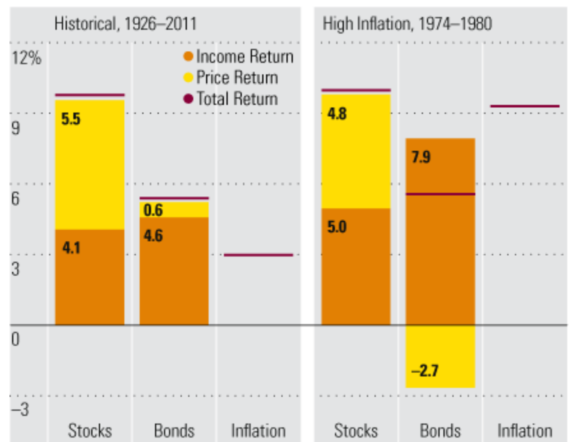
Investing With Integrity

July 2012 | Vol. No. 9 | Investment Updates

Dividends and Inflation

As an investor, you may ask if an allocation to dividend stocks in your retirement portfolio will help keep up with inflation. Examining stock returns during periods of high inflation may answer this question. Dividend-paying stocks may offer benefits such as stability through income return and inflation protection. While stock prices tend to be volatile, dividends may serve as a stable component of total return and may provide better inflation protection compared with bonds. Between 1974 and 1980 (high inflation period), the average rate of inflation was 9.3%, much higher than the historical rate of 3%. During this time, bonds yielded 7.9% from income, but prices declined by 2.7%, resulting in a total return of 5.6%—way short of inflation. On the contrary, stocks returned a total of 10%: 5.0% from dividend income and 4.8% from price return, outpacing inflation for this time period.

Performance of Stocks and Bonds Relative to Inflation



The 1974–1980 time period was chosen as representative of high inflation because it contains multiple consecutive years when inflation was 5% of higher (except 1976). The sum of the price return and income return may not equal the total return due to compounding. Past performance is no guarantee of future results. Dividends are not guaranteed. Diversification does not eliminate the risk of experiencing investment losses. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. 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 the other asset classes. Stocks are represented by the Standard & Poor's 90 index from 1926 through February 1957 and the S&P 500® index thereafter, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general. Bonds are represented by the 5-year U.S. government bond and inflation by the Consumer Price Index.

Integrity FINANCIAL PLANNERS

Advisor's Corner

Integrity Financial Planners

cb@integrity-fp.com
541-469-4080
www.integrity-fp.com

Charles Blozinski, CFP offers his clients the advantage of over 25 years of experience in financial services. He provides to his clients independent, unbiased financial advice in a fee-only environment. Charles is President and CEO of Integrity Financial Planners. The firm is a registered investment advisor in the State of Oregon.

How to Cope with Financial Anxiety

Integrity:

- Throughout my career, I've seen time and time again Financial Advisors take advantage of client anxiety by selling existing investments and buying new ones. With a fee only firm like Integrity, we don't make money when your funds are moved from one investment to another. When we make investment changes, you know they are in YOUR best interest and not to generate commissions.

No one likes uncertainty. We want to maintain at least the illusion of control. But that's almost impossible to do today, given the volatility of the stock market and employers' belt-tightening. Even the steadiest hand is shaking just a little. It is imperative to avoid letting your emotions get in the way of making smart investment decisions. In times of doubt, it might be in your best interest to follow these steps for re-examining your current financial strategy.

Reassess Your Risk Tolerance: Today's investor is living those “hypothetical” questions that appear on risk-tolerance questionnaires. If you haven't checked your risk tolerance (the degree of uncertainty that you can handle in your investment portfolio) in more than a year, you're most likely due—especially if you're uncomfortable right now. Maybe you've taken on more risk than is prudent. If so, it might be in your best interest to change your asset mix. If you find that you're taking on the appropriate amount of risk for your goals, just sit tight.

If You Have to Do Something, Review Your Expenses: When dealing with uncertainty, some people feel compelled to act. Instead of trying to time the market (which even the professionals can't do with any consistency), focus on things you can control with certainty: expenses. Identify where you can tighten your belt. Try to identify unneeded or underused services. After such cuts, you’ll have some extra cash to invest each month. Expenses also matter in investment accounts. Do you know what you’re paying in expense ratios, 12b-1 fees, front- or back-end loads? Burn up some of your nervous energy by making sure those expenses aren’t eating up what little positive returns you might have.

Create a Shopping List of Investments: Research stocks or funds that would complement your portfolio, then see where they are currently trading. This could be a great opportunity to pick up some of your favorite picks at rock-bottom prices. However, make sure they are trading at historical lows because of investor overreaction and not because they are no longer financially sound.

Win the Psychological Battle: Don't let the financial media scare you into making poor investment decisions. Times of great uncertainty are usually bad times to be making major decisions. What is healthy is knowing how the human mind works and factoring that into your investment decision-making process. Researchers and academics in the field of behavioral finance attempt to better understand and explain how emotions and perceptions influence investors and their decisions. If you are interested in learning more, there are plenty of publications devoted to this relatively new field.

Consider all of the complex financial decisions faced by investors today. Without experience in different market environments or knowledge of market history, how might investors make such decisions? Potentially through their perceptions or based on their emotions. Thus, it is imperative that investors understand and combat the myriad of illusions to which they might be prone.

When the markets are doing well, people tend to think the trend will continue indefinitely. During the recent crisis when the market was struggling, we witnessed overreaction: Investors were running away from the stock market. However, if you think U.S. companies are still fundamentally strong and will profit in the next five to 10 years, then you should still have a stake in the stock market. Just make sure you set your asset allocation policy first, and then stay the course with an appropriate mix of stocks, bonds, and cash. Investing is a long-term proposition—don’t let your emotions overpower your sense of reason.

Stocks are not guaranteed and have been more volatile than bonds. Past performance is no guarantee of future results. Diversification does not eliminate the risk of experiencing investment losses.

Income Gap

Integrity:

- I was raised on dividend paying stocks. Most companies who pay dividends are large, stable companies who make money (profits) even when the market is down. When they make profits, they pay their shareholders. So regardless of whether the market is up or down, clients can typically count on dividends. For those clients who reinvest the dividends into more shares, the compounding effect is extremely powerful.

The recent low interest rate environment has resulted in lower income from short-term fixed income investments. Relying on yields alone may not generate the cash flow needed to meet your income requirements in retirement. If you are looking to generate more income, consider adding dividend-paying stocks to your retirement portfolio.

Dividend stocks may provide income through dividend payments as well as the potential to benefit from stock price appreciation. Further, these dividend payments may soften losses during turbulent markets, particularly when investors incur negative returns. This means that when dividends are paid out, they act as a cushion and are positive whether stock returns are positive or negative.

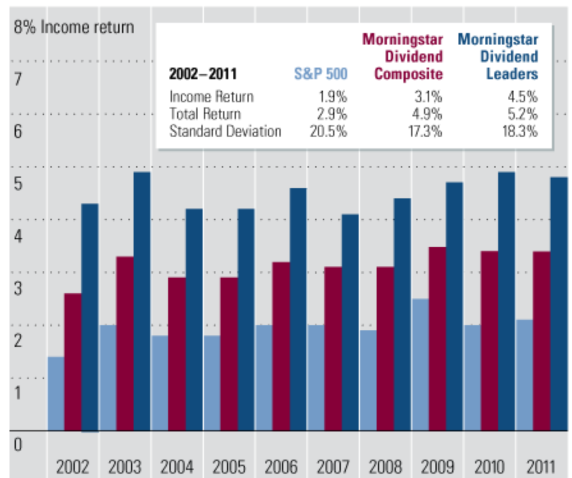
The image compares the annual income return for the S&P 500, Dividend Composite and Dividend Leaders index over the past 10 years. As seen in the image, dividend-paying stocks produced higher income returns relative to the S&P 500 over this time period. The 10-year average income return for the S&P 500 was 1.9%, compared with the Dividend Composite and Dividend Leaders indexes, which returned 3.1% and 4.5%, respectively.

Stocks that pay dividends may serve as an income source while also providing investors with exposure to the growth potential of the stock market. Consult your financial advisor to learn more about adding dividend-paying investments to your portfolio.

Past performance is no guarantee of future results. Dividends are not guaranteed. Diversification does not eliminate the risk of experiencing investment losses. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. 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 the other asset classes. Income return and total return are represented by the compound annual return over the time period analyzed.

The Morningstar Dividend Composite Index captures the performance of all stocks in the U.S. Market Index that have a consistent record of dividend payment and have the ability to sustain their dividend payment. Stocks in the index are weighted in proportion to the total pool of dividends available to investors. The Morningstar Dividend Leaders Index captures the performance of the 100 highest yielding stocks that have a consistent record of dividend payment and have the ability to sustain their dividend payments. Stocks in the index are weighted in proportion to the total pool of dividends available to investors.

Income Returns 2002–2011



S&P 500 is represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general. Morningstar Dividend Composite is represented by the Morningstar Dividend Composite Index, and Morningstar Dividend Leaders by the Morningstar Dividend Leaders Index.

The Importance of Rebalancing

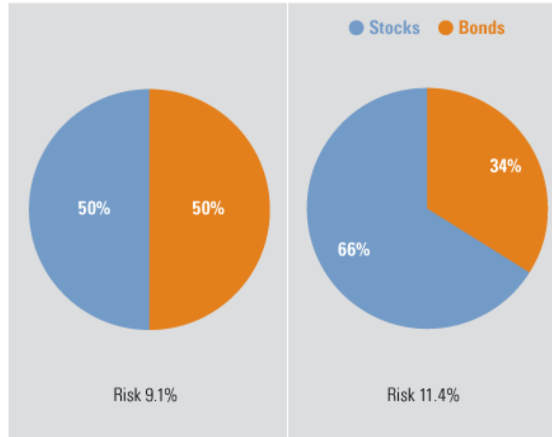
Integrity:

- One of the most important functions of our firm is to regularly rebalance our client portfolios. While it's counterintuitive to sell the great performers and buy the laggards, it's simply "selling high and buying low". As a client of Integrity, you know your portfolio is being rebalanced on a regular basis.

Over time, your asset-allocation policy can veer off track because of market ups and downs. This is illustrated quite clearly in the attached image; a strong stock performance can cause a simple 50/50 portfolio mix to become unbalanced over time. After 30 years, what was once a 50% allocation to stocks now sits at 66%—quite a jump. Moreover, not only does the portfolio's allocation change, but the portfolio's risk also changes, rising sharply from 9.1% to 11.4%. If your needs and/or risk tolerance have not changed, your allocation shouldn't either.

But why would anyone want to sell investments that have done great in order to purchase laggards? While rebalancing might seem odd at first, it is all about risk control. If more and more of your total portfolio winds up in one investment, you risk losing a lot should that investment stumble.

Change of Portfolio Allocation: January 1982–December 2011



Keep in mind that an investment cannot be made directly in an index, and past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. The sale of an investment for the purposes of rebalancing may be subject to taxes. Risk is measured by standard deviation. Standard deviation is a statistical measure of the extent to which returns vary from the expected returns. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. Stocks are not guaranteed and have been more volatile than bonds.

Source: Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and is considered to be representative of the stock market in general; Bonds—five-year U.S. Government bond.

Integrity Financial Planners
Integrity Financial Planners
PO Box 4790
Brookings, Oregon 97415
cb@integrity-fp.com
www.integrity-fp.com
Tel:541-469-4080