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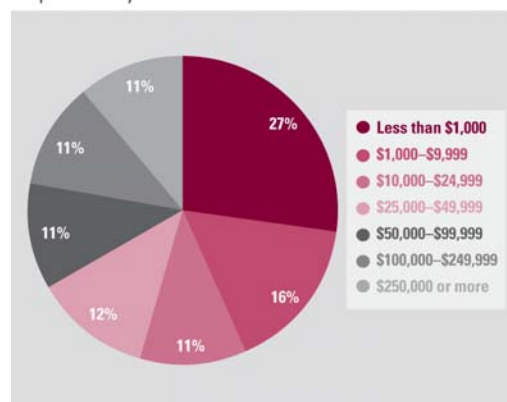
August/September 2010 Volume 3 Issue 7 **Investment Updates**

Bleak Picture

The Employee Benefit Research Institute (EBRI) is an organization founded in 1978 with the mission of encouraging and contributing to the development of sound employee-benefit programs and public policy through objective research and education. Every year, the EBRI publishes a retirement confidence survey. The 2010 survey interviewed 902 workers and 251 retirees in order to find out their views and attitudes about investing for retirement and their confidence in being able to meet retirement financial goals.

Unfortunately, the survey results look pretty bleak this year. For example, as the image illustrates, 27% of workers report having saved less than \$1,000, and 16% report retirement savings in the \$1,000 to \$9,999 range. Overall, more than half of workers have less than \$25,000 saved, at a time when people start questioning if \$1 million will be sufficient for a safe retirement. Take a minute and see if you recognize yourself in this picture.

Total Savings and Investments Reported by Workers



Source: EBRI 2010 Retirement Confidence Survey, No. 340, March 2010. Savings reported not including value of primary residence or defined-benefit plans. Percentages may not add up to 100% because of rounding.



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Adviser Corner

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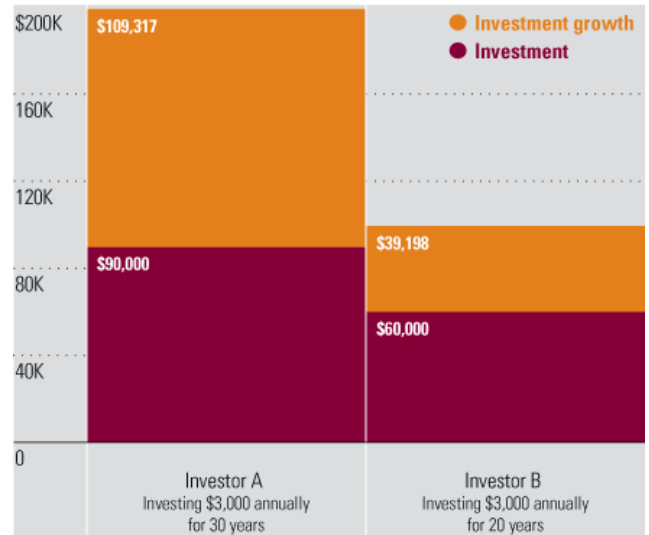
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The Costs of Financial Procrastination

Retirement usually doesn't start until you're in your 60s, but there is a good reason to start saving much sooner. The earlier you contribute to your nest egg, the more time your portfolio will have to grow in value.

The image illustrates the ending wealth values and effects of compounding of two investment portfolios. Consider two hypothetical investors who begin investing \$3,000 at an average annual rate of return of 5%. Investor A invests \$3,000 for a 30-year period, which results in an ending wealth value of \$199,317. On the other hand, investor B invests \$3,000 for a 20-year period, which results in an ending wealth value of \$99,198. Investor A invested an additional \$30,000 compared to Investor B. However, a large difference in the ending wealth value can be attributed to the compounding effect of the \$30,000 for the additional 10 years. In other words, your dollars saved now will be worth a lot more than your dollars saved in retirement.

The Effect of Compounding



Source: This is for illustrative purposes only and not indicative of any investment. The image represents a hypothetical rate of return of 5%. The values represented do not account for inflation or taxes. Past performance is not a guarantee of future results. The opinions herein are those of Morningstar, Inc. and should not be viewed as providing investment advice. Please consult with your financial professional regarding such services.

Shifting Responsibility for Cost Basis

The basic rule sounds so simple: When you sell an investment in a taxable account, you figure out whether you had a profit or loss and report it to the IRS. Unfortunately, figuring out whether you made or lost money can be very difficult, especially for investments acquired many years ago and for shares purchased through dividend reinvestment. If you haven't kept the necessary records, the IRS requires you to make a good faith effort to reconstruct your tax basis. The good news is that the recordkeeping burden will be shifting from investors to brokerage firms, starting in 2011. The bad news is that the process will be gradual and it will only apply to investments acquired in the future.

The law will require brokerage firms to maintain records of your cost basis and to report details of your gain or loss on a 1099 form to both you and the IRS. This rule will apply to stocks purchased after Jan. 1, to mutual funds, exchange traded funds and dividend reinvestment shares purchased after Jan. 1, 2012, and to bonds and other investments

purchased after Jan. 1, 2013. If you are selling only part of your holdings, brokers will use cost information for the first shares acquired (first-in, first-out) for stocks and average cost information for mutual funds unless you specify otherwise at the time of the trade. One benefit of the new law is that brokers will be required to transfer cost information along with the assets when you change firms.

If you don't know the cost for investments you currently have in taxable accounts, there's no time like the present to start rounding up the information. Old paperwork (statements, confirmation slips) is the first place to look. Tax returns showing taxable dividends can help for shares acquired through dividend reinvestment. If you inherited shares, you can look up the value on the date of the person's death. However, you have to be careful to take into consideration stock splits, spinoffs and mergers that have happened in the meantime. If you are unable to determine the cost basis, you'll owe taxes on the entire amount when you sell.

Retirement Planning in Your 20s and 30s

Is it too early to start planning for retirement in your 20s? The answer is no. As life expectancy continues to increase, planning early can ensure a comfortable retirement. While planning for retirement at this age may be the last thing on your mind, the earlier you start the better chance you have of achieving your retirement goal. An early start also allows more time for your investment to grow through compound interest. In addition to starting early, here are some steps you should consider when planning for retirement in your 20s and early 30s.

Maximize your employer match: Young investors should consider maximizing their employer 401(k) match, since failure to utilize this benefit means missing out on free money. According to a recent study by Hewitt Associates, younger participants are more likely to stop contributing or lower their contribution rates compared with older participants. This study suggests that more than 17% of participants ages 20 to 39 decreased their contribution rates in 2008. Typically employers match 50 cents per dollar invested by an employee, up to a predetermined maximum contribution percentage. If your employer provides this, make sure to put enough money in your 401(k) plan to maximize your employer match.

Consider a Roth investment: Much like a company-sponsored retirement plan, traditional IRAs are a common investment vehicle for investors. Traditional deductible IRA contributions are not taxed, but withdrawals are taxed. A Roth IRA or Roth 401(k) gives you the option of taxing your contribution up-front at the time of investment while the account grows in value tax-free thereafter. This means that withdrawals during retirement are not subject to income tax, provided you are at least 59½ and the account is held for five years or more. This is a great way for younger investors to take advantage of

lower tax rates, especially if they expect to be in a higher tax bracket closer to retirement.

Manage your risk: One mistake young investors make is selecting a less than optimal stock/bond allocation based on their age. Typically, investors in the 20s or 30s are best advised to select a stock-heavy portfolio with a minimal allocation to bonds. For investors who feel less comfortable with selecting their own investments, target-date funds can serve as a convenient alternative. Target-date funds start out with heavier allocations to stocks and become more income-oriented depending on the participant's age. If you are in your 20s or 30s, it might make sense to choose an aggressive portfolio allocation and limit your investment in bonds.

Avoid market timing: A look back in time suggests that some of the biggest gains in the stock market have followed periods of poor market returns. Investors can make the mistake of timing the market by pulling out of their investments during market losses and buying back when the market has rebounded. Investors who attempt to time the market run the risk of missing returns. With time on your side, it is best to adopt a long-term approach to investing.

Keep in mind that you should first determine how much money you may need in retirement as well as determine your annual expenses such as living, health-care, and miscellaneous spending before considering the options outlined above. It is always a good practice to track your spending in addition to identifying your savings and investments.

-- The information, analysis, and opinions presented herein do not constitute investment advice, are provided solely for informational purposes, and are not warranted to be correct, complete or accurate. The opinions expressed are as of the date written and are subject to change without notice.

Source: "How Well are Employees Saving and Investing in 401(k) Plans," 2009 Hewitt Universe Benchmarks.

How to Make the Best of a Lousy 401(k)

Should you even bother investing in a company plan that doesn't measure up? If you're not earning a match on your contributions, your first step should be to consider a Roth IRA — or even a traditional deductible IRA — before steering funds into a company retirement plan that's a stinker. But if you determine that the tax-deferred nature of the company retirement plan offsets the weaknesses therein, it's possible to at least make the most of that subpar plan.

Here are some tips if you find yourself in this predicament.

1. Go the index route. Maybe your plan doesn't feature mutual funds managed by topnotch stock-pickers. But if the plan's options include index funds — offerings that track a given market benchmark rather than attempting to beat it — you can obtain broad market exposure at a reasonable cost. Even if the index funds in your plan aren't the best, you're probably still better off going the index route than opting for a lackluster active fund. True, active managers — even the ones with subpar past records — have a shot at beating their benchmark, at least in theory. In practice, however, the active fund's expenses — as well as transaction costs that aren't reflected in its expense ratio — weigh heavily on that manager's ability to beat the benchmark.

2. Take the best and leave the rest. It's natural to want to craft a 401(k) portfolio that's diversified across all of the major asset classes (bonds and U.S. and foreign stocks), but that might not be practical or prudent if your company plan doesn't offer viable options in all of these areas. If your plan features a few standout options and the rest are subpar, load up on the few decent funds and avoid the rest. You can use your IRA, your taxable accounts, or your spouse's retirement plan to delve into

the asset classes and investment styles that your own plan lacks.

3. Investigate the brokerage window, but do so with care. Increasingly, 401(k) plans — particularly those from large employers — are offering so-called "brokerage windows," also called "self-directed accounts." If your plan offers such an option, you'll have the opportunity to get into hundreds of other mutual funds, stocks, and even exchange-traded funds that aren't part of your 401(k) plan's preset menu. But before you jump aboard, be sure to read the fine print. You may pay an extra fee to participate in the brokerage window. In addition, you may pay separate transaction costs to buy and sell securities that are part of the brokerage window.

4. Talk to HR. If the employees in your company are grumbling about a subpar retirement plan, let your human resources department know how you feel. You may not be able to enact change overnight, because a lot of factors — not just the quality of investment options — figure into a company's decision to opt for one retirement-plan provider over another. But your employer should still be aware that its benefits package isn't measuring up.

5. Check out other options. If you've determined that your company plan is weak, that means you'll have to make the most of all of the investing options available to you, tax-sheltered and otherwise. Investigate whether you're eligible to contribute to a Roth or other IRA, and plan to max out your spouse's plan if it's better than yours. Also be savvy about investing in your taxable accounts.

-- Diversification does not eliminate the risk of experiencing investment losses. Stocks are not guaranteed and have been more volatile than bonds.

Questions to Ask Your Retirement Plan Sponsor

Many employers provide a 401(k) retirement plan to their employees; however, not all plans are alike. Retirement plans usually differ in the number and type of investment choices available to plan participants. Contributing to a 401(k) retirement plan can increase your savings through both a matched contribution and a reduction in your current tax liability. If you're wondering where to start, here are a few questions you should ask your retirement plan sponsor that will help you with your contribution and investment selection decision.

Q. What is my company match? Several employers match employee contributions toward a 401(k) retirement plan. Matched contributions typically range from 25 cents (25% match) to one dollar (100% match) per dollar contributed by the employee, up to a predetermined limit (6% of pay). For example, if your annual salary is \$100,000 and your employer provides a 50% match on a maximum contribution of 6%, then you receive an additional \$3,000 in matched employer contributions for your \$6,000 contribution.

Q. What are my investment options? A good plan should offer a variety of investment options that allow plan participants to build a diversified portfolio and select investments that best fit their risk profile. Options may include investments across different stock market capitalizations, market sectors, domestic and international investments, bonds, and cash. Be sure to read the investment prospectus and ask questions about items that you are unsure about before investing.

Q. What fees are associated with investments available to me? Funds within a 401(k) retirement plan vary not only by investment objective but also by fees. The expense ratio (annual fee) shows the actual amount that a fund takes out of its assets each year to cover its expenses. Investors should note not only the current expense-ratio figure, but also the trend in these expenses; it could prove useful to know whether a fund is becoming cheaper or more

costly over time. When considering high expenses versus low expenses, investors must also consider the fund's objective and its size. Certain objectives, such as foreign-equity funds, have higher costs and therefore, higher expense ratios. As for size, smaller funds are normally costlier than larger funds, as they do not have the benefits of economies of scale. Pay attention to expense ratios that are greater than 1%. Expense ratios for many funds exceed 1.5%. The average fund investing in large-cap stocks carries an expense ratio of 1.26% of the investor's holdings as of December 2009. In addition to expense ratios, some funds may also charge sales loads, i.e. initial (front-end) and deferred (back-end) sales charges imposed by a fund. Some charges are triggered when an investor transfers assets out of a fund within a specified time frame.

If your plan provides a number of investment options, make sure to evaluate all your choices. Be careful not to only select funds that have the best return in the past year or past few years. Take into account your investment goals, risk profile, asset allocation needs and expenses before you invest. There is no limit to the number of 401(k) plans you can have at any given time; however, you can only contribute new money to the plan at your current employer. Make sure you check your account statements regularly. Employers are required to provide participants with annual statements, but a vast majority of plans provide statements quarterly as well. If you have questions, be sure to consult with human resources at your company. By asking the right questions about your retirement plan, you can make an informed decision based on the options that are available to you.

Source: Expense ratio data is from Morningstar's open-end database. This is for illustrative purposes only and not indicative of any investment. The opinions herein are those of Morningstar, Inc. and should not be viewed as providing investment advice. Please consult with your financial professional regarding such services.

Morningstar Monthly Market Commentary

The end of summer brought cooler temperatures and lackluster economic news. Apathetic consumer spending, slower-than-normal service-sector growth, increasing imports and weak employment data point to a slow and difficult recovery. The debate between the hopeful optimists and the double-dip-recession pessimists continues.

Employment: After March and April's temporary dramatic improvement, companies have continued to add jobs but at a much slower rate. Private payrolls grew by 67,000 in August, well short of the 200,000 to 300,000 monthly growth typically seen in a real recovery. In total, there were 800,000 jobs added since December, an insignificant number when compared with the 8-million-plus jobs lost during the recession.

Consumer spending and saving: Revised personal-income data paints a more pessimistic picture of the recovery than previously estimated. The second-quarter savings rate of 6.1% was relatively high, indicating that consumers are still hesitant about spending. This means, however, that consumers may have more room to increase spending in the months ahead if confidence in the economy returns. Small or nonexistent personal income growth may also explain why consumers are still fearful and protective of their earnings. The dismal consensus is that, in general, personal income posted no growth when adjusted for inflation.

Economic growth: The GDP estimate for the second quarter was revised down to 1.6% from a previous estimate of 2.4%. The higher estimate was based in part on expectations of increased consumer spending. Instead, consumers were more frugal than expected, and when they did let go of their money they spent it mostly on consumer electronics and apparel, sectors which consist of largely non-U.S. merchandise, stimulating imports rather than the U.S. economy.

Balance of trade: Consumer demand for imported goods in June created a \$50 billion trade deficit. This helps explain why GDP forecasts were revised to much lower numbers. The growth that was expected from U.S. production came from imports instead: Import growth was responsible for reducing GDP growth by more than 4%. More bad news ahead: Expectations are for a \$48 billion deficit in July, meaning that GDP growth will continue to be weak.

Manufacturing, retail, and services: Durable-goods orders posted a very weak 0.3% growth rate in July, but August numbers looked much better, and some of the market worries about the manufacturing sector have subsided. Back-to-school sales drove August growth in the retail sector. Slow growth in the service economy, on the other hand, has stalled this recovery's potential, especially in the health-care and financial-services sectors.

The market: Earlier this year, strong market returns in February, March, and April prompted forecasts of a strong recovery, but subsequent months proved them wrong. The quick upswing might have been the beginning of a real recovery that got sidetracked by the European debt crisis and the flash crash of May 6. The S&P 500 fell by 5.2% in June and gained 7.0% in July, reflecting a persistent uncertainty in the market. Looking forward, Morningstar economists forecast another six to 12 months of slow but steady growth with smaller imports, better exports, slightly higher consumer spending, and improvement in business investment and spending.

All these recent developments confirm that the economy is not as strong and not recovering as well as most optimists believed. Economic indicators are still highly volatile from one month to another, and forecasts will likely stay conservative for the remainder of the year.

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Market Returns

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