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The Barely-Believed Bull Market

The old adage tells us stocks historically climb a wall of worry. And, with the Standard & Poor's 500 Index racking up a 16% total return in the first 9½ months of the year, the cliché would seem to apply.

To be sure, there is no shortage of bad news. We've experienced the slowest economic recovery of the post-World War II era. With unpleasant memories of 2008 to 2010 — the worst recession since The Great Depression — still fresh in mind, unemployment remains stubbornly high. Fears about Europe's recession worsening and the Eurozone crumbling persist. The prospect of another Mideast war looms large amid increased political instability in the region.

Yet, through all of it, stock prices have risen. Who could have predicted it? Chalk up another one for long-term strategic asset allocation. Modern Portfolio Theory has worked. However, amid the strong stock gains, it's wise to remember that nothing goes straight up. Nonetheless, the unnoticed bull market continues to be accompanied by generally encouraging economic releases.

Earnings. The consensus forecasts for earnings on the S&P 500 have remained strong. In September 2012, Wall Street analysts expected stocks in the S&P 500 index to earn $103 a share for 2012, and stocks traded at a 13.9 price-to-earnings (p/e) multiple, meaning investors were paying $13.90 for every $1 of earnings. In mid-September, however, speculation grew that corporate profits might falter. An earnings slowdown could dampen enthusiasm for stocks quickly. If companies deliver profits in line with expectations, however, it would make sense for stock prices to continue along the same rising trajectory as earnings.

Valuations. At 14, the p/e multiple on stocks in mid-September was, by no means, high by historical standards. When the bull market became grossly overvalued in 2000, stock prices traded at a p/e of 30.

World Growth. While Europe is expected to end the year showing negative growth, it recently was expected to grow modestly in 2013. The U.S., the world's largest economy, is expected to grow 2% in 2012 and slightly more in 2013. Meanwhile, China, the planet's second-largest economy, has slowed but still expected to grow at nearly an 8% pace for 2012 and slightly more in 2013.

Pleasant Surprises. The Citigroup U.S. Economic Surprise Index turned positive in early September 2012. The

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Standard & Poor's 500 Index Has Climbed A Wall Of Worry

Source: Standard & Poor's. Data through September 7, 2012.

Your Financial Reality Check

As financial advisors, our job is to help clients understand the realities of the market regardless of, or even in spite of, popular sentiment. Often the two are widely different. For example, many investors believe the Standard & Poor's 500 Index dropped significantly during each of the last three years, according to a recent study by Franklin Templeton Investments, when in reality it gained 26.5% in 2009, 15.1% in 2010 and 2.1% in 2011.

Negative sentiment, which was a natural byproduct of the financial crisis and deep recession of 2008, caused many investors to miss out on the very strong rebound in stocks. Which is where we come in.

Working with us in a financial advisory relationship means that we proactively review your investment portfolio for both opportunities and potential pitfalls based on your risk tolerance, assets and income. We constantly look out for your long-term financial security so you avoid making long-term decisions based on short-term sentiment.

Finally, we also proactively review your financial plan. This year, with major tax changes on the horizon, we have been extra diligent in taking steps to mitigate their effects if your situation warrants it.

Don't hesitate to call us if you have questions about the markets or how specific economic news may affect your financial goals. That's what we're here for – to be at your side when you need us.

Second Homes and State Double Taxation

Do you own a second home in a resort area that you use personally or occasionally rent out? You could be in for a rude surprise at tax time, if the state where the home is located insists you're a legal resident and must pay income taxes. In some cases, that may trigger hundreds of thousands of dollars of extra tax liability.

Several states, including Arizona, California, Hawaii, and New York, have been challenging the assertions of homeowners who claim to live out of state. A state may maintain that the owners actually reside within its borders, even if they consider the dwelling to be a vacation home. With other cash-strapped states taking notice of these tactics, the trend may well continue and expand.

In one high-profile case, John J. Barker, a Wall Street investment manager, and his wife argued that they were Connecticut residents who made only sporadic visits to a second home near the exclusive Hamptons area of New York. During the tax years that a New York state audit brought into question—2002 through 2004—the Barkers said the home was used by other family members. Due to New York State tough residency rules, however, New York ended up assessing a tax bill of more than $1 million for the three years and tacked on penalties of around $220,000. The Barkers have appealed the ruling but may eventually have to pay at least part of the bill.

In another recent case, media personality Martha Stewart, too, argued that her legal residence was in Connecticut and her place in the Hamptons was just a second home. But New York prevailed and Stewart had to pay almost $222,000 in back taxes.

The Empire State has a reputation for being one of the toughest states for audits, and it often targets residents of states such as Florida, Nevada, and Texas that have no income taxes. But farmers in the heartland and jet setters up and down both coasts face similar problems. In the worst-case scenario, you could even be hit by taxes from two states on a single property.

You may be able to avoid trouble if you clearly establish your residency in a single state of your choosing. Because residency laws vary from state to state, you'll have to research the method for documenting your legal domicile. At the very least, obtain a driver's license, register to vote, and file your income tax returns in your home state. Other things that generally help evidence where you live include memberships, where you receive you mail and maintain your bank accounts, and where you register your vehicles. And be sure to keep detailed records of your whereabouts, including a summary of frequent-flier accounts, credit card receipts documenting trips between homes, and phone records that you could use to bolster a claim of residency (or of non-residency). ●

When Your Financial Advisor Accepts The Role Of Fiduciary,

In the world of financial advisors there are myriad labels, certifications, registrations, and other terms that tend to be meaningful only to industry insiders. But one distinction could be crucial: An advisor bound by contract or law to serve as a "fiduciary" is obligated to act solely in your best interest. That's different from others who may seem to work for you but in fact owe primary allegiance to the companies that pay them.

With other professionals, such as lawyers and CPAs, there's typically a fiduciary responsibility that requires them to act in clients' best interests. But for financial advisors, fiduciary status is not yet standardized or guaranteed. So while you may think your stockbroker offers unbiased advice, he or she is probably receiving a commission for selling you products. To complicate matters, even a fee-based advisor who charges for advice may not be acting solely in your interest.

Not surprisingly, there's wide-spread confusion among consumers on this point. According to a recent survey by a major financial services firm:

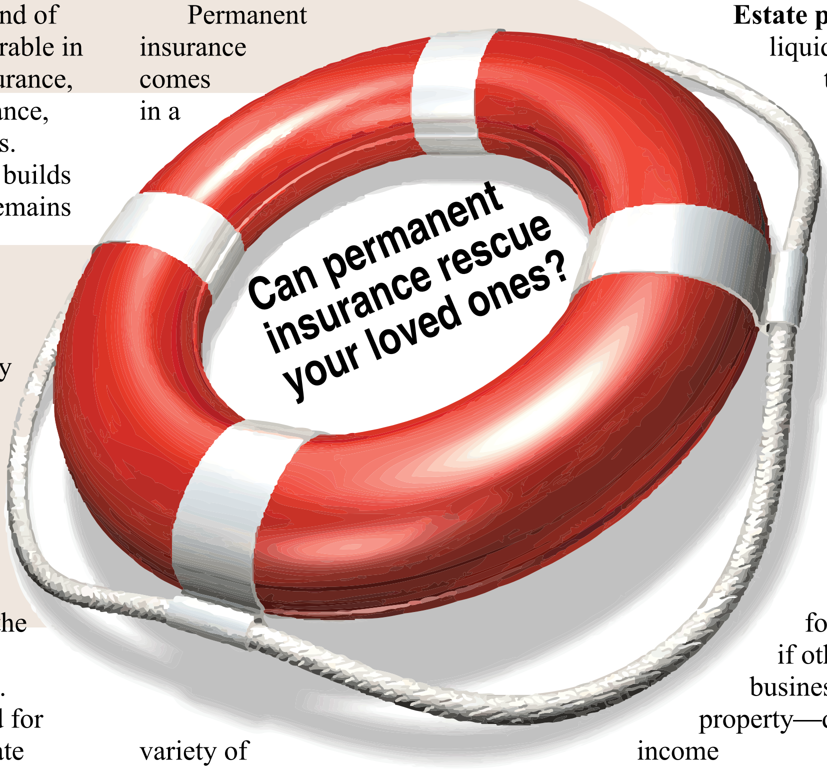
- More than half of the investors interviewed believed both stockbrokers and Registered Investment Advisors (RIAs) have an obligation to act in the client's best interests.
- Three out of four investors didn't realize that only independent RIAs, like Financial Decisions, have a fiduciary duty to their clients.

RIAs must inform clients of potential conflicts of interest, and they're legally obligated to act as a fiduciary. They have a fiduciary duty to act in their clients' interest at all times. Stockbrokers don't have the same obligation. Brokers must make recommendations that are suitable but are not required to adhere to the higher standard of care—to always do what's in your best interest—as

The Case For Permanent Insurance

Term life insurance is like coverage to protect your car or pay medical bills. As long as you keep paying the premiums, you're covered. With term life insurance, if you die while the policy's in force, your beneficiaries will receive a specified payment. But there's another kind of life insurance that may be preferable in some situations. Permanent insurance, also known as cash value insurance, also requires premium payments. However, part of each payment builds the value of the policy, which remains in force throughout your life.

Although term insurance is generally less expensive than permanent insurance at first, if you keep renewing a term policy at progressively higher rates, it could eventually cost more than a permanent policy. If your need for life insurance will end—when the house is paid off, say, or when the kids are grown or your spouse has sufficient wealth to do without the income you provide—term insurance may be the way to go. However, if there will be a need for cash whenever you die—to create needed liquidity, help fund a succession plan at your business, or for another purpose—a permanent life policy may be preferable.



The extra expense of permanent insurance stems from your investment in the contract. Though much of each premium covers insurance costs, the rest goes into a kind of savings account. You own that account, which ultimately increases the value of your policy.

Permanent insurance comes in a variety of forms, with some enabling you to adjust premiums based on policy earnings, borrow against the policy, or pay off premiums in a lump sum or over a fixed period of time. And if you decide you no longer need a permanent policy, you can surrender it for its cash value.

Here are two situations in which permanent insurance may play a crucial role.

Estate planning. Creating liquidity at death is a tried-and-true use for life insurance, and with a permanent policy, you know it will be there when it's needed. It can be employed for any of the following.

- To fund a "special needs" trust for a disabled or incapacitated child or relative who requires life-long care
- To provide cash for a surviving spouse if other assets—a home, business, or other property—don't produce income
- To fund an irrevocable life insurance trust (ILIT). Though a life insurance death benefit isn't taxed as income, it will be included in your taxable estate. A properly executed ILIT can pass along insurance proceeds to heirs without estate taxes.
- To generate cash to pay estate taxes

Business buyouts. For business owners, permanent insurance can provide reliable liquid assets to buy out a deceased owner. For example, your company could purchase a life policy on each owner. Then, if you die first, the death benefit paid to the business could be transferred to your heirs in exchange for your interest in the company.

Choosing a life insurance policy that protects your family and suits your financial situation can be tricky. Please give us a call if you'd like us to review your current coverage and see whether changes are needed. ●

You Have A Foundation For Trust

a fiduciary.

The distinction between an advisor who is a fiduciary and one who is not could be critical when weighing an advisor's recommendations. There may be a hidden agenda—for example, if an advisor is receiving better commissions for selling you one mutual fund instead of another.

Securities and Exchange Commission rules permit brokers to give you investment advice on a fee basis and not act as a fiduciary. In these instances, a broker can only give you advice about one or two issues—such as your retirement plan or investing. If a broker wishes to give you comprehensive financial advice that spans insurance, taxation, college planning and estate planning as well as investing and retirement planning, the broker must accept his or her role as a fiduciary to you. He must disclose that he will begin giving you advice as a fiduciary and then tell you when he has stopped acting as a fiduciary and reverted back to his role as your stockbroker.

Working with someone who is a fiduciary, or will sign an agreement to act as a fiduciary, doesn't guarantee you'll profit from the advisor's recommendations. But it does give you a greater assurance that you're both sitting on the same side of the table.●

The Two Pillars of Sound Investing

Diversification and asset allocation are twin building blocks of a solid investment foundation. Though the concepts are closely related, truly understanding each 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 other instruments – 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. 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 between 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.

This is diversification with a little more science. Because it's likely that if one category loses value, another may be on the upswing, 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. It is also crucial to keep your asset allocation the same through the vagaries of the markets by harvesting gains.

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. ●

Barely-Believed Bull Market

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index quantifies the volume of economic surprises. Before every major economic data release, Bloomberg, a news service, polls economists' expectations. The index compares consensus forecasts gathered by Bloomberg to actual releases on unemployment, gross domestic product, and other economic data. The positive turn of this index was itself a pleasant surprise.

Service Sector. While the media often pays attention to manufacturing growth, manufacturing activity accounts for just 29% of the output of the U.S. economy. In contrast, services account for 64% of U.S. economic output. Most recent figures from the Industry for Supply Chain Management showed surprising strength in non-manufacturing services. According to Fritz Meyer Economic Research, an independent consultant, two forward-looking sub-indexes in the services sector — new orders and employment — both showed encouraging growth.

Conclusion. The direction of the economy will become clearer now that the presidential election is over, and the many positives could continue to surprise investors. Asset allocation, broad diversification, and avoiding big bets on a market or specific security have worked. But the strong returns of recent months may make it more likely that an investor's ability to control emotional reactions to volatility could be tested in the months ahead. Some parting observations:

- The U.S. remains the world's most stable and liquid economy.
- It's unlikely that the recovery from The Great Recession of 2008 to 2010 will strengthen soon.
- Interest rates are the lowest they have been in decades.
- Federal Reserve Board Chairman Ben Bernanke has indicated he will keep interest rates low until the jobs picture improves.
- The Fed now regards the threat of inflation secondarily to job-creation.
- Positive surprises in U.S. economic data are a reassuring reminder of the resilience of the U.S. economy.

In a period when the Iranian nuclear threat, fiscal cliff, and unity of the Euro alliance are on the cusp, investors are on edge. But the first nine months of 2012 was an opportunity to capitalize on progress in an era of pessimism. ●