Investor Insights & Outlook

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Floating-Rate Options When Interest Rates Rise

An Important Asset Class

- Floating rate loans help reduce volatility when interest rates rise.
- Floating rate loan funds also pay monthly interest.
- A pool of loans helps reduce the risk of one loan defaulting.
- Most portfolios with Integrity Financial contain a portion of floating rate loans.

Given the expectations that interest rates will rise in the not-too-distant future, it's no wonder that many fixed-income investors are considering floating-rate securities for their portfolios. The key distinction between floating-rate and fixed-rate securities involves how each investment type reacts to movements in market rates. A floating-rate bond tends to keep its value if rates rise, whereas a fixed-rate bond will lose value. That's because an existing bond with a fixed rate is worth less if investors can buy new bonds at higher rates. If rates drop, the opposite occurs: The existing fixed-rate bond will increase in value.

Because of the protection that floating-rate bonds may offer against rising interest rates, some investors may use them to reduce the rate sensitivity of their portfolios. One commonly used type is known as a bank loan. Corporations needing to borrow money may do so with help from one or several commercial or investment banks, which syndicate the loans and help sell them to investors. These loans typically receive below-investment-grade ratings, reflecting a relatively high risk of default. As is the case with other bond types, investment-grade floating-rate securities tend to pay lower interest rates than fixed-rate bonds do, while non-investment-grade floating-rate securities offer higher rates but also carry more credit risk.

For fixed-income investors concerned about a rise in interest rates, floating-rate securities may be a viable option. But investors may have to either settle for reduced yields (in the case of investment-grade floating bonds) or added credit risk and volatility (as in the case of bank loans). With corporate bonds, an investor is a creditor of the corporation and the bond is subject to default risk. High-yield corporate bonds exhibit significantly more risk of default than investment grade corporate bonds.

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Advisor's Corner

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 Widow-Proof (or Widower-Proof) Your Portfolio

Mitigate the Heartache

- Usually one spouse is not involved in the succession of family finances; this can cause unintended negative consequences.
- My clients have heard me repeatedly say, "You don't have to know how the watch works, but you need to know how to tell time".
- Let a Certified Financial Planner at Integrity Financial help make sure your loved one is organized and not taken advantage of should something happen.

Plenty of people who pass away or become debilitated leave their spouses with overly complicated financial plans, too little information, and no clear instructions about where to turn for help. Below are some of the key ways to make sure that doesn't happen to your family.

1) Start the Conversation. Even if your spouse is happily hands-off, it's important that he or she is looped in on the basics of your financial plan, including how much you have, your chief financial assets, and what type of withdrawal rate your portfolio can safely support. Alternatively, or in addition to having a money conversation with your spouse, share at least the basic information about your finances with your most financially literate (and trustworthy) child.

2) Simplify. Assuming a financial plan includes a well-thought-out asset allocation and reasonable intra-asset -class diversification, less may be more in terms of the number of individual holdings. That's particularly true if you're concerned about your spouse's ability to manage the portfolio on his or her own.Of course, multiple accounts with multiple providers may be inevitable in some households, but collapsing your overall number of accounts (and the holdings within them) could be a good starting point on the road to portfolio simplification.

3) Shape Up (and Share) Your Record-Keeping System. Organizing files in broad, easy-to-understand categories (for example "Investments," "Insurance," and so on) is a good starting point, with subfiles for each account. Another good idea is to create a master directory, which can be either electronic or paper. It should contain financial assets such as bank, fund, and brokerage accounts; company-retirement plan and pension fund details; real estate holdings, and business interests. Alongside or beneath each account name, include account numbers, URLs, passwords, key contacts, and phone numbers. Include similar details for debts you owe and insurance policies. Having such a document can be a good way to provide your spouse with a 3,000-foot view of your household's finances; just be sure to tell him/her where to find this document and keep it password-protected or under lock and key.

4) Provide Guidance on Where to Go for Cash. Many surviving spouses may not have adequate cash reserves to fund their near-term living expenses. Stashing too much of your portfolio in cash may carry a steep opportunity cost right now, but every retiree household should aim to keep at least two years' worth of living expenses in true cash. It's also important to provide your spouse with guidance on which assets are most liquid and appropriate to tap in a pinch and which are less so.

5) Put It on Autopilot. Putting as much of your investment plan on autopilot as possible can allow your portfolio to run itself for a time if need be. A key benefit is that you'll be less tempted to override your carefully laid investment plan at an inopportune time, but another is ease of use. Investigate what options your investment provider has for automating your investment program. Switching on features such as automatic required minimum distributions is a good example of this idea.

6) Help Identify a Suitable Advisor. Many individuals with spouses who are disengaged financially take comfort in knowing that their spouse will be able to turn to an advisor after they're gone. If you think your spouse will eventually need to turn to an advisor, it doesn't hurt to begin the search for a qualified advisor while you're still around to help with the screening.

This is for informational purposes only and should not be construed as legal, tax, or financial planning advice. Please consult a legal, tax, and/or financial professional for advice specific to your individual circumstances. Asset allocation and diversification are methods used to help manage risk. They do not ensure a profit or protect against a loss.

Fight or Flight?

It Should Never Be Either/OR

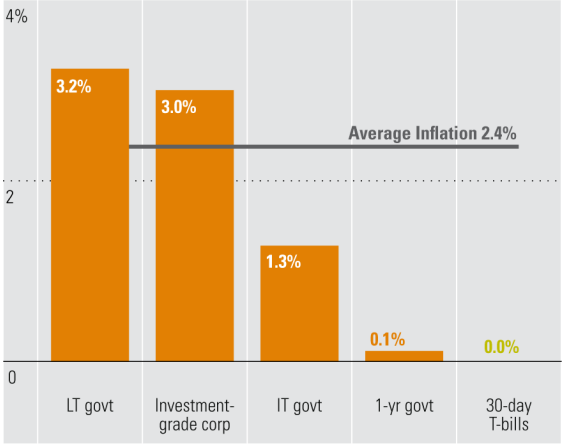
- Government and investment grade bonds should be in every portfolio no matter how aggressive or conservative the client.
- Quality bonds help reduce volatility and they pay interest on your investment.
- When stocks go down in value, people look to these bonds as a safe haven; consequently these bonds increase in value.
- Your portfolio with Integrity contains these high quality investments.

The market turmoil of 2008 has caused panicked investors to flee to safety, from stocks and mutual funds to risk-free investments like Treasuries and savings accounts. However, a risk-free portfolio might carry a high price. With their low returns and limited growth potential, some fixed-income investments may leave investors with little return after inflation. Further, by dumping stocks and investing solely in fixed income, investors are not only losing out to inflation, but they are also missing out on an eventual market recovery and growth. Although Treasuries at times provided investors with a safe haven from market volatility, they didn't provide much protection against inflation over the time period analyzed. The image illustrates the current rates for fixed-income instruments with varying maturities, as well as the average inflation rate over the last 10 years. The yields for intermediate- and short-term instruments examined are currently below the average inflation.

Locking investments in Treasuries' current yields might not provide a long-term real return, especially with expectations of a high inflationary environment on the horizon. Too much allocation to conservative investments can cause investors to forfeit long-term growth. An allocation to equity and longer-term bonds could position portfolios to capitalize on an eventual rebound.

Average inflation is annual, from 2004 to 2013. Current yields are for the month of April 2014. 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 and Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest.

Current Yields of Fixed-Income Instruments Versus Trailing 10-Year Inflation



Investment-grade corporate bonds are represented by the Barclays U.S. investment-grade corporate bond index, long-term government bonds by the 20-year U.S. government bond, intermediate government bonds by the 5-year U.S. government bond, 1-year government bonds by the 1-year constant maturity U.S. government bond, Treasury bills by the 30-day U.S. Treasury bill, and inflation by the Consumer Price Index.

Large Stock Dividend Yield Versus 10-Year Treasury Yield

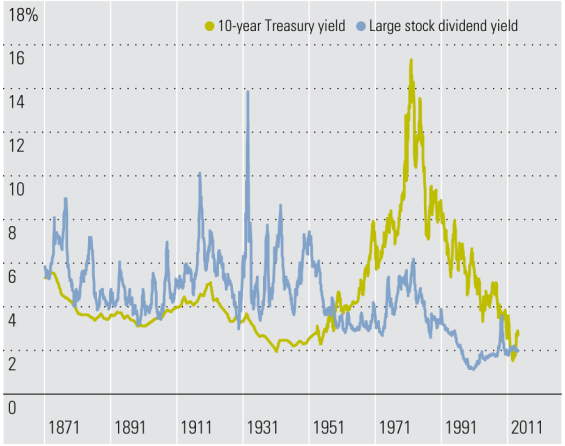
Both are your Investment Friends

- Dividends from large blue-chip stocks are my favorite investment vehicle.
- Companies raise dividend payouts over the years; helping you and your family stay ahead of inflation.
- Blue chip stocks and treasuries are an effective complement to those investors seeking income.

In the recent context of likely-to-rise-at-any-time interest rates, it may be interesting to take a look at the historical relationship between stock and bond yields. As illustrated in the image, stock dividend yields were much higher than 10-year government-bond yields before 1957, with dividend payouts a form of compensation for the additional risk of investing in stocks.

In the more modern period, this relationship has changed. As capital appreciation became a bigger driver of stock performance, bonds became the main engine for potentially steady income generation. After 10-year Treasury rates significantly declined following the 2008 financial crisis, stocks yielded more than 10-year Treasury bonds for the first time since 1957. Recent rising interest rates, however, have pushed government yields above stock dividends once again.

Stock and Bond Yields
January 1871–March 2014



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. Stocks are not guaranteed and have been more volatile than the other asset classes. Dividends are not guaranteed and are paid solely at the discretion of the stock-issuing company. Government bonds and Treasury bills are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest. U.S. government bonds may be exempt from state taxes and income is taxed as ordinary income in the year received. With government bonds, the investor is a creditor of the government. In general, the price of a debt security tends to fall when interest rates rise and rise when interest rates fall. Securities with longer maturities and mortgage securities can be more sensitive to interest-rate changes.

Data: Large stock dividend yield is represented by monthly S&P Composite Index. 10-year Treasury yield is based on the monthly yield of 10-year government bonds. Both indexes are from Robert J. Shiller's Data Library

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