Investor Insights & Outlook

April 2014 | Vol. No. 1 | Investment Updates

Quick Facts: Retirement

1. According to Aon Hewitt's "The Real Deal" 2012 study, an average full-career contributing employee needs 11.0 times pay at age 65, after Social Security, to expect to have sufficient assets to last through retirement. For example, if your salary is $80,000, you will need to have accumulated $880,000 by the time you're 65 and ready to retire.

2. In reality, the same employee is expected to have only 8.8 times pay in resources at retirement, which translates into a 2.2 times pay shortfall. To reuse the example above, this means you'd be $176,000 short.

3. The 2013 Transamerica Retirement Survey found that the percentage of participants who have taken a loan from their 401(k) plan has increased from 16% in 2008/2009 to 21% in 2012, then slightly decreased to 17% in 2013.

4. Wells Fargo conducted a survey of 1,000 middle-class Americans. The study shows that across middle class members of all generations, only 24% are confident in the stock market as a place to invest for retirement. The apprehension about the market is stronger for those age 25 to 29, with 56% expressing fear of losing their nest egg. When asked if given $5,000 for retirement where they would invest, 58% of those age 25 to 29 said they would invest in a savings account/CD.

5. Only 18% of workers are very confident they will have enough money to live comfortably in retirement (according to the EBRI 2014 Retirement Confidence Survey).

Sources: Aon Hewitt's "The Real Deal: 2012 Retirement Income Adequacy at Large Companies." "14th Annual Transamerica Retirement Survey of American Workers," Transamerica Center for Retirement Studies, July 2013. Wells Fargo news release, "Middle Class Americans Face a Retirement Shutdown," October 2013.

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The Great Yield Chase

Diversification Counts for Bonds as Well

- While searching for more yield is one factor, an increasing desire to diversify risk is also driving investors to look at more alternatives in the fixed income markets. This includes by time frame as well as issuer.
- Mike

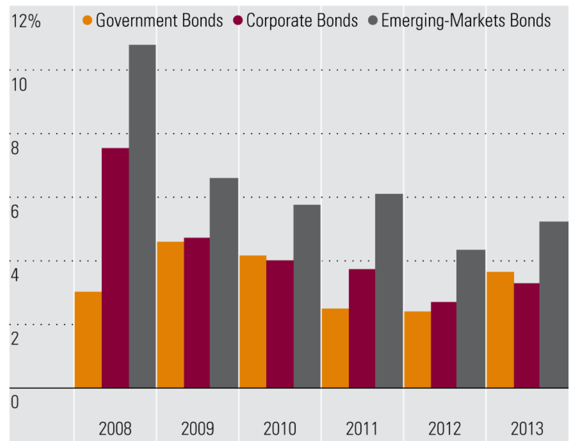
With Treasury yields still relatively low and worry about the eventuality of rising rates ever present, many investors have been moving away from Treasuries and into other fixed-income sectors in their quest for income. Two fixed-income segments seeing activity from this migration are corporate and emerging-markets bonds.

Corporate bonds: Many investors have bumped up their allocations to corporate bonds for reasons that are pretty straightforward. Company balance sheets are about as healthy as they've been for many years, with cash holdings high and default rates at multiyear lows. In addition to these attractive fundamentals, buying has been strongly encouraged by central bank policies, including the Federal Reserve's quantitative-easing programs. They have played a major role in suppressing agency mortgage and Treasury yields, which in turn has pushed investors to take on more credit risk in search of more yield.

Emerging-markets bonds: The trend of holding emerging-markets bonds has gained popularity in recent years. Again, investors have been given incentive to hold higher-risk assets because developed-markets central bank policies have pushed Treasury yields down. A byproduct of these central-bank policies is that assets have not only poured into U.S.-based investments but also into emerging-markets bonds of all kinds, including both sovereign and corporate sectors. Further boosting their attractiveness, emerging-markets credit ratings have been rising based on a number of factors, including economic structural reforms and growth rates that are meaningfully higher than in developed markets. To top it off, the underlying balance sheets of many emerging economies look increasingly appealing when compared with the debt-laden, major economies of the West.

With greater return potential comes greater risk. The ultimate questions for investors moving out of Treasuries are whether their investment alternatives will stand up to potential trouble down the road and whether their portfolios still line up with their risk and return expectations. There's a tension between trying to provide the best possible returns when things are going well and maintaining the kind of portfolio that should provide better diversification in the case of volatile equity markets. In recent years, investor demand has significantly pushed prices up and yields down. Those new lower yield levels suggest that, even under the best circumstances, the prospect for future returns is muted. While currently attractive, there's reason to be wary of how these sectors will perform under stress scenarios. Most investors aren't expecting a repeat of 2008, when Treasuries rallied and risky assets sold off, but it's nearly certain that bumps in the road will appear at some point. It is important to be aware that a dearth of yield may be causing some investors to take on more risk than they realize.

Yields for Government, Corporate and Emerging-Markets Bonds



Diversification does not eliminate the risk of experiencing investment losses. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. With corporate bonds, an investor is a creditor of the corporation and the bond is subject to default risk. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, and differences in accounting and financial standards. Emerging-markets debt carries unique risks and may not be suitable for certain investors. Emerging-markets investments are more risky than developed-markets investments.

Data: Government bonds—20-year U.S. government bond; Corporate bonds—Barclays U.S. Corporate Investment-Grade Index; Emerging-markets bonds—Barclays Emerging Markets Aggregate Index.

How Can Grandparents Help with College Costs?

If your grandchildren are fortunate enough to have you chip in with their college costs, there are a few things you need to be aware of before you start writing checks.

The most straightforward way for a nonparent to help a student pay for college is with a cash gift. Gift tax rules in 2013 allow any individual to give another individual up to $14,000 per year ($28,000 from a couple) without the gift counting against the lifetime estate tax exemption. A problem with this approach is that your contribution will be taken into consideration when the student applies for need-based financial aid. Cash given directly to a student the year before he or she applies may be considered student income, reducing need-based aid by as much as 50% of the amount given. Furthermore, money held in the student's name is treated as a student asset, reducing aid by another 20%. Cash given to the parents also counts against financial aid, albeit at a much lower rate of up to 5.64%. To potentially avoid any financial aid impact with a cash gift, keep in mind that the Free Application for Federal Student Aid takes into account income from the prior year in determining need-based aid. Hence, consider giving the money when you know the student will not be applying for aid next year.

Another approach is to offer to help pay back the student's loans. By waiting until the student is done with school, you avoid financial aid concerns and help ease his or her debt burden as the student enters the workforce. This strategy may be particularly useful for students with subsidized loans, which don't begin to accrue interest until after graduation.

Grandparents may also open a 529 college-savings account in the name of a student. One of the advantages of this approach for the account owner (the grandparent) is that many states offer income tax deductions on 529 contributions, though you must typically make the contribution to your home state's plan in order to earn the deduction. Another benefit is that the IRS allows a five-year acceleration of the gift tax exclusion for such contributions, allowing an individual to contribute as much as $70,000 in a single year to a 529 in a student's name. A disadvantage to this approach is that distributions from a 529 owned by someone other than the student or his or her parents are counted as student income and may reduce the amount of need-based financial aid available by $0.50 for every dollar distribution. Waiting to use 529 distributions from a grandparent-owned account until the student's final year is one way to avoid this problem.

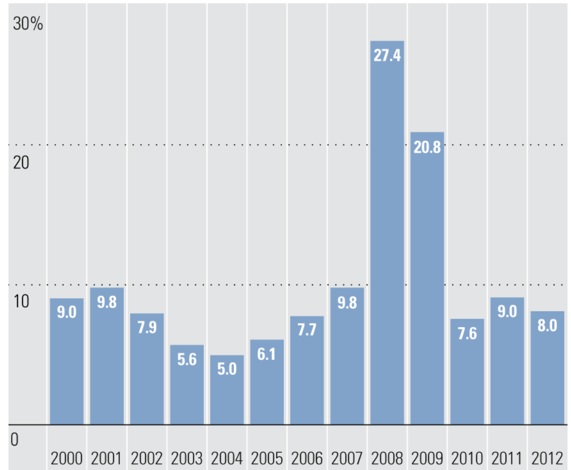
One final option that some grandparents might consider is paying tuition directly to the university on the student's behalf. This has special appeal for those who want to give large amounts but who are worried about gift tax consequences. The good news is that payments made directly to the university to cover tuition are exempt from the gift tax, although additional costs such as room and board are not. Unfortunately, direct tuition payments may be counted as either income against the student's financial aid allocation (reducing it by 50%), or as a financial resource available to the student (reducing financial aid dollar-for-dollar). Hence, this only makes sense for students who are not concerned about need-based aid or if the payment is made during the final year of school.

Tax law is ever-changing and can be quite complex. It is highly recommended that you consult with a financial or tax professional with any tax-related questions or concerns. An investor should consider the investment objectives, risks, and charges and expenses associated with municipal fund securities before investing. More information about municipal fund securities is available in the issuer's official statement, and the official statement should be read carefully before investing. 529 plans are tax-deferred college savings vehicles. Any unqualified distribution of earnings will be subject to ordinary income tax and subject to a 10% federal penalty tax.

Dividend Income: Not So Fixed

Since interest rates are still relatively low right now, many investors looking for income and yield have begun to assess switching a portion of their investment allocation from bonds into dividend-paying stocks. However, it is important to remember that the interest payment of a bond is a contractual obligation of the company, whereas dividend payments are not. If a bond issuer does not pay either interest or principal on time, the company will be in default, and likely will be placed into bankruptcy. However, dividend payments are not a contractual obligation of a company and can be either cut or raised by its board of directors at will. When times are tough, companies may cut dividends to conserve cash, such as during the 2008 credit crisis. Conversely, when times are good, companies may increase their dividend payments, providing investors with additional upside.

Percentage of Companies That Cut Dividends



Source: Morningstar analysis. This is for illustrative purposes only and not indicative of any investment. Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed, and stocks have been more volatile than bonds. Dividends are not guaranteed and are paid solely at a company's discretion. Percentage of companies that cut dividends is calculated for listed companies on NYSE, NASDAQ, and NYSE AMEX.

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