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Top Wall Street Strategists Wrong Again On Sectors

Every December, Wall Street's top strategists launch a media blitz to tell investors where to put their money. Articulate, attractive and extremely high-paid spokespeople appear on Fox Business News, CNN, and CNBC and get quoted in magazines, newspapers, and financial websites. How do their picks pan out? Not too well.

Among the most respected financial publications to ask Wall Street for its most favored and feared stock sectors is Barron's, a jewel in the Dow Jones & Company media empire owned by Rupert Murdoch that includes The Wall Street Journal. Founded in 1921, Barron's is named after Clarence W. Barron, described on Wikipedia as "one of the most influential figures in the history of Dow Jones and considered the founder of modern financial journalism." Barron's is known for its investigative reporting, incisive analysis, and cutting commentary from Alan Abelson, one of financial journalism's all-time great columnists.

But for all its sophistication, Barron's falls into the trap that most financial media succumb to: it quotes experts who try to predict the future.

Maybe it's because it sells papers and gets viewers, or maybe the financial press actually believes some people can predict the future. While you could speculate about the motive, what's certain is that the vast majority of the financial press wants investors to believe that these gurus can tell you which industry will soar over the next year and which will plunge.

For the record, it is the opinion of this firm that no one can predict the future. We certainly can't. Our prescription for investment success relies on broad diversification rather than trying to pick the hottest sector. That's one of the reasons why this firm is independent and not part of the Wall Street forecast machine. While Wall Street's top ranked strategists may get some bets right some of the time, we are not in the prediction business. Data from Fritz Meyer Economics Research confirms our approach is sound.

Fritz Meyer, an independent economist who has worked in the investment business for over 30 years, including a long stint as a strategist at a large mutual fund company, has methodically tracked Barron's annual interviews with Wall Street's top strategists for over a decade. His scorecard shows just how bad Wall Street's strategists are at predicting the best and worst industry sectors.

The accompanying table compiled by Meyer shows the picks and pans of 10 senior strategists from Wall Street largest firms in a Barron's article from December 19, 2011. Telecommunications, for example, was favored by just two of the 10 strategists in the weekly magazine's 2012 investment outlook. One strategist suggested avoiding the sector while seven — a majority — voiced no opinion on telecom. Surprise: As of mid-August 2012, telecom was the No. 1 performing sector, with a 19% return. "That's a big miss," says Meyer.

(Continued on page 4)

Market Uncertainty Continues, But There Are Some Certainties

Though recent gains have provided some relief, the stock market remains volatile due to economic and political headwinds.

Europe continues to negotiate bailouts of its weaker economies and is facing recession, while fiscal and political uncertainty in the United States has continued. As is usually the case with stock investing, there is little certainty about the next move up or down by the market.

You might take some comfort in the old saying, "The markets climb a wall of worry." They have been making this climb as of late.

While the market's uncertainty continues — and almost always will remain uncertain in the short-term — we can find some certainty elsewhere: taxes. To paraphrase another old saying, it is one of the things in life that is certain.

We encourage you to focus on year-end tax planning right now. Those in the 15% Federal tax bracket or lower have an expiring opportunity to pay zero Federal capital gains taxes on sales of appreciated securities this year. The window of opportunity closes at the end of 2012. Please contact us if you wish to discuss these issues and how you might be able to position yourself and find opportunities to lower your tax burden.

Another thing that is for certain: We're thankful for the wonderful clients with whom we work, for the new clients who have recently joined us, and for your continuing confidence and referrals.

Judy

Should You Consolidate Your IRAs?

Everyone's financial situation is different, but people at various stages of life often share similar concerns. Here's a question from a client we encountered under such circumstances:

"I am in my 60s and recently retired from my full-time job. Over the years, I've opened several traditional IRAs and a Roth IRA. Also, I have a 'rollover IRA' with funds from a 401(k) at a previous job. Should I consolidate all of these IRAs into one for tax purposes, or should I just leave things the way they are?"

While there is no real tax benefit one way or the other, there is a trap to watch out for if you do consolidate. Combining the assets of your traditional IRAs into a single IRA could provide a few advantages, however.

For starters, it may be more flexible and cost-efficient to have just one IRA, as well as relieving you of considerable clutter if you're still receiving paper statements from all of your IRA custodians. Also, if one IRA has provided better investment returns than the other or offers other advantages, it might make sense to shift more funds to the IRA with those advantages. (Of course, past performance is no guarantee of future results.) And you may find it easier to coordinate your plans for retirement, and focus on your main objectives, with a consolidated IRA.

Moreover, consolidating accounts might help you avoid a complication that can arise when you start taking "required minimum distributions" (RMDs) from your traditional IRAs. The law mandates that you begin taking RMDs no later than Apri1 1 of the year following the year in which you turn age 70½. These withdrawals from your account, the amount of which is based on life expectancy tables, must continue annually for the rest of your life. If you have several IRAs, you'll have to choose the source of your annual RMD. It can come from one or multiple IRAs. But no matter how you arrange the distribution, the IRS treats it for tax purposes as coming from all of your IRAs on a "pro-rata" basis.

Let's say you have four IRAs with a combined value of $500,000, and this year you withdraw $20,000 from one of them. The applicable percentage is 4% ($20,000 divided by $500,000), so it's calculated as if you had withdrawn 4% of the balance in each IRA. Consolidating your IRAs would eliminate any confusion.

Finally, be aware that you can't commingle the funds in traditional and Roth IRAs. This is the trap we alluded to earlier. Because Roths have an edge over traditional IRAs—qualified Roth distributions are tax-free and you don't have to take lifetime mandatory distributions—you wouldn't want to put them together anyway. Should you consolidate all of your Roth IRAs? Many of the same considerations that apply to combining traditional IRAs also are applicable to Roths. ●

Two Investment Principles In Tandem

Diversification and asset allocation are twin building blocks of a solid investment foundation. Though the concepts are closely related, understanding each rather than just mixing them together can help you make the most of both. Consider these basics:

Diversification. This is the method of spreading out investment dollars among different categories, or "baskets," in order to reduce your overall risk. For instance, even if you're 99% sure that a particular stock is about to take off, you don't want to invest your life's savings in only one stock. There's still a chance it will tank, leaving you in a financial hole you may never get out of. Similarly, you want to avoid putting all of your investment dollars in a single basket—stocks, bonds, or copper, say—no matter how fundamentally sound the category may seem.

Diversification may work because different kinds of investments tend to rise and fall at different times. If you hold a variety of investments, some may do well when others stumble. Additional benefits can come from diversifying within categories—by spreading your stock investments over many industries and also holding shares in foreign companies. By the same token, you'll probably want to own different kinds of bonds with various maturities. Yet while broad diversification may help your investments weather a worst-case scenario, it can't protect you from losses, especially in a declining market.

Asset Allocation. Closely related to diversification, asset allocation goes a few steps further. Here, you seek to divide your holdings among major investment categories based on a set percentage for each category. Because each group has a unique combination of historical risks and returns, it's expected that each also will perform differently in the future.

Year-End Tax Planning: Go Against The Grain?

For the first time in recent memory, year-end tax planning will feel like "Alice in Wonderland" in 2012. Many basic tax strategies won't make sense this year. Instead of the tried-and-true philosophy of accelerating deductions into the current year and deferring income to the next year, you may be inclined to do the exact opposite: defer deductions to 2013 and accelerate income into 2012.

The reason for this "Mad Hatter" approach is that federal income taxes are going up next year (barring any last-ditch legislation from Congress). Besides increases in ordinary income tax rates, the current rates for long-term capital gains and dividends also will be raised, effective January 1. In addition, certain high-income taxpayers will face a new 3.8% Medicare surtax on investment income, plus a new 0.9% surtax on wages, beginning in 2013.

Here are several year-end tax planning ideas for 2012 that defy conventional wisdom:

Capital gains. Usually, investors focus on harvesting tax losses from securities sales at year-end. Capital losses can offset capital gains, plus up to $3,000 of ordinary income, and any excess loss can be carried over to the following year. But this year you might emphasize harvesting capital gains, not losses. For 2012, the maximum tax rate on net long-term capital gain is 15% for high-income investors. That rate is scheduled to increase to 20% in 2013. The rate in 2012 for investors in lower brackets is 0%, and will jump to 10% or 15% in 2013.

State and local taxes. In the past, you may have prepaid state and local taxes due in January to increase your deduction for the current year. However, because deductions likely will be more valuable to you in 2013, when they will offset more highly taxed income, hold off on this strategy.

Charitable gifts. Similarly, a standard approach is to give gifts to charity in December, thereby increasing your charitable deduction for the current year. A donation made by credit card is deductible if it's made in December—even if you don't pay off the charge until January. However, you might decide to wait until next year to make large charitable gifts, when the tax write-off will be more beneficial.

Medical and dental expenses. This is a little trickier. For 2012, you can only deduct medical and dental expenses that exceed 7.5% of your adjusted gross income (AGI). But the AGI floor is being raised to 10% in 2013 for individuals under age 65. Basically, you should try to shift nonemergency expenses to the tax year in which you have the best chance at a deduction. If it's clear you'll surpass the 7.5%-of-AGI floor in 2012, by all means accelerate medical expenses into 2012. Otherwise, you might as well defer expenses to 2013.

Year-end bonuses. Normally, you would benefit from receiving a year-end bonus in January instead of December. That effectively enables you to defer tax on the bonus for another year. However, with tax rates increasing in 2013, high-income employees might arrange to receive an annual bonus before January, so that it likely will be taxed at a lower rate.

Self-employed income. In the same vein, if you're self-employed, you can accelerate income into 2012 by invoicing earlier in the year, instead of waiting until late December or January. Any extra income you receive this year will be taxed at the current rates rather than the higher rates scheduled to take effect in 2013.

Mortgage interest. One common year-end strategy for homeowners is to pay the mortgage installment due on January 1 of the following year in December of the current year. The idea is to increase your mortgage interest deduction by making a13th mortgage payment during the year. But unless you expect 2013 to be a low-income year, you may want to bypass this strategy in 2012.

Roth IRA conversions. If you convert a traditional IRA to a Roth IRA, you must pay tax at ordinary income rates on the value of the converted assets on the conversion date. Assuming a conversion otherwise makes sense for your situation, you might benefit from making the switch in 2012 instead of 2013 to reduce the tax hit, even though that means you have to pay the tax sooner. Alternatively, you could begin a series of partial conversions that take your projected top tax brackets for future years into account.

These are just a few ideas to consider. Of course, the year-end tax moves you make, or don't make, depend on your personal situation and the guidance of your tax advisor. ●

This is diversification with a little more science. Because it's likely that if one category loses value, another may be on the upswing while a third holds steady, devoting an appropriate percentage of your portfolio to each can keep your portfolio in balance.

Yet there's also a lot of art involved in asset allocation. Choosing the best percentages for your circumstances requires looking at several variables, such as your objectives, age, health status, amount of assets, and tolerance for risk. And because your goals are likely to shift, allocations need to be reevaluated and adjusted periodically. Typically, your choices will become more conservative as you near or reach retirement.

Asset allocation provides a rigorous method for achieving diversification in your investment portfolio. Having the two ideas working smoothly together can help you move closer to your financial goals. ●

Wall Street Stratagists Wrong

(Continued from page 1)

Wall Street's Top Strategists Wrong Again

	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Technology	Materials	Telecom Services	Utilities
Federated	👍	👎	👍	👎		👍	👍	👍		👎
Blackrock				👎	👍		👍			
Barclays Capital		👎	👍	👎	👍		👍	👎		👎
Putnam				👎[1]		👍	👍			
Goldman Sachs	👎	👍				👎	👍	👎	👍	
JPMorgan	👍	👎		👍	👍	👍	👍	👍	👎	👎
Citibank	👎	👍				👎	👍		👍	
Morgan Stanley	👎	👍			👍	👎				👍
Prudential	👍			👎		👍	👍	👎		
Merrill Lynch		👍		👎			👍	👎		
2012 Sector Returns YTD[2]	+14%	+10%	+4%	+15%	+11%	+9%	+18%	+7%	+19%	+4%
Sector Ranking By YTD Return	4	6	9	3	5	7	2	8	1	10
Comment	Big Miss		Mistake	Big Miss			Good call		Big Miss	Good call

Source: Fritz Meyer Economic Research

Forecasts published in Barron's, Dec. 19, 2011. [1] Big money center financials. [2] Through August 13, 2012.

Conversely, nine of the 10 strategists in the story liked technology stocks, and this sector gained 18%, as measured by Standard & Poor's 500 Industry Sectors. That happens. It's random, however, and unpredictable. "If you think that even the smartest strategists on Wall Street can successfully and systematically pick the right asset classes, you'd be mistaken," says Meyer. "Forecasts, even by the top-ranked strategists, are extremely problematic."

Point is, no one has shown the ability to predict systematically that growth stocks will beat value stocks, small caps will beat large-caps, or dividend-paying stocks will outperform. Anyone can have a hot hand, but it's unsustainable. "There has not been a year that the Wall Street strategists, as a group, have added return with their calls to outperform the S&P 500 stock index," says Meyer.

Broad diversification, periodic rebalancing, and choosing low-expense investments — while relying on the precepts of Modern Portfolio Theory — is a prudent path. ●

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