Stafford Wells Insights

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Politics and Investment Performance

With the Nov. 2 elections come and gone, here's the result of an investigation into the relationship between the composition of the legislative and executive branches of the U.S. government and market performance. The data table displays the average annual returns for the S&P 500® and a 60% stock/40% bond portfolio in three different situations. The "unified" situation refers to years when the Senate, the House of Representatives, and the White House were all controlled by the same party. The "partially divided" situation represents years when the House and Senate were controlled by the same party, but the White House was held by a different party. The "completely divided" situation uses data from years in which the two houses of Congress were divided. Both the S&P 500 and the diversified portfolio averaged the highest returns during unified years, lower returns during partially divided years, and the lowest under completely divided years.

Average Annual Returns
1926–2010

	S&P 500	Diversified portfolio	Number of years
"Unified" years	14.8%	9.9%	45
"Partially divided" years	11.1%	9.5%	30
"Completely divided" years	1.0%	6.8%	10

Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Diversification does not eliminate the risk of experiencing investment losses. Government bonds 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 time period examined is 1926–2010, and the returns are average annual returns.

Stocks—Standard & Poor's 500 index, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds—20-year U.S. government bond.

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Personal wealth management.
A fee only registered investment advisor

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Advisor Corner

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Susan Templeton is the founder of Stafford Wells Advisors, a wealth management firm investing globally for high net worth individuals and corporate retirement plans. Stafford Wells was founded in 2008 with the mission of delivering independent, complete, unbiased investment advice free of any conflicts of interest. Susan Templeton has more than twenty years experience in investment management.

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Common Investing Mistakes

Almost all of us have made investing mistakes. The key is not to make the same mistake twice. These mistakes can directly affect whether or not you achieve your desired goals. By repeating even just one mistake, individual investors can quickly become their own worst enemy. Below are some common mistakes that many fall prey to and some suggestions on how to sidestep them.

Starting Too Late

The first mistake a large number of investors make is waiting too long to initiate a long-term investment plan. The earlier you can start the investment process, the more likely it is that the plan will succeed. For example, let's consider two investors—Bill and Tim. Bill began investing $5,000 per year 30 years ago. Tim began investing $10,000 per year 20 years ago. Assuming a hypothetical return of 10% per year, Bill's ending wealth value was $822,470 compared to $572,750 for Tim. Thanks to the power of compounding, a small amount of money, wisely invested early on, can turn into a large sum over time. Avoid procrastinating; start investing today.

Lack of Diversification

By investing all of your money into just one asset class, industry, or company, you are placing all of your eggs into one basket—and this can be extremely risky. It is better to combine a variety of investments, such as stocks, bonds, and cash, which are unlikely to move in the same direction. Your risk exposure should be lessened as a result.

Chasing Past Performance

Yesterday's hot stocks or mutual funds may not be today's best investments. A good number of investors purchase assets when they have already reached their peak, only to watch their performance subsequently suffer. It may be a good idea to choose investments with a history of good performance as well as quality management.

Lack of Research

No matter what type of investment you plan to make, be sure to conduct the proper research. It is unwise to allocate your money to an investment you do not understand. There are a number of helpful resources that you can explore—ranging from public information to professional advice. Take advantage of these when possible.

Unrealistic Expectations

Many investments require time to grow. Investors often become frustrated with the early performance of their investments, decide to sell too quickly, and move the proceeds into other investments. This will result in too much trading, which is not only expensive, but also usually unnecessary. It is important to maintain a long-term view and to not be distracted by short-term results.

Overconfidence

Confidence is a good thing, but overconfidence can cause investors to improperly select investments. Too much assurance in one's knowledge and ability can lead investors to focus on the upside and deemphasize the potential downside of investments. Instead, a solid financial plan constructed by a professional can go a long way.

To Trust or Not to Trust

Investors work hard and make significant efforts to maintain a disciplined saving approach throughout their lives in order to meet long-term financial goals such as retirement, saving for children's education, or passing an estate to grandchildren. Thinking about what will happen with your estate when you are no longer here is not pleasant; it is important, however, to think ahead and plan how you and your spouse will pass your assets to your family.

The most important issue that arises in estate planning concerns estate taxes, which can be very high indeed. When a spouse dies, the tax law stipulates that an unlimited amount of property and money can pass to the surviving spouse free of federal estate taxes. However, when an estate is passed on to children or family members other than a spouse, federal estate taxes have to be paid on amounts exceeding $3.5 million (Federal Gift and Estate Tax law as of 2009, but subject to change in the future). A solution to this tax dilemma is to establish a trust.

A trust is a legal entity through which you transfer control (not ownership) of your estate to a trustee (this is usually an institution or a corporate entity, such as a bank). The term "estate" generally refers to your assets—everything you own (or have certain interests in), such as real estate property, cash, securities, insurance, retirement plans, and business interests.

Let's assume that Mr. and Mrs. Smith have a $4.5 million estate to leave to their children. Without a trust, if Mr. Smith passes away and leaves everything to his wife, she will not have to pay any taxes. However, when she passes away and leaves the $4.5 million to her children, they will have to pay federal taxes on $1 million. With a top bracket tax rate of 45%, this can mean as much as $450,000 paid in taxes.

If Mr. Smith establishes a trust before he dies, however, the situation is different. Suppose Mr. Smith, in his will, establishes a $4.5 million trust with his wife as the beneficiary. This means that Mrs. Smith is able to receive income from the trust for the remainder of her life and even retrieve an amount of the principal, if necessary. When Mrs. Smith passes away, the balance of the trust would be passed to the children, and—here is the most interesting part—since the trust is not considered part of Mrs. Smith's estate, it escapes (or bypasses) federal estate taxes. This is why such trusts are usually called "bypass trusts." By establishing the trust, Mr. and Mrs. Smith are able to pass to their children $450,000 that would otherwise have been paid in taxes.

Of course, there is always the possibility that tax laws will change. In 2001, President George W. Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001, a 10-year tax act that would expire in 2011. This act eliminated the federal estate tax for people dying in 2010. However, President Obama upset that arrangement by maintaining the 2010 estate tax at its 2009 parameters. What will happen in 2011 is still uncertain. Unless changed beforehand, 2011 estate taxes will revert to pre-2001 rates, which could mean a marginal rate of up to 55%.

All this tax and legal jargon can be confusing and intimidating, but it is important to learn about which laws apply to you and what will happen to your estate in the event of your death. It is highly recommended that you consult a financial or legal professional to discuss your options and see if establishing a trust might be the right move for you. An estate tax of up to 55% next year means that more than half of the money you want to leave your children could melt away in taxes. It may be well worth it to spend a little of your time now to ensure this does not happen.

The information contained herein should not be viewed as Morningstar providing investment, tax, or legal advice. Please contact your financial professional regarding such services.

In Case of Emergency

Nobody likes to think about the possibility of job loss, serious illness or other major expenses. But these are all possible in an uncertain world, and having an emergency fund in place can help if such situations arise.

An emergency fund is a money market, savings or checking account where you keep a specified amount of money to cover expenses. The important part here is that the money is stored in an investment vehicle that allows quick and easy access to funds. But you do not touch the money in this financially liquid account unless a real emergency pops up. No ifs, ands or buts.

Setting up an emergency fund is usually the first step toward building a solid financial plan. If you don't already have one in place, start building one as quickly as you can. It obviously takes perseverance to stash money from each paycheck into your emergency fund, but it may be well worth it one day.

How much cash should you put aside? Most financial advisors recommend to first aim to keep enough money in the fund to cover at least three months of expenses. However, as your take-home pay increases or your expenses grow, you may need to keep six months or even as much as a year's expenses in your fund.

Take it one step at a time. Once you've saved enough to cover three months of expenses, try for the six-month mark, and so on. Easier said than done, sure, but if you treat your emergency fund like any other must-pay monthly bill, it will undoubtedly grow over time.

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