

HOLIFIELD HUNTLEY

Financial Advisers

October/November 2010 Volume 3 Issue 8

Investment Updates

Budgeting In Uncertain Times

Most budgeting starts with the assumption that you've got a steady paycheck and just have to plan your spending around it. But what if your paychecks are anything but steady?

Fluctuating incomes are a way of life for many as companies rely more heavily on freelancers, contingent workers and part-timers whose hours can be ramped up or reduced in response to changing demand. Even retirees are now more likely to see work opportunities come and go and investment income rise and fall.

The result: Many of us are discovering what sales people, artists and performers always have known — planning is a lot tougher when you don't know how much income is in your future. Yet planning is even more important if your income is irregular.

You can get the ball rolling by creating two worksheets — one for your sources of

Read more:

www.mint.com Free software for budgeting and tracking expenses.

<http://www.bls.gov/cex/csxann07.pdf>

Compare your spending to national averages in the Consumer Expenditures Survey.

www.kiplinger.com/basics Helpful articles and worksheets from Kiplinger's.

<http://articles.moneycentral.msn.com/SavingandDebt/LearnToBudget/ASimplerWayToSaveThe60Solution.aspx> Provocative article from MSN Money on "The 60% Solution".

household income and the other for expenses. Assign each item to one of three categories, writing in the dollar amount. Categorize your income as *Reasonably Secure* (Social Security, a pension, a steady

See BUDGETING, Page 2



Helen Huntley & Rhonda Holifield
(727) 823-3801
www.holifieldhuntley.com

Adviser Corner

Holifield Huntley is a fee-only wealth management and financial planning firm. That means we are paid by our clients, who can count on us to be objective and have their best interests at heart. We do not receive commissions or compensation from others for selling their products.



Our firm is proud
to be affiliated
with the
National Association of
Personal Financial Advisors.

BUDGETING, from Page 1

job), *Likely* (a recurring freelance gig) and *Sporadic* (everything else). Categorize your expenses as *Rock Bottom* (basic needs and contractual obligations like your mortgage and debt payments), *Getting By* (you'd really hate to give it up) and *Comfortable* (vacations and Starbucks).

If you have trouble remembering all your expenses, reviewing your credit card statements might help, as might keeping a record of everything you spend for a month or two. It's important not to overlook expenses that come around less frequently such as insurance premiums, car repairs and holiday spending. You can estimate those expenses and divide by 12 to save something toward them each month.

Put the two worksheets together and you can create a personalized spending road map. Your *Rock Bottom* expenses need to match up with your *Reasonably Secure* income (the preferred arrangement) or *Reasonably Secure* and *Likely* income combined. If your *Rock Bottom* expenses are higher than that, your focus needs to be on reducing them. One way to do that is to pay off debt, eliminating required payments. Another way is to acknowledge that some expenses aren't really necessities and belong in the *Getting By* category.

When spending money in good times, avoid saddling yourself with obligations that will increase your *Rock Bottom* expenses when times aren't so good. That means, for example, if you buy a new car when you've just gotten a big bonus, you need to either pay cash or put down enough that your monthly payments will fit within your *Rock Bottom* budget.

Use your expense worksheet to set spending priorities and create a running list of what needs to be paid when. Make sure the *Rock*

Bottom expenses get taken care of first, with other items added as funds become available. Some people use a system of envelopes to earmark cash for future expenses.

Be sure to keep enough in your checking or money market account to cover at least a month's worth of expenses. The more erratic your income, the more you need to keep on hand. On top of that cash-flow account, it's vital to have an emergency fund to cover the unexpected like home and car repairs or to tide you over if you were to lose your job. It might cover as little as three months' worth of expenses if you've got a working spouse or you have substantial secure income, but you should have six months' or more if you're on your own. Funds like that usually are built up gradually so don't worry if you're not there yet. Just make it a priority to get there and save a little toward it each time you have extra money.

Other things that might help:

- Stay on top of your tax liability and make quarterly payments or increase payroll withholding appropriately so you don't get stuck with a big tax bill.
- Avoid credit card debt. Don't run up bills expecting to be bailed out when times improve. Instead, save in advance for trips, car repairs, gifts or whatever else is on your agenda.
- Start putting money away for retirement while you are young even if it's only a very small amount. The more years you have to save, the more compounding can work in your favor.
- If your work is at all seasonal, arrange to pay your insurance premiums and make discretionary payments such as charitable contributions at times when you're more likely to have money in your bank account.

The Rollover IRA: Taking It With You

One of the most convenient and flexible options for dealing with a retirement plan from your ex-employer is to transfer the money to a Rollover Individual Retirement Account. A Rollover IRA is, in essence, a traditional IRA where you can park the cash you're transferring from your old employer's retirement account. The money you invest in a Rollover IRA accumulates tax-free until you take it out in retirement, just as it does in a defined-contribution retirement plan (401k). You can open a Rollover IRA with just about any investment firm, including mutual fund companies, insurance companies, and online brokers. You're allowed to invest the money in stocks, mutual funds, bonds and other types of investments. That's why the Rollover IRA is your most flexible choice when leaving a job.

You have a number of options after you open your Rollover IRA, too. Of course, you can leave it alone until you retire. But if you move

on to a new job, you may be able to transfer the money you have invested in your Rollover IRA into your new employer's retirement plan (assuming the qualified retirement plan has language permitting such rollovers). And if a Roth IRA is more to your liking, you can convert your Rollover IRA into a Roth IRA, if you meet the criteria.

Keep in mind that you can't take a loan from a Rollover IRA as you can from some employer-sponsored retirement plans. Moreover, Rollover IRAs are also subject to the same withdrawal limits as other tax-deferred retirement accounts. So, if you take any money out before you turn 59½, you'll pay a 10% early withdrawal penalty in addition to taxes.

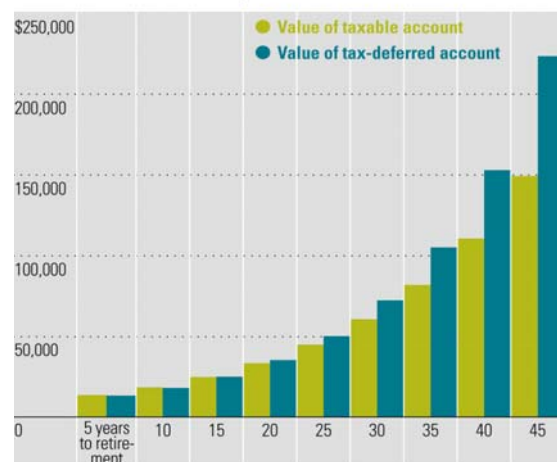
Remember: Returns and principal invested in stocks are not guaranteed. Stocks have been more volatile than bonds.

Take Advantage of Tax-Deferred Accounts

One of the main reasons retirement accounts are so beneficial is the power of tax deferral. In a tax-deferred investment vehicle such as a 401(k) plan or an IRA, your earnings are not taxed until you begin withdrawing money from your account in retirement. Consider the image. A hypothetical value of \$10,000 is invested in both a taxable and a tax-deferred account. The difference in value between the two accounts becomes quite substantial after 20+ years. For investors with a long investment time horizon, a tax-deferred portfolio is an excellent choice.

Please keep in mind that once you begin to withdraw money from your retirement account, you will be taxed accordingly. However, since you will most likely earn less in retirement, withdrawals from a deferred portfolio may be taxed at a lower rate.

Benefits of Deferring Taxes



Withdrawals of tax-deferred accumulations are subject to ordinary income taxes. A 10% federal tax penalty may apply to withdrawals made before age 59½. Returns and principal invested in stocks are not guaranteed.

Source: This hypothetical example is for an investor in the 28% bracket using the 2009 tax code (estimated to become the 31% tax bracket in 2011). \$10,000 is invested in stocks at the beginning of year 1 (2010). Assumes an 8% annual total return (6% price return and 2% income return) and a 15% tax rate on capital gains and dividends in year 1 (2010), after which the rates revert to 20% and the investor's marginal tax rate, respectively. The investment is taxed at a 28% marginal tax rate in year 1 (2010), and then reverts to 31%. Taxes are assessed yearly on the taxable account but only at the end of the period on the tax-deferred account. Estimates are not guaranteed.

Common Investing Mistakes

Almost all of us have made investing mistakes. The key is not to make the same mistake twice. These mistakes can directly affect whether or not you achieve your desired goals. By repeating even just one mistake, individual investors can quickly become their own worst enemy. Below are some common mistakes that many fall prey to and some suggestions on how to sidestep them.

Starting Too Late

The first mistake many folks make is waiting too long to initiate a long-term investment plan. The earlier you start the investment process, the more likely it is that the plan will succeed. Let's consider two investors: Bill and Tim. Bill began investing \$5,000 per year 30 years ago. Tim began investing \$10,000 per year 20 years ago. Assuming a hypothetical return of 10% per year, Bill's ending wealth value was \$822,470 compared to \$572,750 for Tim. Thanks to the power of compounding, a small amount of money, wisely invested early on, can turn into a large sum over time. Avoid procrastinating; start investing today.

Chasing Past Performance

Yesterday's hot stocks or mutual funds may not be today's best investments. Many investors purchase assets when they have already reached their peak, only to watch their performance subsequently suffer. It may be a good idea to choose investments with a history of good performance as well as quality management.

Lack of Diversification

By investing all of your money into just one asset class, industry, or company, you are

placing all of your eggs into one basket—and this can be extremely risky. It is better to combine a variety of investments, such as stocks, bonds, and cash, which are unlikely to move in the same direction. Your risk exposure should be lessened as a result.

Lack of Research

No matter what type of investment you plan to make, be sure to conduct the proper research. It is unwise to allocate your money to an investment you do not understand. There are a number of helpful resources that you can explore — ranging from public information to professional advice. Take advantage of these when possible.

Unrealistic Expectations

Many investments require time to grow. Investors often become frustrated with the early performance of their investments, decide to sell too quickly, and move the proceeds into other investments. This will result in too much trading, which is not only expensive, but also usually unnecessary. It is important to maintain a long-term view and to not be distracted by short-term results.

Overconfidence

Confidence is a good thing, but overconfidence can cause investors to improperly select investments. Too much assurance in one's knowledge and ability can lead investors to focus on the upside and deemphasize the potential downside of investments. Instead, a solid financial plan constructed by a professional can go a long way.

A Beginning Investor's Reading List

There are plenty of resources to help beginning investors who are willing to put in a little time and effort. Here are a few of the more popular and recommended books, with the caveat that this list is far from exhaustive.

The Only Investment Guide You'll Ever Need By Andrew Tobias

This book is a classic overview of the essential things of which any investor should be aware. Writing in a witty, irreverent style, Tobias covers the basics of stocks, bonds, mutual funds, 401(k)s, IRAs, real estate, and how to save and invest prudently for the long term. If you feel totally at sea when it comes to investing, this book is a good place to get your footing.

Buffett: The Making of an American Capitalist By Roger Lowenstein

This biography on legendary investor Warren Buffett is a good way to introduce yourself to the man and his investing philosophy. Buffett has become one of the world's richest people by investing in good businesses at low prices through his holding company, Berkshire Hathaway, using timeless principles that are helpful for anyone. This biography has a lot of background information that explains how Buffett got where he is today.

The Bogleheads' Guide to Investing By Taylor Larimore, Mel Lindauer and Michael LeBoeuf

John Bogle, founder of the Vanguard Group, is another investment legend. His relentless emphasis on the importance of low expenses changed the mutual fund industry — he invented the index fund, among other things — and has saved money for countless investors over the years. This book (with a foreword by Bogle) is a great introduction to Bogle's ideas and how to apply them to your investing life.

A Random Walk Down Wall Street By Burton Malkiel

This book is the most entertaining and accessible defense of efficient-market theory, which says that

it's impossible to predict what the market will do with any kind of consistency. This idea is one of the cornerstones of modern academic finance, and it's also a key element in John Bogle's advocacy of low-cost index funds that simply track a market index rather than trying to beat it. Malkiel discusses various versions of efficient-market theory, explains what they mean for investors in practical terms, and discusses challenges to the theory.

Stocks for the Long Run By Jeremy Siegel

This is another modern classic. Siegel, a finance professor at the University of Pennsylvania's Wharton School, has long promoted stocks as the best long-term investment available, and in this book he provides plenty of evidence to back up that claim. There is quite a bit of market history, but there are also excellent explanations of such topics as stock indexes, futures and options, global stock investing and the Federal Reserve. Siegel discusses historical evidence about which types of stocks perform best over the long run, as well as various attempts to beat the market and thus disprove the efficient-market hypothesis. A chapter at the end on how best to use stocks in a portfolio is especially valuable for beginners.

All About Asset Allocation By Richard A. Ferri

Asset allocation, or the percentages of stocks, bonds, cash, and other investments in your portfolio, is a very important topic that doesn't always get the attention that it deserves. Several of the above books touch on asset allocation, but this book goes into more depth on this important topic in a way that's accessible to investors who are just starting out. Ferri includes a big-picture overview of asset allocation and why it matters, discussions of the various asset types (U.S. stocks, foreign stocks, bonds, real estate, and alternative investments) and a clear discussion of how to build and maintain a portfolio.

©2010 Morningstar, Inc. All Rights Reserved. The information contained herein (1) is intended solely for educational purposes; (2) is proprietary to Morningstar and/or the content provider; (3) is not warranted to be accurate, complete, or timely; and (4) does not constitute investment advice of any kind. Neither Morningstar nor the content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. "Morningstar" and the Morningstar logo are registered trademarks of Morningstar, Inc.

Monthly Market Commentary

Overall, positive economic indicators in October and a few very eventful days in the first part of November have, at least partly, removed market uncertainty. The economy has been improving slowly, but consistently, driven by better consumer spending and the Federal Reserve's major quantitative easing announcement.

Quantitative easing: On Nov. 3, the Fed announced that it would implement quantitative easing in an effort to revive the U.S. economy. A policy of quantitative easing means that the Fed will purchase Treasury bonds and bills in the open market in order to keep interest rates low. With low rates, businesses and consumers should be more likely to borrow and spend, which in turn would further stimulate the economy. All of us have been watching and waiting to see how the market would react to such colossal news: The stock market rose swiftly in response to the announcement, with the S&P 500 reaching its highest level in two years.

Midterm elections: U.S. Congress is now divided. Democrats retain control of the Senate, but Republicans have the majority in the House of Representatives. A divided Congress may be less likely to agree on new business and financial regulations, reforms, or economic stimuli. In addition, President Obama's plans to revive the economy through more government spending may become more difficult to implement. This situation may point to stabilization between the public and private sectors, but not necessarily to further growth.

Employment: The October jobs report was surprisingly positive, with employment growing by 151,000 jobs, more than double the 70,000 expectation. Most of this improvement came from the service sector, as opposed to the manufacturing sector, suggesting that potential future growth will also most likely be generated by service industries. The retail sector now looks

particularly robust, with preparations for holiday sales on the way. On the unemployment side, the number of people collecting unemployment is beginning to fall, but unfortunately, this is happening mostly because they hit their 99-week limit, not because they found jobs.

Taxes: Uncertainty about what will happen to taxes is keeping people on edge. If Congress doesn't agree on new legislation, the Bush tax cuts will expire and taxes will go up in 2011.

Consumer spending and saving: This year, consumer spending increased by 2.2% in the second quarter and by 2.6% in the third quarter, indicating stronger consumer confidence. Consumer electronics and apparel are two sectors with thriving retail sales, but since most of these products are imported into the U.S., this isn't very helpful for U.S. production. Since consumer spending will likely remain the key driver for future economic growth, the sustained increase in recent numbers is encouraging.

Economic growth: Third-quarter earnings reports were also positive, with industries such as restaurants, airlines, and technology particularly strong. Even though manufacturing news was not so good, increased consumer spending on services is something we definitely want to keep seeing, as most of this spending remains in the U.S., as opposed to consumer-goods spending, which is largely on imports. Real GDP grew by 2.0% in the third quarter, and Morningstar economists expect a 2.5% growth in the fourth quarter, accelerated by low net exports and continued consumer strength.

In conclusion, all these recent positive developments are extremely welcome, but investors shouldn't throw caution to the wind just yet. Even though stocks have experienced an impressive rally, there are still many questions to be answered about sustainable long-term growth.