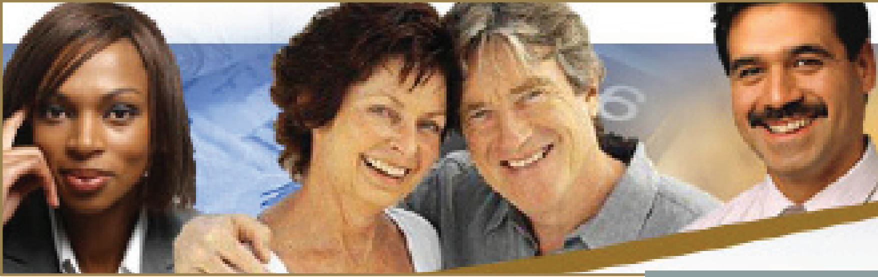

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Volume 7 | Issue 3 | May-June 2010

NAPFA Planning Perspectives

NAPFA
The National Association of Personal Financial Advisors

More than 400 NAPFA members attended the National Conference in May in Chicago for presentations about investments, estate planning, insurance, communications and more.

Watching Your Investments

The last few months have been very difficult for major stock markets around the world. Some experts point the finger at the economic crisis in Greece as the trigger for falling stock prices, while others point to other factors. Investors are wondering whether the next shoe will drop, given that the economic recovery seems so fragile.

Yet, as hard as it is to maintain perspective, it's important to remember that the short-term dips in the market are just that: short-term. Successful investors maintain a long-term perspective, stay diversified, and don't react emotionally to every fluctuation. Those are the basics of being a smart investor.

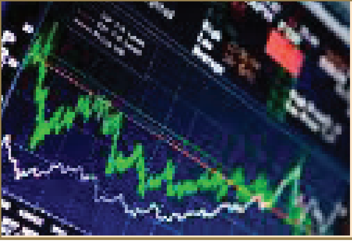
This issue of *NAPFA Planning Perspectives* goes beyond the basics. We look at the psychology of investing, the pros and cons of being a "green" investor, and the hidden costs of some types of mutual funds. Along the way, we puncture some myths about how to be an effective investor. We hope you find the articles to be interesting and valuable.

Free Webinar Series Continues

NAPFA's free consumer webinar series will continue throughout the summer with hour-long sessions on critical personal finance topics. All sessions are free, but participants must register in advance at http://www.napfa.org/consumer/ConsumerWebinarSeries.asp.

On July 2, NAPFA member Carolyn McClanahan, CFP®, will explain the impact of the national healthcare reform bill that was passed by Congress earlier in the year. An M.D. as well as a financial advisor, McClanahan has a deep understanding about healthcare from all angles—cost and availability of insurance, changes in care delivery, and tax implications. The session will be held from noon to 1 p.m. Central time.

NAPFA also has online archives of every prior webinar. If you need information about financial planning for small-business owners, leaving a legacy, managing your 401(k), and many other topics, check out the webinar archives at http://www.napfa.org/consumer/ArchivedSessions.asp.



Stock Market Returns and Your Portfolio: Accentuate the Negative?

By Tom L. Posey, CFP®, JD   www.fposeycapitalcom

Generally, a positive outlook is good for you. It's probably helped many parents raise their teenaged children to adulthood, for example, without changing the locks on them even once.

But when it comes to expected returns on your investments, it's best to be as realistic as possible. "The faith in fancifully high returns isn't just a harmless fairytale," wrote Jason Zweig in one of his January 2010 *Wall Street Journal* columns. He examined the expectations of trustee-level investors, economic professors, seasoned investment advisors, and fellow financial journalists, and he received opinions on hoped-for long-term market returns (after inflation, expenses, and taxes) ranging from an anemic 0.5 percent per year to a feverish 22 percent per year.

Overall, the data suggest that most investors' expectations are too high. Way too high. Zweig cited a 2009 nationwide survey that indicated investors were expecting annual U.S. market returns of 13.7 percent during the next 10 years. He quipped, "What are we smoking, and when will we stop?"

What sort of long-term return expectations would be realistic for stocks? Lacking a crystal ball, single-digit returns seems a far more prudent assumption than anything even close to double-digits—especially if inflation stays as low as it is now.

Here's why. According to financial economics, stock returns are driven by the "equity premium," which is the amount that stocks earn above the risk-free rate of one-month Treasury bills. The risk-free rate, in turn, is the rate earned above inflation. Translating that into a simple equation, it looks approximately like this:

Rate of Inflation + Risk-Free Rate + Equity Premium = Expected Stock Returns

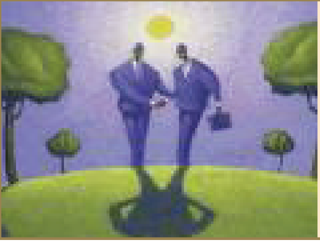
Current inflation rates are around 2.2 percent. Historically, the risk-free rate has earned about 0.7 percent. (It's a relatively small return, precisely because it's essentially risk-free.) Conservatively, the equity premium has hovered at around 4.8 percent over long time periods. So, plugging in these numbers:

2.2% + 0.7% + 4.8% = 7.7%

Will your expected returns be exactly 7.7 percent? Of course not. For one, the math is based on historical returns, and nobody can predict the future so accurately. In addition, most investors temper their equity investments with fixed income, which offers a more stable ride, but also lowers expected returns.

The point is, particularly if inflation stays so low, the average rate of return on stocks over the next 20 years won't be anywhere near 22 percent. It probably won't approach the average U.S. investor's expectation of 13.7 percent over the next decade, either.

Does 7.7 percent sound low to you? If so, consider that this is 5.5 percentage points more than the current rate of inflation. That means, with a long-term, compounded rate of return of 7.7 percent for the equity portion of your portfolio, you should still be able to beat inflation by quite a lot and build real wealth through appropriate portfolio construction.



Exploring Facts and Myths About Dollar-Cost Averaging

By Michael Chamberlain CFP® www.chamberlainfp.com

"Dollar-cost averaging" (DCA) is a methodology to invest money that reportedly decreases certain risks. Unfortunately, there is a great deal of misunderstanding about DCA and the validity of the process.

The goal of DCA is to lower total average investment costs per share over time. A person invests a set amount at predetermined times, thus purchasing more shares when the price is low and fewer shares when the price is high.

Example: You just inherited $20,000, and you decide to invest it in the stock market. Once you have determined a proper asset allocation (mix of investments appropriate for your risk tolerance, risk capacity, and goals), you could invest it all at once or do dollar-cost averaging by purchasing a set dollar amount of securities at predetermined intervals. An example for investing your $20,000 inheritance would be investing $1,666.67 on the first of each month for 12 months.

DCA is NOT the same as a putting a pre-determined amount into your retirement savings on a regular basis. Using the same $20,000 figure, in a savings program you would save $1,666.67 a month from your income so that at the end of the year you would have invested $20,000. This can be a great idea for building retirement savings and regular investment accounts, but it is not the same as DCA.

The first issue with DCA is that no one makes an investment expecting the price to go down. But DCA works "better" if the share price falls lower in the future than it is currently. However, historic price information has shown that the stock market goes up more often than it goes down. That being the case, investors who use DCA would be better off the majority of the time to have invested earlier, rather than over a period of time.

The second problem of DCA is that it fails to address the higher transaction costs (dollars and time) of making more numerous, smaller acquisitions. This may be why many investment companies encourage you to cost average; they earn higher fees.

If you search on the term "dollar-cost averaging" online, you will find highly favorable comments that are not always supported by financial research. Here's an example from About.com's article, "Investing for Beginners," by Joshua Kennon. He writes, "DCA is a technique that drastically reduces market risk."

Not only does Kennon not cite any evidence for his statement, but one can find highly reputable economists who do not support the use of DCA strategies. Nobel Prize winner Kenneth Fama states that if you have determined the proper allocation for your investments, you are better served to be in the proper allocation sooner rather than later. DCA can delay reaching that proper allocation. Fama believes that DCA is a method to "ease the investors' worries of making a larger investment in the market versus a number of smaller investments over time."

While easing worries is a legitimate benefit of DCA, let's not confuse it with improving investment performance.

Do Green Investments Deliver?

By Donald E. Askey, CFP® *www.providentadvisory.com*

One of the results from the 2009 worldwide Summit on Climate Change in Copenhagen has been renewed interest among investors in green and clean-energy technology and the companies poised to benefit from this interest. Is that interest sustainable enough to justify reevaluating your own investments if you share those environmental and social values?

Each of us wants our investments to be aligned with our values. After all, values-based alignment is the very purpose of good financial planning and the promise of good financial advisors.

Many of the most attractive green companies today, especially those developing solar and wind technologies, are small and young. Their research and development has been temporarily spurred by the keen political interest in alternative energy. "How long will this political interest be sustained?" the long-term investor has to ask.

Many of the mutual funds specializing in alternative energy have erratic track records. This is not surprising, as almost any single sector in our economy demonstrates high volatility. An investor cannot practically be diversified if he or she is over-concentrated in one sector.

If we stretch our concept of "green" beyond the environment or climate to include corporate governance responsible to society, then opportunities arise for us to increase investment diversification. Instead of limiting the screen to alternative-energy companies, we could include companies whose labor policies or executive-compensation policies we believe are more congruent with our values.

However, even when we expand the pool of socially responsible investments (SRI), we are challenged by diversification limitations. These limitations translate into greater volatility and, among mutual funds, greater expenses. This is not to say that SRI leads to underperformance, but it certainly leads to riskier investing.

Most of us want our dollars to be used in ways that benefit us without causing injury or harm to our environment or society. But for the individual investor, over-emphasizing green or socially responsible investing carries a risk. Investing "green" might be more prudent as a sideline or satellite strategy, not as a core strategy.

Also, it is important to keep in mind that by buying shares in a green company or in a green mutual fund, the individual investor has no direct impact on the environment, on pollution, or on the conduct of any company. As individuals, we have a greater impact on the environment by recycling and by buying green. Nor should we overlook old-fashioned political activism.

Avoiding the High Cost of Mutual Fund Turnover

By Joseph Alfonso, CFP®, ChFC *www.aegisadvisory.com*

The *Wall Street Journal* recently published an article that referenced the performance of the CGM Focus mutual fund. The paper reported that the fund was the decade's best-performing mutual fund, rising more than 18 percent annually, yet investors in the fund experienced a yearly loss of 11 percent during this same period. How could this be?

The CGM Focus Fund illustrates the issues with mutual funds that have excessive "turnover." Turnover is the rate at which a fund's holdings change every year. A turnover rate of 50 percent means that half of the stocks held by a fund are completely replaced within one year.

The typical managed mutual fund has a turnover rate of 85 percent. Index funds, which hold all the stocks in a stock market index and do not sell unless the index itself changes or in order to generate cash for redemptions, typically have turnover rates in the single digits. According to Morningstar, CGM Focus Fund's turnover rate was an astonishing 504 percent, meaning that its entire portfolio was being replaced five times over the course of a single year!

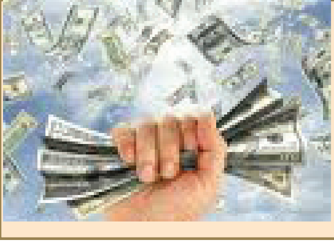
In addition to generating excessive taxable gains in non-deferred accounts and driving up trading-related costs, high-turnover funds can have one more negative effect: they can be very volatile. If they are volatile, the actual return experienced by fund investors is often lower than the internal return of the fund itself because fund's volatility increases the likelihood that investors will buy and sell at inopportune times.

When asked about the great disparity in fund performance vs. investor performance, CGM Focus Funds' manager Ken Heebner replied, "A huge amount of money came in right when the performance of the fund was at a peak. I don't know what to say about that. We don't have any control over what investors do."

Would You Do That With Your Own Money?

I would argue that, while a fund manager might not be able to control investor behavior, any fund manager realizes that increased volatility also increases the likelihood that investors will buy high and sell low—and suffer in the process. John Bogle, founder of the Vanguard Group, Inc., which has long been a leader in low-cost index funds, certainly feels differently than Heebner. In a recent interview, Bogle railed against funds with turnover rates of 100 percent or more annually. "Would you do that with your own money? Do you think those managers would do that with their own money?" Bogle pointedly asked.

Like Bogle, I feel that the best approach is to work with investments that are low-cost, tax-efficient and have low turnover as part of a long-term approach aimed at achieving a fair, market-rate of return. The issues raised with the strategy of funds like CGM Focus illustrate why a market-rate approach is highly compatible with a fiduciary standard of care that places a client's best interests first at all times.



How We Can Be More Intelligent Investors

By Gary R. Smith, PhD, CFP® www.pleasantonfinancial.com

As we learn from experience or from seasoned investors, we begin to weigh available information in more intelligent ways and avoid counterproductive behavior. Then we can be more successful as investors and progress more rapidly towards our financial goals. Let's look at some common statements made by investors, what they indicate about the investors' thought processes, and our suggestions for how to make more intelligent decisions.

That stock is worth less than when I bought it. I'll sell it when it recovers.

People often hold onto a failed investment far too long, thus missing opportunities for better investments. This occurs because humans tend to feel the pain of a financial loss more acutely than the joy of a gain.

An investor who thinks about the price at which a purchase was made is focusing on the past performance of the investment. Advisors use knowledge of past market cycles and current economic trends to explain our expectations of future performance. We can't change the past, but we can work to improve the investor's future.

I've lost thousands of dollars on that investment. I can't afford to lose any money.

People tend to think about each investment separately, rather than as a part of a total portfolio. In addition, they sometimes focus on the amount of wealth they have, rather than on their ability to cover expenses or achieve other financial goals. Advisors counsel their clients that better investment decisions arise from having a broad financial view.

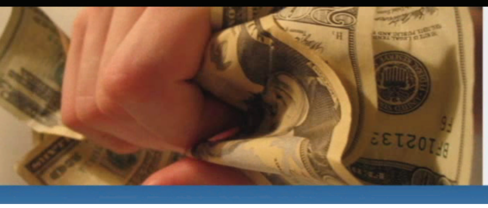
That fund has been down for two years. Why would I want to invest in something that is losing money?

Humans naturally assume that current conditions will continue. Knowledge and discipline are required to anticipate cycles and to operate in an environment where random events determine results. Advisors can help clients envision an end to a downtrend in prices so that clients can understand why their stock and bond holdings should be maintained or increased.

I can't believe I bought that crummy stock. I should have known it was overpriced and ready to tank.

Investors can rarely recreate the mental context in which earlier decisions were made. Advisors can remind clients about issues that affected those decisions but are now almost forgotten. In this way, everyone can see that decisions had a certain logic at the time and that no one should feel blame or embarrassment that decisions didn't work out as hoped. No investor is successful 100 percent of the time.

We each have tendencies to fall into mental traps. Avoiding them can allow much greater investment success, as well as greater comfort with the often stressful activity of investing. Financial advisors can help their clients to be better investors, simply by acknowledging the difficulties that we all feel to some extent and by explaining the reasons for taking actions that seem illogical. Other clients might choose to limit the time they spend on investment activities and delegate to their advisors the authority to make investment decisions.



Briefly Noted…

Commodities: Investing Cautiously Can Pay Dividends

Investing in commodities used to be: Make a fortune, or lose your shirt. But commodity investing has tamed in recent years through broad-basket ETFs, and almost all investors should have commodities in their portfolio.

Commodities are volatile—but volatile in a good way. They tend to zig when your equity positions are zagging, and they can lower the overall volatility of your portfolio. Commodities can not only improve the stability of your overall portfolio, they can boost returns over the long-term, provided you periodically rebalance—adding to your position when prices are down, and trimming back when they're up to keep your allocation steady.

Here are a few tips:

- Invest in a broad basket of commodities via an ETF, ETN (exchange-traded note), or mutual fund that tracks an established broad index, covering metals, livestock, textiles, food, and energy.
- Don't invest in single-commodity niche instruments such as gold or oil. Even pros have a poor track record in forecasting one commodity's movements.
- Start slowly. Start with 5 percent to 10 percent of your portfolio and watch the behavior of your overall portfolio—not just the commodity portion—as the pieces all act in concert.
- Don't go too far too fast. If you happen to invest in commodities at just the right time, you might rack up a very nice short-term profit and be tempted to add more. But that is often exactly the wrong move, as a sharp increase in prices may mean it's time to trim your holdings, or at least stop adding to them. Conversely, you might see a sharp price drop and be tempted to sell your position—an equally bad move. Remember, rebalancing imposes a discipline on yourself to systematically buy low and sell high.

-- By Jerry Miccolis, CFP®, CFA®, www.brintoneatoncom

What If We Run Out of Drinking Water?

Did you know that the amount of potable water available today is the same as it was 10 million years ago? What's different—six billion people. The International Food Policy Research Institute says that by 2020, an additional two billion people will be in competition for the short supply of water.

Water shortages can potentially create global tensions. Some experts predict cartels for water instead of oil. This may generate long-term investment opportunities, too, as water becomes a global business.

A few facts to consider:

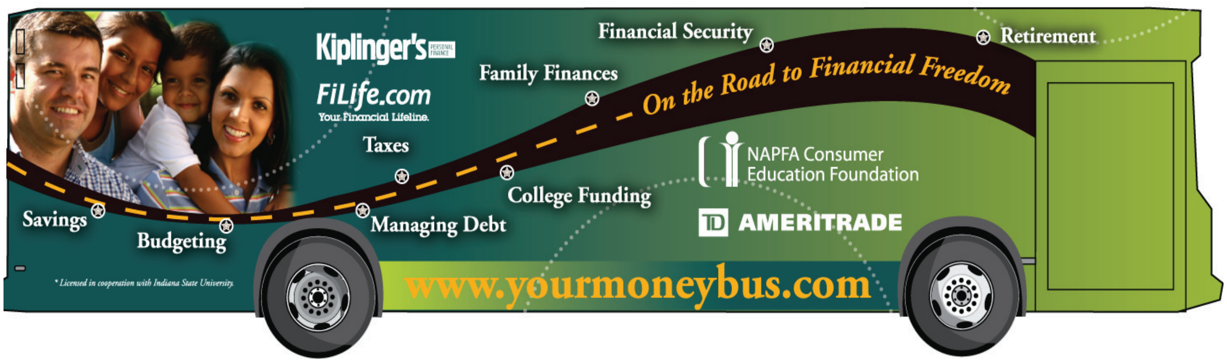
- 97 percent of the world's water is non-potable salt water, and 70 percent of potable water consumption is for inefficient agricultural purposes, according to the World Health Organization and UNICEF.
- In most areas of the world, water is a more precious commodity than oil. A gallon of crude oil typically is in the range of $1.00-$2.00 per gallon. Evian water is typically $10 or more.
- China has about the same amount of water as Canada, but with a population 40 times larger. India has 18 percent of the world's population but only 4 percent of its water resources.

-- By Jill Hollander and Brian Pon, www.FinancialConnections.com

www.NAPFA.org

Consumer Education

Watch for our Your Money Bus in your town...



YourMoneyBus Tour will be making 9 more stops across the country this summer and fall. Check the schedule below to see when it will be in YOUR TOWN. Check back often for updates of events. Visit us at www.yourmoneybus.com

Portland, OR	6/17/2010-6/19/2010
Colorado Springs, CO	7/7/2010-7/9/2010
Kansas City, MO	7/22/2010-7/24/2010
Omaha, NE	8/5/2010-8/7/2010
Wausau, WI	8/19/2010-8/21/2010
Milwaukee, WI	9/9/2010-9/11/2010
Indianapolis, IN	9/16/2010-9/18/2010
Detroit, MI	9/23/2010-9/25/2010
Washington, DC	9/30/2010-10/2/2010

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