Investor Insights & Outlook

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A Quick Look at Mid-Cap Stocks

What's Mid-Cap?

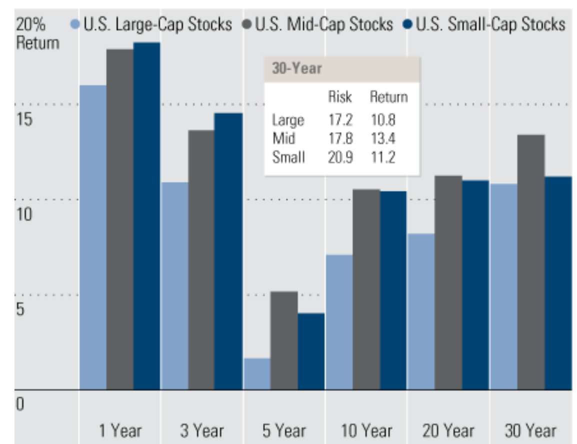
- In this case, "cap" refers to a company's size or "capitalization. We try to incorporate a range of company sizes into client portfolios as typically any size can out perform for a period of time.

Investors often hear about large- and small-cap stocks, but what about mid-caps? A quick look at large-, mid-, and small-cap stock performance over various time periods shows that investors may want to consider U.S. mid-cap stocks for their portfolio.

Mid-cap stocks offered the highest compound annual returns in four out of the six time periods analyzed, and were relatively close (in terms of return) with small stocks in two other time periods. In terms of risk, the data shows that mid-cap stocks had a 30-year annualized risk of 17.8%, which was lower than the 20.9% risk of small stocks and only slightly higher than the 17.2% risk of large stocks.

Talk to your financial advisor to see if there is potentially a place for mid-cap stocks in your portfolio allocation.

Annualized Stock Performance as of December 2012



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Diversification does not eliminate the risk of experiencing investment losses. U.S. large stocks are represented by the Standard and Poor's 500®, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general, U.S. mid-cap stocks by the S&P MidCap 400®, and U.S. small stocks by the Ibbotson® Small Company Stock Index. Returns and principal invested in stocks are not guaranteed. Furthermore, small stocks are more volatile than large stocks and are subject to significant price fluctuations, business risks, and are thinly traded. Risk and return are measured by standard deviation and compound annual return, respectively. Standard deviation measures the fluctuation of returns around the arithmetic average return of the investment. The higher the standard deviation, the greater the variability (and thus risk) of the investment returns.

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Jim has more than 16 years of experience in the financial services industry. He started his career with Ameriprise Financial where he became a member of their Advanced Advisor Group. In 2007 he became a founding partner of Kerntke Otto McGlone Wealth Management Group. Jim's primary focus is working with individuals and families to achieve their goals and dreams through a long term consultative relationship.

Three Reasons to Add ETFs to Your Portfolio

Where do EFTs fit?

- EFTs can be a cost effective way of accessing specific investment areas. We often use these in conjunction with mutual funds to gain the benefits of each type of structure.

Innovative offerings in equities, fixed income and alternatives have made ETFs one of the fastest-growing investment vehicles in the financial industry. ETFs are a popular investment choice among both active and passive investors because of their flexibility to trade like a stock and diversification similar to a fund, allowing investors to use ETFs for both long-term strategic asset allocation and short-term tactical allocation. Here are three ways how ETFs may be used in a portfolio.

Better diversification: ETFs may be used to construct a diversified portfolio from the ground up because they allow for potentially low-cost diversification that may be suitable for a client's investment objectives, risk profile and time horizon. A core-satellite portfolio approach allows investors to create a core holding consisting of broad market funds, such as, for example, an S&P 500 ETF and an aggregate bond ETF, to serve as the foundation of the portfolio. Meanwhile, the smaller satellite component of the portfolio allows investor to explore other investments such as industry specific funds, potentially adding value. This core-satellite strategy allows investors to have a larger portion of their portfolio passively mirror the overall market indexes while also actively investing the smaller portion of their portfolio, which may deviate from the overall markets.

Exposure to all corners of the market: ETFs may allow investors to make short-term tactical decisions. Given their liquidity and trading flexibility, ETFs may help adjust an existing portfolio to target specific undervalued or overvalued market segments based on a market view. Another way ETFs can complement an existing portfolio is by providing access to alternative asset classes that may be inaccessible or too costly for an average investor to invest in directly.

Hedging risk: The diverse coverage and trading flexibility of ETFs may offer downside risk protection, allowing investors to reduce their exposure to certain sectors and therefore potentially minimize risk. For example, an investor may be heavily weighted in the financial sector but because of potential employer stock restriction or tax consequences, is unable to sell. In order to reduce exposure to the financial sector, one option for the investor would be to buy the equivalent inverse ETF. An inverse ETF uses various financial derivatives to offer the opposite return of the underlying index.

Understanding the risks associated with each of these portfolio strategies, as well as the costs and potential tax consequences, are important. Speak with your financial advisor to better understand how ETFs can be used in your portfolio.

Holding an exchange-traded fund does not ensure a profitable outcome and all investing involves risk, including the loss of the entire principal. Since each ETF is different, investors should read the prospectus and consider this information carefully before investing. The prospectus can be obtained from your financial professional or the ETF provider and contains complete information, including investment objectives, risks, charges and expenses. ETF risks include, but are not limited to, market risk, market trading risk, liquidity risk, imperfect benchmark correlation, leverage, and any other risk associated with the underlying securities. There is no guarantee that any fund will achieve its investment objective. In addition to ETF expenses, brokerage costs apply. Fees are charged regardless of profitability and may result in depletion of assets. Inverse ETFs are not appropriate for a long-term or buy and hold investment strategy. They are designed for short-term or intraday trading for investors seeking daily investment results and who intend to actively monitor and manage their investments as frequently as daily. Keep in mind that diversification does not eliminate the risk of investment losses. Investors should consult a financial professional before considering complex investing strategies involving derivatives.

How Are Variable Annuities Different When Held in a Qualified Account?

There are some basic differences when a VA is held inside a qualified account, meaning an IRA (traditional or Roth) or employer plan.

Contract Titling Difference: A non-qualified contract can be held by two owners or a trust, whereas a VA held in a qualified account must have an individual owner who is also named as the annuitant. (Note that on the Lifetime GMWB, joint spousal coverage can be achieved on an individual retirement account.)

Product Differences: Often, a VA contract or benefit held in a qualified account has a different issue age. For example, one lifetime income rider must be purchased by age 77 when held in a qualified account, versus age 80 in a non-qualified account. In a few cases, fees and expenses are different. One variable annuity contract charges an extra 20 basis points when held in a qualified account. One carrier waives the annual account fee for qualified accounts with a minimum balance of $20,000. In one case, the VA product itself was designed exclusively as a qualified contract. For one carrier, an owner of a qualified contract has the option to terminate a living benefit, whereas non-qualified contracts cannot terminate a benefit once elected. Select carriers increase the withdrawal percentage to equal the RMD. Other living benefits treat RMDs favorably.

Tax Treatment—Different IRS limits on contributions: Non-qualified VAs do not have IRS restrictions on annual contributions, while qualified VAs are limited by the $5,000 annual contribution ceiling. 1) RMD requirements: Qualified VAs need to start required minimum withdrawals at age 70 ½ (except if the VA is held in a Roth IRA). Non-qualified contracts do not have RMD requirements. 2) RMD calculation is different: When calculating the RMD, the carrier factors in the present value of any enhanced death benefit and living benefit. As a result, RMDs can seriously erode account value. 3) Treatment of annuity payments: There is no exclusion ratio on payouts from a qualified VA, since no taxes have been paid on any of the investment principal. So 100% of the withdrawals are taxed as ordinary income. 4) Acceptance of rollovers: Proceeds from a qualified plan rollover are eligible to be rolled over directly to a qualified VA without taxation. Conversely, qualified plan rollovers cannot be placed in a non-qualified VA contract without taxes being owed.

Advisor Tips: When a variable annuity is held in a qualified account, name the owner and the annuitant as the same person. Once the owner passes away, the death benefit will pay to the primary beneficiary. When a living benefit is held inside a qualified account, an RMD may erode the account value quicker unless the rider is "RMD friendly," meaning an RMD above the allowable withdrawal percentage is not considered an excess withdrawal. Be aware of how an RMD affects the benefit base, especially when using a GMIB rider, most of which have no special treatment of RMD withdrawals. Look for "RMD friendly" living benefits.

The examples presented herein are for informational purposes only. They are not representative of any specific annuity and do not constitute investment advice. Annuities are suitable for long-term investing, particularly retirement savings. Withdrawal of earnings will be subject to ordinary income tax and, if taken prior to age 59½, may be subject to a 10% federal tax penalty. Investing in a variable annuity within a tax-deferred account will provide no additional tax savings and, therefore, should be considered only for other benefits that may be provided by the annuity or associated riders. Additional fees apply for living-benefit options. Investment restrictions may also apply for all living-benefit options. Violating the terms and conditions of the annuity contract may void guarantees. Read your prospectus carefully for all the fees and expenses that may apply to your variable annuity contract. It is also recommended that you consult with a financial advisor and tax advisor before purchasing an annuity.

Five Lessons from the Three-Year Market Rally

…now a four-year market rally, but the lessons are still relevant. 1) The turning point is not always obvious. In hindsight, it seems like it should have been dead obvious that stocks were cheap four years ago. But, because of their inability to clearly identify market bottoms, investors may be better off sticking with a strategic asset-allocation plan. 2) Don't let past performance control your portfolio. To the extent that you can, let your strategic asset-allocation framework be a key driver of where you deploy new cash. 3) To help maximize participation, make a little room for the risky stuff. Even though higher-quality stocks tend to hold up better during downturns, the opposite tends to be true during recoveries. Investors may want to maintain exposure to both types of companies: high-quality, wide-moat dividend payers and economically sensitive small- and mid-caps. 4) But there are also chicken ways to play. You don't need to pile on the risk to generate robust gains in absolute terms. Investors who have shorter time horizons or are simply more comfortable with lower-risk stocks can reasonably allocate more toward such stocks without completely ceding their upside potential. 5) There will be bumps (and buying opportunities) along the way. The movement hasn't always been upward since the market bottomed. If your portfolio is light on stocks at the outset of a rally, periodic sell-offs may provide opportunities even at a later time.

Diversification and asset allocation do not eliminate the risk of investment losses. Stocks are not guaranteed and have been more volatile than other asset classes. Small stocks are more volatile than large stocks, are subject to significant price fluctuations and business risks, and are thinly traded. This should not be considered financial planning advice. Please consult a financial professional for advice specific to your individual circumstances.

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