Financial Decisions

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A Little Bond Logic Yields Insights

Interest rates have been on the low side recently, but what goes down must come up, so you can expect this trend to eventually reverse and interest rates to climb again.

If you're wondering how these developments affect bonds you already own, it's a good question. Even experienced investors can find it a challenge to grasp how bond markets really work. However, there is logic behind the ups and downs.

Bond Basics. Put simply, a bond is an IOU. Governments and businesses issue bonds to raise cash for various purposes. The markets use several descriptors to identify a bond: the issuer's name, the bond's face (or par) value, the rate of interest paid to the bondholder, and the maturity date (on which the issuer repays the principal). Because bonds trade on the open market, their prices fluctuate—and that is where things can get complicated.

How Interest Rates Affect Bond Prices. While many factors may push the price of a bond above or below its face value, perhaps the most direct impact comes from changes in interest rates. As interest rates rise—or threaten to rise—bond prices tend to fall, and vice versa.

Imagine you own a bond that pays 5% interest. After a Federal Reserve rate hike, newly-issued bonds offer a 6% rate. To someone in the market for bonds, the new rate seems much better. Lower demand for the 5% bond translates into lower prices. Conversely, if the prevailing rate falls to 4%, your bond suddenly becomes more attractive, and should command a higher price. (Note, these figures are hypothetical.)

Price vs. Yield. However, markets generally refer to bond values not by price, but by yield—the annual interest divided by the current price. If your 5% bond has a face value of $10,000, you receive $500 a year in interest. If the bond sells "at par"—the face value—the yield would be 5% ($500 divided by $10,000). But if the bond's price dips to $8,000, the yield would be 6.25% ($500 divided by $8,000).

Therefore, as price falls, yield rises, and vice versa. Think of it this way: if you buy a $10,000 bond at $8,000, your investment will "yield" more as the interest payments, in percentage terms, reflect a better return on your investment. (That's known as current yield. Another measure, yield to maturity, gauges the total return you would receive by holding the bond to maturity.)

So, once again:

- As interest rates rise—or threaten to rise—bond prices tend to fall, and vice versa.
- As prices fall, yields rise. On the contrary, as prices rise, yields fall.

That means:

- As interest rates rise—or threaten to rise—bond yields tend to rise. The same is true for the reverse.

These movements bring the yields of existing bonds into line with those of new issues.

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Big News For FD Partner Ken Gutwillig

This autumn was an exciting time indeed for Kenneth Gutwillig, our Chief Investment Officer. In September, Ken was invited to join the prestigious Bretton Woods Committee. The Bretton Woods Committee, founded in 1983, is a nonpartisan network of prominent global citizens which works to demonstrate the value of international economic cooperation and to foster strong, effective international financial institutions (IFIs) as forces for global well-being. Membership of this committee is by invitation only.

"I am honored to be asked to join this esteemed group," commented Ken. "This membership will grant Financial Decisions, and our clients, access to some of the great minds in the world of business and finance."

The Committee explores current issues in global finance, development and trade. In fact, Ken traveled to the IMF/World Bank meetings in Lima, Peru this past October to attend several high-level economic meetings and lectures.

Also in October, Ken was appointed a Fellow of the Foreign Policy Association. The 97-year old organization strives to serve as a catalyst for developing awareness, understanding, and informed opinion on U.S. foreign policy and global issues. Through its balanced, nonpartisan programs and publications, the FPA encourages citizens to participate in the foreign policy process.

Congratulations Ken! We look forward to seeing where these opportunities will lead!

Florence Dupont and Linda Schoenthaler

Taking Aim At Target Date Funds

"Target date" mutual funds can be a convenient way to invest for retirement, college savings, or other investment goals. Also known as life cycle funds, these diversified investments provide a "glide path" toward a future objective, ratcheting down investment risk as you get closer to the time you'll need the money. In some cases, target date funds are actually "funds of funds," allocating their assets to other mutual funds.

However, target date funds also have several important disadvantages worth considering.

Portfolio diversification: Whether you have a target date fund in a tax-deferred retirement plan or in a taxable brokerage account, you may be inclined to treat it as stand-alone investment. But it's important to think about how it fits with other holdings in your portfolio. If you don't look at all of your investments collectively, you could end up with too much or too little in a particular kind of investment, reducing your overall diversification and possibly increasing the risk of your investments in ways you didn't intend.

Glide path: This provides the formula for allocating assets within the fund. When you approach the target date, the allocation usually skews more to the conservative side. That makes sense as a way to cut the risk of losses when you're about to use the money. But you're not required to cash out when the target date arrives, and continuing to keep your money in very low-risk investments may not make sense in your situation.

The glide path automatically rebalances, becoming more conservative at pre-set milestones. This means the investor loses control over when to rebalance, which can be a disadvantage. As an example, if a reallocation point occurs in the midst of a declining market, the fund may automatically sell depressed assets, locking in losses.

Expected retirement: Investors often zero in on retirement as the target date. But what if your plans change? You might end up retiring early or working longer than you expected—and that could put your current goals out of line with the glide path of the fund. If that happens, you may need to choose a different target date fund, or make adjustments in other parts of your portfolio.

Fees and expenses: The expense ratio of a target date fund may be a weighted average of the expenses of underlying funds, plus the fund could tack on other fees to cover management costs. High fees can undermine your portfolio, so it's important to know what you're paying, so try to educate yourself about your funds' fee structures.

Risk factors: Target date funds often are touted as low-risk investments. But there's an inherent risk in almost any kind of fund, and target date funds certainly weren't spared during the stock market downturn of 2008-09. Because many target date funds include a healthy dose of stocks, yours could end up being more volatile than you expect.

Target date funds often seem to be an appealing way to diversify your investments and give you a smooth path to a future financial goal. However, other factors may come into play, so make sure to take the big picture into account. ●

8 Smart Moves For College Grads

Have you or one of your children recently recently graduated from college? There's a lot to look forward to—a first job, maybe marriage and family and financial success. But college graduates can't assume that good things will happen automatically. Here are eight moves to make as soon as the ink on the diploma dries:

1. **Get organized.** Put your house in order by collecting vital papers such as your Social Security card, passport, and any investment documents and insurance policies. For optimal protection, store papers you don't need regularly in a bank safe deposit box or another secure location.

2. **Start paying down debt.** If you've borrowed money while earning your degree, chip away at your liability. The top priority is to wipe out credit card debt, on which you're likely paying a sky-high interest rate. What about student loans? Often those interest rates are low and much of your repayment will make a dent in the principal.

3. **Devise a monthly budget.** Once you have a firm grasp on both your monthly income and expenses—rent, car payments, and the like—create a budget. The goal is to be in the black, spending less than you earn, with some savings to spare, but allocate funds for entertainment, too.

4. **Open bank accounts.** If you don't already have them, set up checking and savings accounts at a local bank. But don't overdo things with your new debit card, and be careful with credit cards. Credit card use can help build your credit history, but it's important to pay off your balance monthly to avoid interest charges.

5. **Think about retirement.** That's not a misprint. It may be decades away, but the sooner you start saving for retirement, the better. Take advantage of company plans

The Reality Behind 6 Estate Planning Misconceptions

Some people avoid estate planning at all costs. But putting aside the inevitable emotions involved in looking ahead to your own demise, it's crucial to understand the process. Misconceptions abound; here are a few of the most common fallacies:

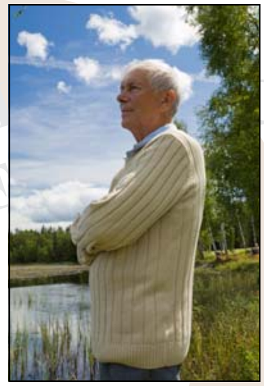
Misconception #1: My estate is too small to need an estate plan.

Reality: You don't need a small fortune for your heirs to benefit from estate planning. For instance, what if you decide to divide your assets among several beneficiaries, instead of designating just your spouse or another person? This is especially important for people in a second or third marriage, who have children from a previous marriage. Other reasons to have a Will include wanting to leave some of your estate to charity, avoiding the delays of probate, seeking to reduce estate taxes, and choosing who will administer your estate.

Misconception #2: I don't need an estate plan because my spouse will inherit everything.

Reality: This is closely related to the first misconception. Just because you have left everything to your spouse under your Will—and your spouse has returned the favor—doesn't mean you won't benefit from estate planning. What happens if your spouse dies first at a relatively early age, or if you die together in an accident? What then? There might be complications because of how assets are titled, who you have named as beneficiaries of your life insurance policies and your retirement plans, or the estate laws of your state.

Misconception #3: If you're wealthy, there's no way to avoid estate taxes.



Reality: That's simply not true. On the federal level, your estate can benefit from a generous \$5.43 million exemption for those dying in 2015 (and that amount is indexed for inflation and will rise in future years). What's more, because you or your spouse can use the other's leftover exemption, the effective amount the two of you can shield from estate taxes is almost \$11 million. Trusts and other tax- saving vehicles can further reduce estate tax exposure. Although state inheritance tax rules aren't always as generous, professional guidance may help there, too.

Misconception #4: Everything is covered in my Will, so estate planning isn't necessary.

Reality: While a Will is a good starting place for an estate plan, it's not likely to be enough on its own. There may be numerous other loose ends to tie up. In addition, depending on your state's laws, your heirs may have to go through a lengthy probate process that can be even more drawn out if you owned property in several states. A revocable living trust can help you pass some assets to your heirs without probate. In addition, your Will should be accompanied by a durable power of attorney, which authorizes a family member or a professional to act on your behalf if you're incapacitated.

Misconception #5: I don't have to worry about life insurance and retirement plan designations.

Reality: You need to coordinate your beneficiary designations for life insurance and retirement plans, as well as for your IRAs, with other aspects of your estate plan. You might want to revise your designations. For example, if you get divorced or your spouse dies, or if you would like to add or change your contingent beneficiaries. Also, it is important to remember that the proceeds from life insurance are included in the taxable estate of the insured, although the proceeds will generally be excluded if you transfer ownership of the policy to someone else or a trust.

Misconception #6: Once my estate plan is complete, I don't have to do anything else.

Reality: Nothing could be further from the truth. Your family and financial circumstances almost certainly will continue to evolve, and your estate plan needs to reflect the significant changes that occur. Marriage, divorce, or the birth of children or grandchildren all could have an impact. And the best-laid plans could be affected by a disability or unexpected death of a spouse. Finally, your plan may have to be fine-tuned to take other events into account, especially as the estate tax laws evolve. It is crucial to review your plan periodically and revise it as needed. ●

such as 401(k) (especially if your company matches contributions) and consider supplementing your savings with an IRA.

6. **Create a "rainy day" fund.** It's impossible to anticipate all of the expenses you'll incur during the next few years. Try to set aside something extra in case of emergencies. For instance, you might face a layoff or an unexpected medical or dental bill. Have enough savings on hand to carry you through for a few months.

7. **Look to invest.** Once you've established your "rainy day" fund and started contributing to your retirement account, if you have any spare cash, you should consider taxable investments. Funding a brokerage can put your extra savings to work for you, by generating interest and dividends. Just remember to keep aside some money to cover the tax on your investment earnings, and keep in mind your personal tolerance for investment risk.

8. **Obtain financial guidance.** Fortunately, you don't have to do it all on your own. We can provide assistance based on your personal circumstances. Don't hesitate to contact our office for more details. ●

How A Financial Advisor Can Help

What are your hopes and dreams for the future? They probably begin with being able to provide for yourself and your family. But you might also aspire to purchase a bigger home, accumulate savings for your grandchildren's education, build a nest egg for retirement, or support your favorite charity.

While you may be able to achieve all of those things, you can't just snap your fingers and make them happen. You'll need hard work and financial discipline, and you'll need to make a long-term commitment to work toward your goals. Enlisting the services of a financial advisor could help guide you along the way.

Of course, you are ultimately the one making the decisions, but an advisor can provide valuable assistance in many respects. An advisor can help you:

- Assess your current financial status, including your income, investments, assets, liabilities, insurance coverage, tax situation, and estate plan;
- Set goals that are both ambitious and reasonable;
- Guide you through personal transitions (births, deaths, marriage, or divorce);
- Address weaknesses in your current investment and retirement plan;
- Develop a comprehensive plan to suit your current needs and future desires.

Couldn't you do all of this on your own? If you're sufficiently savvy about financial matters you could, but few people have the time, expertise, and inclination to do all that's required. And even those who are capable often need a push to get started. What's more, a third party such as a professional financial advisor may add a valuable new perspective to your own outlook. You might benefit from having someone objectively review key decisions about your financial future.

Even if you don't feel you need the help of a financial planner now, something could happen to trigger a call for help. For instance, maybe you've inherited a large sum of money or property and you're not sure how to handle it. Perhaps you, or your spouse, have been laid off from a job and suddenly money is tight and you're forced to make financial trade-offs. Or you may require assistance on other financial fronts ranging from elder-care planning to paying higher-than-expected college costs for your children, or resolving a shortfall in your retirement savings.

If you do decide to use a professional financial advisor, you'll still need to find one who is experienced and has expertise helping clients in your situation. We would be glad to show you the high level of services that we provide. ●

A Little Bond Logic

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Exploring the Yield Curve. Long-term bonds tend to have higher yields than short- or intermediate-term bonds. That's because long-term bonds carry more risk—more can happen to affect the price during the longer term of the bond—and investors expect a higher yield for that extra risk.

The yield curve plots the current yields of bonds of various maturities on a graph. A normal curve shows a rise in yields as terms get longer. With a steep curve, long-term yields are substantially higher than short-term yields, while a flat curve shows short- and long-term yields that are more or less equal. An inverted curve happens when short-term yields are higher than long-term yields.

The yield curve is important because it may reflect investor sentiment or expectations. For instance, a steep curve indicates investors are bidding up the price (and therefore driving down the yield) of short-term rates. That could mean they expect interest rates to rise. They want to hold short-term bonds that will mature quickly, so they can reinvest at a higher rate.

What About Inflation? Why does the bond market often fall on good economic news? The fear is that strong economic growth could trigger inflation—which means bond investors would be repaid (both principal and interest) in cheaper dollars. Positive economic news can also lead investors toward stocks and away from bonds, which are often considered "safer" investments to turn to when times are tough.

In reality, of course, all markets are far more complex than this, and unusual market movements can confound even the most sophisticated analysts. Still, a little logic can make *"Inflation fears send bond yields higher"* a little easier to understand. ●