The
FINANCIAL UPDATE

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401(k) Target Date Funds Coming Under Scrutiny

For business owners who put their faith—and their employees' retirement plan dollars—in target date funds, their performance during the last market downturn was disappointing. Touted as all-in-one investments, target date funds are supposed to shift to a more conservative asset allocation mix as a specified retirement date approaches, helping protect investors from market meltdowns a few years from retirement. But the poor performance of many of these funds during the bear market of 2008, has brought the Securities and Exchange Commission and the Department of Labor to consider possible improvements to target date funds.

For employer sponsors of 401(k)s and other tax-advantaged plans, target date funds had seemed like a good vehicle for fulfilling fiduciary responsibility to plan participants. The Pension Protection Act of 2006 lets employers automatically enroll workers in retirement plans, and plan sponsors may designate target date funds as their plan's default investment.

But for employers who made that choice, performance figures from 2008 are disturbing. According to Morningstar Inc., target date funds with targets from 2000 to 2010—and thus, presumably, with the most conservative allocations—lost an average of almost 23% in 2008, and losses for 2010-dated funds ranged from a low of 3.6% to a high of 41%, which was worse than the 37% retreat of the Standard & Poor's 500 stock index. Funds with dates from 2011 to 2015 declined an average of 28%, according to Morningstar. Funds have since recovered along with the market but the correlation is worrisome.

While financial companies defended the track records of target date funds and said they needed to keep the freedom to determine their funds' allocations, participants have criticized the funds' performance and construction. It turns out many funds continue to keep most of their money in stocks, even close to their target dates. In 2008, equity allocations in 2010-dated funds ranged from 9.15% to 65%. That kind of variation can be dangerously misleading for fund investors, saddling many with riskier portfolios and larger losses than they'd expected. In fact, according to an online survey of 250 American workers by Behavioral Research Associates, many investors believed target date funds couldn't lose money or guaranteed they could retire by the date in the fund name.

Many target date funds are funds of funds, investing in narrower funds to handle particular allocations, and they typically use funds from only the issuing company's roster, neglecting other, potentially stronger investment managers. Some critics believe fund companies should offer more than one risk level for each target date, letting

(Continued on page 4)

Filtering The Economic News

If you follow news of the economy, you'll often see conflicting stories. Articles in the same publication may proclaim widely differing views. A February email alert from Kiplinger's Practical Economics quoted Peter Schiff stating that "We're in the Early Stages of a Depression". Two articles in that same newsletter were titled "Smoother Road Ahead for Economy" and "Economy Shows Signs of Growth".

As financial planners we are inundated with "news" about the US and Global economy. We use a variety of filters to get a clearer reading of the situation:

1) We follow price trends and technical analysis on sites such as Stockcharts.com, Decision Point and Aden.
2) We participate in conference calls and read newsletters and blogs from leading money managers at firms including PIMCO, Goldman Sachs, GMO, Schwab and Vanguard.
3) We look for consistency and credibility from an author. The sources we choose have decades of experience.

We encourage our clients to watch, read and listen, but filter what you see so that you are not unduly influenced by the story. Please feel free to call and discuss any concerns you may have. We want you to have confidence in your investment strategy.

John R Day Bill Ennis

It's NOT The Economy, Stupid!

In 1992, then-candidate Bill Clinton used the slogan "It's the economy, stupid" to help him stay on message and pound President George H.W. Bush for his failure to pull the country out of a recession. The point was that jobs and other economic issues were what mattered most to voters. Yet while that may still be true as far as elections go, it oversimplifies things when it comes to investments. Your results ultimately have more to do with the choices you make in responding to economic conditions, rather than the actual state of the economy itself.

This is an important distinction that underscores the limits of a pure "buy and hold" strategy that just sticks with investments to wait for them to match their average past performance. While stocks do tend to track the general economy over very long periods of time—and stocks, like the economy, have always ultimately prospered—few investors can afford to wait several decades for beaten down investments to bounce back. Instead, it makes sense to take steps to mitigate the risk of sharp losses.

The events of the past few years have forcibly illustrated the fact that equities can be extremely volatile in the short term. And even if you're still 20 or 30 years from retirement, market ups and downs have a real impact on your returns. It's only at the 40-year mark that returns tend to fall in line dependably with economic progress, according to a recent study by economist Richard W. Kopcke and researcher Dan Muldoon at the Center for Retirement Research at Boston College.

Their study—"Why Are Stocks So Risky?"—shows that investor behavior has a far stronger influence over returns than do the gyrations of the economy, especially over periods of 20 years or less. The authors define investor behavior as "the way shareholders react to their uncertainty about economic conditions, form opinions about the future, and manage their portfolios."

The good news is that of the two factors—economic conditions and investor behavior—that influence investment returns, the one that exerts the greater influence is the one you control. What really matters are the decisions you make in setting up and operating your investment portfolio.

Those choices include everything from defining your risk tolerance and setting life goals to diversifying your portfolio and reallocating assets in response to shifting short- and long-term trends. Maintaining broad diversification spreads your risk across and within multiple asset classes, and making regular, strategic reallocations helps you stay diversified even as conditions change.

Now, as the economy embarks on what could be a long, uncertain recovery, we can help you make sure that your portfolio is positioned to reflect who you are and what you want to accomplish.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Veil Lifted From Municipal Bond Market

Municipal bonds have long been prized for their tax-exempt status and because they aren't as likely to default as are corporate bonds. However, the default rate has skyrocketed amid the global economic crisis, increasing the need for transparency in this specialized market.

Regulators have responded with three new measures designed to help investors navigate the complex world of municipal bonds, which are debt instruments issued by cities, counties, and local agencies such as school districts, publicly owned airports, and development agencies. Munis pay for projects such as hospitals, schools, public buildings, roads, and utilities. Bonds that fund programs for the public good are usually exempt from most taxes, including federal.
While mutual funds, banks, hedge funds, and corporations all invest in the $2.7 trillion municipal bond market, 64% of muni investors are individuals.

In 2008, 140 issuers defaulted on $7.6 billion in muni bonds as states and cities across the nation faced massive budget deficits. That compared with just $226 million in defaults during 2007. This trend, which is likely to continue, makes munis a bigger risk, and means investors need timely information more than ever. Here are three ways the federal government is bringing more transparency to the muni market.

Putting it all online. Over the summer, a new website called Electronic Municipal Market Access (EMMA, at http://emma.msrb.org) began offering free information, from financial filings to trading records, on most of the 1.2 million outstanding municipal bonds. Operated by the Municipal Securities Rulemaking Board (MSRB), the site allows investors to research municipal bond issues and keep track of new filings. In the past, investors often were not aware if an issuer had failed to file statements or had taken some action

Recession Reshapes College Choices

At a time when getting into college has become more competitive than ever, the nation's economic crisis is making it harder for students and their parents to pay tuition and obtain financial aid. Those trends are affecting students' choices of where to apply and how many applications to send, and there are more hard choices to be made when admission letters arrive.

Families at all income levels, beset by job layoffs and mortgage woes, are trying to make college plans despite persistent economic uncertainties. At the same time, investment losses have forced many universities to cut back on scholarships and other aid. Rising numbers of private lenders, including such giants as Bank of America and Wachovia Bank, are pulling out of the student loan market, and lenders that remain have tightened requirements and raised interest rates and fees. And though government-backed loans carry lower interest rates, that pool of funds is limited.

Meanwhile, many households are cutting back on savings for college, and the value of education accounts has taken a hit. According to Morningstar Inc., all 79 of the tax-advantaged 529 college savings plans it tracks lost value in 2008, with most falling 10% or more. Another potential source of funds to pay for college—home equity loans or lines of credit—is also becoming more difficult to tap, according to Dennis Nostrand, vice president of enrollment management at the University of New Haven in Connecticut. "The value of homes has dropped, and banks are being extremely cautious in making home equity loans," says Nostrand.

David Hawkins, director of public policy for the National Association for College Admission Counseling, agrees that the economic slowdown is making it more difficult for families to plan for college. "They just don't know what to expect," Hawkins says. "We see students and parents attempting to hedge their bets by filling out more applications, a trend that has further fueled the increasing competition."

The average student today applies to five to seven schools, and some apply to 10 or more, Hawkins says. A generation ago, students typically applied to just two or three. "State colleges, which tend to cost much less than private institutions, are reporting higher-than-expected application numbers," says Hawkins. "Students and families are including state colleges in their application lists in larger numbers than in the past."

For example, Clemson University, a state school in South Carolina, has seen a 10% increase in in-state applications, and applications are up 18% this year at both the University of Idaho and the University of Central Florida. Binghamton University in New York, however, may take the prize, posting a 50% surge in applications for classes in fall 2009.

Another factor boosting the level of competition is steady growth during the past 15 years in annual numbers of high school graduates. That trend is expected to peak in 2009, when some 2.9 million teens will finish high school.

Students today have about a 70% chance of acceptance into a four-year college, according to Hawkins. Ivy League schools are among the most competitive, with some accepting fewer than one in 10 applicants, while a wide range of top-tier universities admits fewer than half of those who apply. Many very selective private colleges, despite their much higher costs, are also seeing application numbers rise. Private institutions often have more scholarship opportunities, some of which are not available through public schools.

In this intensely competitive environment, more parents are hiring educational consultants, sometimes when their children are only high school freshmen or sophomores, to help guide them through the application process. Yet while applications are surging at many colleges, pushing down the chance of being accepted, the economic crisis means universities often don't have the institutional dollars they once could use to convince admitted students to matriculate. "In the spring, when admission and financial aid letters go out, students and families are really going to have to take a close look at each school's combination of scholarships, grants, and loans," Hawkins says. "There is going to be some serious comparison shopping."

As you and your children formulate their college admissions strategies, we can help you explore ways to pay tuition and costs that won't undercut your own retirement planning. Please give us a call. ●

affecting a bond or its rating. The site also offers educational materials.

Into the open, and quickly. The Securities and Exchange Commission has proposed a new rule that would force issuers to disclose on EMMA any change in their financial status within 10 days. That would include changes in an issuer's credit rating, withdrawals from reserve funds, and late payments of principal or interest. In the past, investors have complained about delays in receiving this information and issuers' failure to file required disclosures.

Turning up the heat. The Financial Industry Regulatory Authority (FINRA) is looking into the sales practices of brokerage firms that sell municipal securities and has asked for detailed information on business conducted during 2009.

All of these actions should make for a more transparent municipal bond market. If you have questions about municipal bond investing or your muni holdings, please give us a call. ●

The term "municipal bonds" is typically used to describe all tax-exempt bonds. Although such bonds are commonly referred to as "tax-exempt," there are numerous federal and state tax consequences associated with the acquisition, ownership, and disposition of such bonds. The tax-exempt status of municipal bonds does not extend in all instances to the Alternative Minimum Tax. Please contact your tax advisor for more information.

Yield vs. Risk In Emerging Market Bonds

Stock markets around the world improved in 2009, but the spectacular growth came in emerging markets, which gained more than 75%, according to Barron's. Foreign stocks and bonds swept up a record $64 billion of American investor assets, with just more than half going into emerging market equities, $2.7 billion into emerging bonds, and the rest into developed market bonds. Meanwhile, U.S. equity mutual funds lost $40.3 billion in assets in 2009.

While the money flowing into emerging market bonds represented a small proportion of foreign investment, it was nevertheless a remarkable development. U.S. investors had paid little attention to those fixed-income securities until the global financial crisis reduced yields on U.S. government bonds to next to nothing. Because bonds of developing countries are considered riskier than U.S. Treasuries, they pay more—and recently, a lot more. Some emerging market debt now pays more than U.S. corporate high-yield bonds.

Emerging market bonds provide a good example of the trade-off between risk and return. U.S. Treasuries have historically been considered "risk-less" and pay little. Emerging bonds, which pay plenty, may bring considerable risks. The Dubai scare, when Dubai World announced in December 2009 that it had to renegotiate at least some of its $59 billion in debt, reminded investors of the 1998 crisis, when Russia defaulted on its bonds. Back then, some emerging market bond funds sported yields well into the double digits, as they did again in 2008, according to The Wall Street Journal.

Yet despite their volatility, emerging market bonds can serve as an effective tool for managing risk. They can squeeze a little extra yield out of the income portion of a portfolio while also decreasing risk, thanks to their diversification value, and may provide a hedge against the fluctuating value of the U.S. dollar, as long as the currency of the country issuing the bonds isn't pegged to the dollar.

The governments of many developing countries have received high marks for their handling of the global financial crisis, and if they can follow up with sensible policies as economic growth returns, investors may be more willing to hold their bonds. At the end of 2009, the "risk premium"—the additional return investors receive for putting money into less stable holdings—on developing world bonds, as measured by JPMorgan's Emerging Markets Bond Index Global, had fallen to just under 3 percentage points above Treasuries.

Many investment experts believe U.S. holdings should account for a smaller proportion of investors' assets than they have in the past, and increasing exposure to international markets could include buying debt in developing countries. We can talk to you about the risks and rewards of such investments and help you review your portfolio mix. ●

Funds Under Scrutiny

(Continued from page 1)

investors choose among aggressive, moderate, and conservative portfolios. There have also been calls for stricter regulations that would cap the percentage of stocks in funds marketed to investors nearing retirement or standardize all target date fund allocations.

Fund companies don't want to be forced to adopt specified investment mixes, and they argue that it's appropriate for funds to have significant commitments to stocks. Even if investors in a 2010 fund, for example, plan to retire that year, they are likely to spend years in retirement and will need the kind of long-term portfolio growth equities have the potential to provide. Improved investor education would solve many problems associated with target date funds, according to the fund firms.

Frank Sortino, professor emeritus at San Francisco State University and director of the Pension Research Institute, believes retirement fund sponsors would be better off choosing another of the automatic enrollment default options: managed accounts. Such services, provided by investment managers, could provide the customized focus on individual needs that target date funds lack, says Sortino, who notes that age is just one of several variables to consider in creating a retirement plan designed to replace preretirement income. ●

Mutual funds are offered by prospectus. Please consider the charges, risks, expenses, and investment objectives carefully before investing. The prospectus contains this and other information. There are certain risks and considerations to take into account prior to investing in a target date fund. A target date fund, also known as a lifecycle or age-based fund, is a fund portfolio that helps investors saving for retirement choose a single portfolio aligned with the year closest to their expected retirement. It is designed to provide an asset mix that becomes more conservative as the date for expected withdrawals to begin approaches. Consider in addition to your age or date of retirement other factors, including your risk tolerance, personal circumstances, and complete financial situation. A target date fund is not guaranteed and it is possible to lose money by investing in the fund, even after the target date has passed. Certain fund's asset allocations may be subject to change and the extent to which the allocations of a target-date fund among types of investments may be modified without shareholder vote.

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