Buck Financial Advisors, LLC

"Helping you Determine your Financial Future"

Vol.5 Issue 8 Oct 2011

Invest For The Long Term !

When building a house the first thing you need is a solid foundation. The same goes for building a solid core for your investments. Investing has become an individual responsibility; as we see the reduction of pensions, underfunded government programs, and increasing costs of health care. Below are tips to develop a good foundation for your investments, to give you long-term results.

First, the guarantee: The one thing that is guaranteed in investing is your expenses will reduce your return. Many times I see financial products, both mutual fund and annuities, that carry expenses upwards to 3% per year. If we are projecting 7% return going forward, that only leaves 4% for you. Add in taxes and inflation and you have a prescription for loss.

Harold Evensky supplies the data on which Money Guide Pro bases the portfolio returns for their software, which I use for plans. He estimates the average annual return on a portfolio of 60% stocks and 40% bonds, after taxes, inflation and expenses, will be about 2.5% to 3% in the years ahead. If you pay the average mutual fund expense charge of 1.2% vs. .2% for a low cost index fund, you will give up 33 to 40 percent of your return. Over a 30 year horizon, a dollar you invest today will forfeit 25% of its future value for that 1% difference.

My recommendation is low cost index mutual funds that minimize the fees. Also keep an eye on the transaction costs of mutual funds. Those costs do not show up in the management fee, but reduce the return of the fund. Low cost index funds also help reduce the impact of taxes on accounts that are not tax deferred retirement accounts.

Since I brought up taxes; if a fund has a high turnover rate per year, the fund will generate higher capital gains and more of them will be short term gains which are taxed at a higher rate. As example, an index fund has 4% turnover, an active fund in the same asset class has 33% turnover. When dividends and capital gains are paid, you have to pay tax on them whether they are reinvested or not.

With the volatility we have been seeing the last few years, don't overlook your losses. You can sell a losing position and reinvest the proceeds in a similar fund and deduct your loses from your income taxes. This is called "tax loss harvesting" and gives you additional funds to invest. One caveat is that you cannot invest in an identical fund within 30 days, or you will violate the "wash rule" and your loss will not be deductible.

Diversification is also key t0 a solid foundation for a long term portfolio. Much has been said about the lost decade of investing. When making this statement, they usually follow up with how bad the S&P 500 fund has done. But the 500 largest stocks do not make the market. When I compare the S&P 500 with a Total Market for the same low cost index fund provider, the diversification of the total market has returned 30% more over the last 24 years.

If you add to this international investments, bonds, and even real estate, natural resources and commodities, you will have greater diversification, and even less volatility.

Last but not least, take advantage of the market volatility to rebalance your portfolio at least annually, or when your portfolio changes by a fixed percentage. The methodology is not magic, the fact that you rebalance is what produces the results. For more on balancing see the article on my website under the financial briefs tab. Above all else, once you have a plan, adhere to it through the ups and downs of the market.

Buck Financial Advisors provides independent, commission-free financial advice for people from all walks of life. When you or someone you know needs help, Buck Financial Advisors is there. See www.buckfinancial.com for more information.

Charles Buck CFP®

Ask a CFP® Professional!

What is the difference between rebalancing and reallocation?

Reallocation is changing from one allocation to a different one. As we grow older, we generally reduce our allocation to stock mutual funds and add more to fixed income. It is not unusual for a young person to have 80% in stocks, but that level of stock risk would be inappropriate for most retirees.

Rebalancing is moving your current percentages back to your original planned allocation. As different market segments move at different rates, your allocation will become over-weighted to faster moving segments. To lock in those gains you sell part and buy the slower moving segment.

To remove your name from our mailing list, please click here. If you have questions comments or seek independent financial advice e-mail Buck Financial advisors at charles@buckfinancial.com or call at 651-330-3585.