Investing With Integrity

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The Asset Allocation Puzzle

Possessing a considerable amount of knowledge about stocks, bonds, and cash is only a small part of the investment planning process. Many investors are under the false notion that the greatest determinant of portfolio performance is the specific investment choices that they make. In reality, the biggest decision you will make is how much to allocate to different investment categories. Asset allocation is all about finding the mix of investments that is right for your situation. Goals, time horizon, and risk tolerance are some of the key factors that should be taken into consideration when allocating assets.

Goals: Determining what asset allocation is appropriate depends largely on the goals you seek to achieve. Are you saving for retirement, college education for your children, or a vacation home? Each goal must be considered in creating the appropriate asset mix.

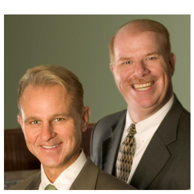
Time Horizon: Time horizon is the length of time your portfolio will remain invested before withdrawals need to be taken. If your average investment horizon is fairly short, you will most likely want a more conservative portfolio—a portfolio with returns that do not fluctuate too much. If your investment time horizon is longer, you can most likely invest more aggressively.

Risk Tolerance: Everyone has a different emotional reaction to sudden changes in their portfolio value. Some people have trouble sleeping at night because they are too busy worrying about how their portfolio is performing. Other investors are unfazed by fluctuations in the market and can endure the uncertainty associated with more risky investments.

As you can see, the asset allocation decision is not an easy one and it may be best to work with an investment advisor who can piece together a plan that is right for you.

Advisor's Corner

Integrity FINANCIAL PLANNERS



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Charles Blozinski, CFP and Thomas Goodwin, CFP, EA offer their clients the advantage of over 35 years of combined experience in financial services. They work as an interactive team to provide independent, unbiased financial advice in a fee-only environment. Integrity Financial Planners is a registered investment advisor in the State of Oregon.

Dividends and Total Return

Integrity:

- The including of dividend paying stocks into a diversified portfolio has two major benefits to the performance of the portfolio. These stable large-cap companies have historically had higher overall returns and typically suffer smaller losses during market declines.

Income is important to consider when choosing an investment. Especially important for investors approaching retirement, income can add meaningfully to one's total return, which comprises income and price return (capital appreciation). Investors can pursue income returns in many ways including bonds, real estate investment trusts, and stocks.

Stock income is typically paid in the form of a monthly, quarterly, annual, or special cash dividend, which can be used to finance current consumption or to reinvest. Dividends are typically expressed in terms of yield. Like an interest rate, yield is represented as a percentage rate and is calculated by taking the annual cash dividend divided by a stock's current price. For example, a stock trading at $20 with a future annual cash dividend of $1 would have a dividend yield of 5%.

Keep in mind, though, that there is no guarantee a dividend will be paid, even if a certain company has a consistent dividend-paying track record. A company can increase, decrease, and even eliminate dividends altogether, depending on its financial situation. Furthermore, if a dividend is declared, the company has to pay dividends for preferred shares first, before any common share dividends can be paid.

Although stocks can be a source of income return, not all stocks are created equal in this regard. Some companies distribute significantly more of their profits in the form of dividends than others, and some don't distribute dividends at all. The following image demonstrates this point. Historically, dividend-earning stocks—represented by Morningstar's Dividend Composite Index—have had compound annual returns of 6.9%, while large stocks have had compound annual returns of 5.0%. Additionally, higher-yielding companies—represented by Morningstar's Dividend Leaders Index—have outperformed large stocks: Dividend Leaders Index components had a compound annual return of 9.0% compared with 5.0% for large stocks during the period studied. For investors looking both for income and total returns, dividend-paying stocks can be a reasonable place to invest.

Although higher-yielding stocks have demonstrated an ability to outperform large stocks, all that glitters is not gold. Dividends are paid at a company's discretion, and exceptionally high yields can indicate a potential dividend cut. For example, had investors been lured to many high-yielding bank stocks in late 2008, they would have been sorely disappointed when many banks subsequently cut their dividends as profitability declined during the credit crisis. When looking at dividend-paying stocks, investors should focus on reasonable dividend yields with companies that have the earnings power to increase their dividend distributions over time. Many large companies with recognizable brand names have demonstrated an ability to offer this slow and steady income distribution to shareholders.

Dividend-Paying Stocks
May Provide Better Returns

This is for illustrative purposes only and not indicative of any investment. Assumes reinvestment of all income and no transaction costs or taxes. An investment cannot be made directly in an index. Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed. Dividends are not guaranteed and are paid solely at a company's discretion.

Source: Large Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general; Dividend-Paying Stocks—Morningstar Dividend Composite Index; High-Yield Dividend-Paying Stocks—Morningstar Dividend Leaders Index. Stocks in both indexes have a consistent record of dividend payment, have the ability to sustain their dividend payments and are weighted in proportion to the total pool of dividends available to investors. The Morningstar Dividend Composite Index captures the performance of all stocks in the U.S. Market Index. The Morningstar Dividend Leaders Index captures the performance of the 100 highest-yielding stocks.

Three Reasons to Consider Exchange-Traded Funds

Integrity:

- Integrity uses ETFs in the construction of our diversified portfolio. Our select process looks at Index ETFs for an asset class which have be in existence for a minimum of 5 years. The ETF will be used in our portfolio model when no mutual fund is found with consistantly superior performance over the long term.

Despite all the buzz surrounding exchange-traded funds (ETFs) these days, many investors are confused about how best to use them. ETFs are versatile investment vehicles that can be effectively incorporated into a portfolio. They are essentially index funds that invest in a representative sample of securities in the index they seek to imitate. Unlike mutual funds, however, ETFs are traded on an exchange, just like stocks. As of November 2010, Morningstar estimates there are approximately 1,099 ETFs in the United States, with a total of about $942 billion in assets.

There are at least three good reasons for investing in an exchange-traded fund: lump sums, tax efficiency and undervalued corners of the market.

Lump sums: If you have a lump sum you are looking to invest, consider an ETF. Why? Well, you pay a brokerage commission each time you buy and sell an ETF, so commissions can add up very quickly with every trade. You can bypass these costs with a lump-sum investment. (If you plan to make periodic investments over time, your overall costs will be lower if you go with a no-load mutual fund.)

Tax efficiency: Equity ETFs are among the most tax-efficient vehicles around. The way they're structured, ETFs rarely make taxable capital gains distributions, those payments to shareholders of security-sale profits. So you'll typically owe taxes only on any capital gains you incur when you sell the ETF. Investors can easily build a low-maintenance, tax-efficient, broadly diversified portfolio with only three ETFs. There are a number of ETFs that offer domestic-equity exposure and others that cater to those looking to take their investment overseas. There are also many fixed-income ETFs to consider.

Undervalued corners of the market: In addition to these ETFs, there are others that track practically every market segment there is. While some of the narrowly focused ETFs are better than others, many can be used effectively if approached with discipline and a long-term view. It can take time for some undervalued corners to produce, so impatient investors need not apply.

There is one terrible reason to invest in ETFs: fads. Many investors think of them as vehicles for making a quick buck on a hot corner of the market. However, by the time one catches your eye, it's about to cool down. Unfortunately, ETF providers have a bad record of launching new ETFs in faddish pockets of the market, which tends to encourage an investor's worst instincts. So watch for fads, and before investing in an ETF in this area (or any ETF, really) speak with your financial advisor.

Keep in mind that diversification does not eliminate the risk of experiencing investment losses. Investors should read the prospectus and carefully consider a fund's investment objectives, risks, fees, and expenses before investing. It is important to note that ETFs are not immune from capital gains distributions; ETFs may make capital gains distributions if changes in the underlying index occur. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, and differences in accounting and financial standards. Keep in mind that concentrated investments are narrowly focused investments that typically exhibit higher volatility than the market in general. These investments will fluctuate with current market conditions and may be worth more or less than the original cost upon liquidation.

Bittersweet

Integrity:

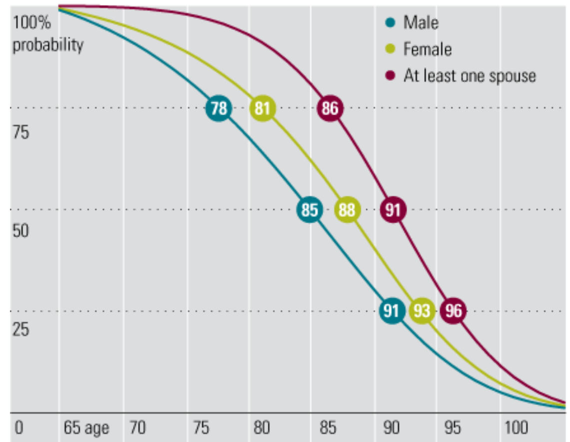
- The current low interest rate environment on bank deposits has, for many people, increased the risk of outliving their assets. Reallocating some bank deposits to income producing bonds and utility stocks can decrease this risk while only taking a small market risk.

The Merriam-Webster Dictionary defines bittersweet as something that is pleasant alloyed with pain. This could also be associated with retirement. The sweet part is that people are living longer thanks to innovations in healthcare. The bitter reality is that when people live longer they risk outliving their assets.

Longevity risk is the possibility of outliving one's retirement savings. While longevity is generally a good thing, the risks associated with it are becoming a major concern for individuals entering retirement.

Luckily, longevity risk can be managed through proper planning and products. To plan properly, consider when you would like to retire, the number of years you anticipate in retirement, and your desired income level.

Probability of a 65-Year-Old Living to Various Ages



Source: Annuity 2000 Mortality Tables—Transactions, Society of Actuaries, 1995–1996 Reports.

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