THE
JENTNER REPORT
Wealth Management Strategies from Jentner Financial Group Spring 2011

Buying and holding mutual funds: very much in style

Today, when investors buy and sell exchange traded funds by the hour, holding a mutual fund for the long term may seem quaint. Yet evidence shows this approach may be the best and easiest avenue to investment success. For a very long-term example, look at two of the oldest mutual funds in America—Pioneer Fund and Massachusetts Investment Trust. Investors who purchased those funds back in the 1920s were amply rewarded for hanging on through depression, recession, panics, world war, and revolution.

The power of patience

Pioneer grew an astonishing 938,000% from 1928 through 2010. A $1,000 investment in 1928 would have grown to almost $10 million by the end of 2010. Its average annual return was 11.8% after expenses. MIT fund did almost as well, returning 8.9% annually since 1924. Of course, many old funds have disappeared due to poor performance. Pioneer and MIT share value-oriented investment philosophies and low stock turnover. Investors must pay attention to factors such as consistency, cost, and investment turnover when choosing funds.

Learning not to fold

In our belief, confidence in the right fund is best accomplished by investing in low-cost index funds and institutional asset class funds. Investors can thus avoid the risk of poor manager performance from actively managed funds.

Investors who are convinced they are in the right funds must learn not to give up during inevitable periods of market under performance. These disappointing periods cannot be predicted. The future of the markets and of specific investments is unknowable.

Various studies show that when funds under-perform, money flows out and when good performance returns, money flows in. Investors who bail during declining markets, only to invest later, end up employing the well-known but little-loved investment strategy of buying high and selling low.

Investors who own a portfolio of mutual funds may find it easier to stick with each fund even though its current performance is below expectations. If an investor invests in different types of assets—large and small stocks, foreign and domestic stocks, bonds—it is likely that some funds will offset the performance of those doing poorly. This could encourage an investor to hold the portfolio for the long term, riding out rough periods in the markets.

Mattress is a bad place for your money

The market crash of 2008 scared away some investors. Others shifted money from stocks to bonds, or stopped contributing to retirement plans. Those strategies backfired. Investors who stuck with or added to their investments did

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The Jentner Report is published quarterly by

JENTNER FINANCIAL GROUP

302 N. Cleveland-Massillon Road
Akron, Ohio 44333-9303
330-668-1000 866-Jentner (536-8637)
www.jentner.com

The President's Word

Exotic ETFs can land you in hot water

A new type of investment carries very high risks for the unsophisticated. So-called leveraged and inverse ETFs (exchange-traded funds) can quickly sink unwary investors, warns the Securities & Exchange Commission and FINRA, self-regulator for the brokerage industry.

Exotic bets

Leveraged and inverse ETFs use exotic investment vehicles: swaps, futures contracts, and other derivatives. Leveraged ETFs try to achieve double or triple the performance of the underlying indexes they invest in. Inverse ETFs try to rise or fall inversely to their underlying index —to go up when the index falls. Leveraged inverse ETFs try to double or triple in inverse relationship to the index. All are designed to deliver such performance on a daily basis only. Results over weeks or months can differ significantly from the index, to the point where an investor in the index would have made money but the investor in the ETF would have lost!

Real life losers

Some investment firms have called these ETFs booby traps for average investors and have asked the SEC to restrict their sale. BlackRock Inc. will not sell these investments to individuals, only to institutional investors, citing how difficult they are to explain. We do not endorse leveraged or inverse ETFs, or daily trading. We do recommend index funds and ETFs designed to reflect the investment results of the underlying index or asset class, as part of an overall risk-appropriate asset allocation. Don't get greedy. Control risks and pursue potential rewards by an allocation that you can live with through the market's inevitable ups and downs.

Bruce A. Jentner, President
Jentner Financial Group

"mutual funds"

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far better than those who sought the safety of the "mattress strategy," says the National Center for Policy Analysis in a study of 2008-2009 portfolios. "Even during a tumultuous year for the market, a stock index outperformed a bond index fund, a money market account or simply hiding the money in the mattress," wrote analyst Pamela Villarreal.

Timing rarely works for those who sell out and try to buy back in when prices are rising. Villarreal noted that "those who invest this way rarely purchase stocks at the optimal time. Selling and shifting money out of an asset when it is priced low is a sure way to lock in a loss."

A lesson for young workers: save as much as you can now

Here's a lesson to keep repeating to your children and grandchildren: it's easier to save $400 per month toward retirement than to save $6,000 per month.

Seems simple, yet it might be the hardest financial chore a young person can undertake. The reward, however, is a secure retirement, rather than to keep working late, live in poverty or depend on government benefits.

A 25-year-old worker who wants to accumulate $1 million by age 65, and who expects to return 7% a year, needs to put away $381 per month. The worker who delays retirement saving until age 55 must put away $5,778 per month—over $69,000 per year from age 55 to 65—to get to that $1 million goal.

It's all about gains compounding over time. The longer a young worker has until retirement allows his or her savings to grow substantially over the years.

The first $381 the worker puts away is the most important: If she starts at age 25 and deposits this each month until age 35, then stopping, and her brother delays until age 35, and puts the same amount away each month until age 65, her brother's account will never catch up to her account, even though she only deposited for 10 years (age 25 to age 35).

Savers who start early get a break later in life: it may be hard to come up with $381 a month at age 25, but as they age and inflation and salary increases occur, it will become easier. In fact, it will later free up cash flow for the increased expenses of raising and educating children. Even if a young worker can't save that ideal amount right away, saving as much as possible each month and then regularly increasing that monthly amount will let him achieve his goals. The worst move is to wait until later in life to start saving.

Help your children become financially literate and financially responsible. Encourage them to start depositing money out of every paycheck, no matter how young they are. Let the wonders of compound earnings over time help them reach their own financial independence.

Gift idea

You may want to encourage your working children or grandchildren to deposit money into a Roth IRA each year since these accounts grow tax free – yes, under current law, tax free, not just tax deferred! While their incomes are low enough to qualify*, and while the law permits, you may want to offer to match their annual Roth IRA contribution up to $2,500 annually. Their contribution of $2,500 and your matching contribution of $2,500 will fund their tax-free Roth IRA up to $5,000 annually. This could help them get an early start toward their retirement investing with an incentive to make this annual investment commitment.

** Contact your income tax professional for details.*

College costs create burden

Weigh the risk to retirement

Middle-aged parents face two huge expenses: college costs for children and the larger cost of their own retirement. Many find it hard to juggle the two priorities.

A recent Gallup survey for student lender Sallie Mae found that 6% of parents in 2010 had taken money from a retirement savings plan or IRA to cover college costs for a child. That was up from 3% who did the same in 2009. The average withdrawals also grew, to $8,554 from $5,318. And 3% of parents said they took a 401(k) loan for college costs.

Robbing Peter

This can cause big problems later in retirement, says New York's College Savings Plan. Parents who rob retirement accounts to pay college bills likely do so from ages 40 to 60. That gives them little time to make up for it.

The 529 plan sponsor noted that while an $8,554 withdrawal doesn't sound big, it adds up if done for all four years of college, and gets worse if done for a second or third child. Also, building up debt in a 401(k) plan before retirement increases one's financial burden.

Parents must pay income tax on withdrawals from an employer savings plan or an IRA. If done before age 59.5 from an employer plan, an additional 10% tax penalty is assessed. The withdrawals, taxes, and penalties leave parents with less in their retirement plans to compound and grow for the future.

Limited expense

Parents should realize that college tuition, while expensive, is limited to the years a child is in college. Retirement, however, can last for decades, with the overall expense hundreds of thousands of dollars higher. It may be better for all concerned to have children borrow for their own education.

www.jentner.com

Jentner Financial Group
302 N. Cleveland-Massillon Rd.
Akron, Ohio 44333-9303

Address Service Requested

Are boomers getting too conservative?

Baby Boomers approaching retirement were hit hard by the 2008 bear market and recession. A study by Cogent Research of affluent boomers 55 to 64 years old found that in October 2010 they had $100,000 less in their retirement portfolios than four years earlier.

The group studied—boomers with at least $100,000 in investable assets—had an average of $708,000 last October, compared with an average of $809,000 four years earlier. Although they still had sizable portfolios, the decline in value was "particularly hard for those approaching retirement," said John Meunier of Cogent.

Pulled back from stocks

There is evidence that this group of boomers lost confidence in the financial markets after the 2008 bear market and reduced the risk in their portfolios. Meunier said, "We saw a significant increase among older boomers last year in allocations to lower-risk investments just as the market was rebounding. Unfortunately, this only served to dampen their ability to regain losses sustained in the downturn."

A study by T. Rowe Price also indicated that investors have been taking money out of stock mutual funds since 2007. However, those investors who stayed with stocks continue to beat inflation.

Younger baby boomers took the bear market more in stride, Cogent said. Its survey showed that boomers ages 45 to 54 had higher exposure to stocks than their older cohorts and had continued to contribute more money to employer retirement plans.

Still contributing

Some 84% of this group contributed to the plans in 2010, up from 79% in 2009. "Some investors are once again thinking ahead and planning for the future instead of [like] last year when they were still hunkered down waiting for the storm to pass," said Meunier.

It is a common feeling at retirement to think that a portfolio must be made conservative in order to avoid losses. But those contemplating retirement should realize that they won't be using all of their assets in the first year and that a good portion should remain in stocks to combat inflation over time.

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REPORT

Spring 2011

"Financial life planning provides better wealth management by asking smarter questions, listening more carefully and applying sound financial and investment strategies to help you achieve personal and objective goals. It is not something different or new; it's simply planning the right way."