The asset allocation model is guided by firm's asset allocation strategies and provides periodic portfolio rebalancing. The fees are usually a percentage on the assets under management. Fees for this service range from .75%-1.75% above the underlying mutual fund management fees.

Portfolio Management Services – A portfolio manager provides a more customized service using individual securities as well as funds within asset allocation guidelines. Selection of the securities is done by the portfolio manager utilizing various disciplines to provide diversification, buy and sell strategy and follows the client's investment objective or an investment policy statement. The portfolio manager works with the investor to consider factors such as income needs, stage of life, income taxes, and inclusion or avoidance of certain securities. Fees are primarily based on a percentage of assets under management and the fees are lower for amounts over a certain balance. For example, a portfolio may be charged 1.25% for first million and 1% for the next million and .8% for the next million.

Terminology – Investopedia.com is a good resource for investment information. Below are some of the investopedia links that help you with understanding the terms and basics.

Asset Allocation	http://www.investopedia.com/terms/a/assetallocation.asp#axzz20E85rhP1
20 Investment Terms	http://www.investopedia.com/university/20_investments/#axzz20E85rhP1Bonds

I am concerned with a concentrated equity position.

Any single security that represents more than 10% of a portfolio is considered a concentrated position from regulators who oversee bank trust departments. Some concentrated positions are more serious concern then others. For example, a 20% position on a two year Treasury bond raises less concern than a 20% position in a single company common stock. Usually this concentration occurs because of three reasons: 1) this could be a "home run" investment and continues to appreciate, 2) the tax basis is low and is subject to significant capital gains tax and 3) this was a gift or inheritance for which you have an emotional attachment.
It is should be remembered that stocks go from a growth to a maturity stage and one should look to harvesting the gain. Don't let your harvest "die on the vine". Accept the payment of taxes as part of your cost of harvesting. Perhaps it was a gift from your grandfather who helped found Kodak. Do you think your grandfather would hold Kodak today if he saw what was happening to film photography? He would most likely rotate the crop.

It is recommended to work with your investment advisor to explore methods of diversifications. If the concentration is over $1million then a specialist should be used to discuss various vehicles to protect the stock value or to provide a diversification strategy.

Are there any tax or inflation concerns regarding your investments?

<u>Tax Concerns</u>
Taxes should never be the primary driver of your investment decisions. You should be mindful of methods to the most tax efficient way to trade a position that accomplishes your goal as well as providing tax benefits. Below are some of ideas to discuss with your investment and tax advisors.
Deferring short-term gains into long term gains – Short-term capital gains (realized gains on a sale of stock purchased one year or less) are subject to ordinary income with the top tax rate at 35% plus state

taxes. As of 2012, long-term capital gains are taxed at a maximum rate of 15% for realized gains on a sale of a stock purchased more than a year ago. Knowing when it is best to sell means significant tax savings. If you have a significant short–term gain and want to lock in the price to revert to long-term gain, then discuss with your investment advisor the use of stock options to insure the price of the stock. The cost of the stock option depends on the volatility of the stock, the spread between the buy and sale, and the length of time.

Offsetting gains with losses – Prior to the end of the year, review your unrealized gains and losses with your investment and tax advisor and determine if there is any tax benefit to offsetting stock sales. Be mindful that for tax purposes a sale of a particular stock cannot be repurchased in 30 days to realize the taxable loss.

Donating appreciated stock – If you intend to make a tax deductable charitable gift in cash, explore with your advisors the concept of giving appreciated stock. By giving appreciate stock you may get the full tax deduction, preserve your cash and avoid the capital gains tax.

Final note – There are many other tax strategies and Congress can make abrupt changes. If you are preparing your own taxes consider a tax advisor. At the least look at the offseason of major tax preparers such as H&R Block. Seek those individuals at that firm who provide educational training to their staff. They can provide additional ideas and run various scenarios on their tax programs.

Inflation Concerns

Inflation concerns about eroding your future purchasing power is a true risk of holding cash and short-term fixed income securities. The problem is that it is not prevalent until five or more years. It is not just the higher price of goods and services; there are state and local government that are under budget pressure to raise income, property and sales taxes. The key to action is to be aware of the inflation rate on your investment by determining your real rate of return by using the following form.

Interest Rate on Investment	
Less Income Tax (Tax Rate times Interest Rate)	
Less Inflation Rate*	
Real Rate of Return	

*Inflation Rate Link	http://www.usinflationcalculator.com/inflation/historical-inflation-rates/

If your real rate of return is negative then inflation is dragging your return. In addition your real rate of return may further reduced if there is a management fee in addition to taxes and inflation.

Knowing your net worth, reserve needs, cash flow and time horizon will give you confidence to seek investment options to mitigate inflation risk.

Am I holding an investment that I would not purchase today?

This is a question for astute investors who are very experienced and expert in a particular area of investment. However, these individuals do not exactly follow their own advice. For example, this person may provide a compelling argument why it is not prudent to buy real estate because the market is overvalued, yet, oddly enough they maintain a sizable real estate holding. Consider disposing an investment holding that you would not purchase today.

How can a financial planner assist in investment accumulation?

A financial planner looks at a person's complete financial situation to help structure an investment program that is suitable to their needs and goals. They can structure a plan to accumulate their investment assets, provide guidance on concentrated positions, put taxes and inflation in perspective and discuss with the client the rational of holding an investment they would not purchase today.

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