CPS Investment Advisors

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Your Guide to Life Planning

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It's time to fund your IRA.

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It's a decision most adults dread: having to take over the financial and day-to-day living decisions for parents who can no longer manage on their own. When caring for your parents, you may need to plan on three levels: managing finances, making health care decisions, and making sure their daily household needs are met.

The best way to manage your assets is to have a steady and consistent asset mix that is developed with realistic expectations and modified only by a judicious reevaluation of your goals, needs, and risk profile.

Common Mistakes of Asset Allocation

Smart people make dumb mistakes all the time. Allocating and managing portfolios successfully in today's marketplace is difficult. There are many pitfalls along the way to complicate matters. When investors fail to avoid mistakes, they place portfolios at risk. At stake are not only the growth and safety of the investor's portfolio but also their future financial independence, control, and security. As a result, investors need to be aware of the common mistakes that can be made when employing asset allocation so that they can avoid them. [1] Some of the more common mistakes are highlighted below.

Failing to Set Realistic Financial Goals

You cannot hit a target you are not aiming for. Investors need to do a fair degree of preparation. Unfortunately, a large number of investors manage their portfolios in a haphazard, sporadic, and ineffective manner. Often they fail to set financial goals, which is a basic tenet of investing. Without a solid understanding of your specific goals and investment needs, you will be unable to design or manage your portfolio properly. An accurate assessment of specific goals and needs is essential in order to establish the right mix and specific allocations of asset classes. Your goals and needs are the driving force upon which your portfolio is built.

Having Unrealistic Return Expectations

One of the most difficult and subjective tasks associated with investing is having realistic expectations. Investors need to exercise significant discretion and resist sabotaging their portfolios simply because of what everyone else is doing or is earning on their investments.

Switching from asset class to asset class in the hopes of earning a higher return hardly ever works out and could spell disaster. You could miss out on nice gains in the asset classes you switched out of, or experience a significant loss from having too much in an asset class you emphasized. The best way to manage your assets is to have a steady and consistent asset mix that is developed with realistic expectations and modified only by a judicious reevaluation of your goals, needs, and risk profile.

Misinterpreting Risk Tolerance

Many investors confuse risk tolerance with risk capacity and vice versa. Your risk tolerance is your willingness to assume risk in order to earn the return you need. Misinterpreting risk tolerance may result in a portfolio that inherently has more risk than appropriate or one where the returns will be less than needed because it was designed to maximize returns with a lower risk tolerance. A well-designed risk tolerance questionnaire, together with a face-to-face meeting with a financial professional, is a prudent approach to identifying your tolerance for risk.

Misjudging Risk Capacity

Don't invest what you can't afford to lose. This wisdom gets at the heart of addressing your risk capacity when investing. Risk capacity is your ability to assume risk. An investor's capacity for risk is not determined by or affected by his or her tolerance for risk. The two are completely different. Some investors do not take into account their capacity to assume risk. Unfortunately, their tolerance for risk often masters their capacity for risk. Remember to always think in terms of your capacity for risk taking. Don't let your emotions get the best of you so that you would invest more than you can afford to lose.

Underestimating Time Horizon

Your time horizon is the period from the present to a future point in time when you will no longer need the assets in your portfolio. Many investors mistakenly believe their time horizon is from the present to the day they plan to retire. Unfortunately, that could not be farther from the truth. At retirement, it is not their time horizon that may change, but rather their risk tolerance and liquidity needs.

Portfolios based on shorter time horizons will be overallocated to fixed-income assets and possibly underperform as a result. Life-changing events, such as retirement, are taken into consideration through asset allocation modifications. Your time horizon typically extends well into your retirement. Once you retire, you can alter your asset allocation, but prior to that point it is wise to have a well-diversified and allocated portfolio that uses an appropriate time horizon.

[1] *Asset allocation does not ensure a profit or protect against a loss in a declining market.*

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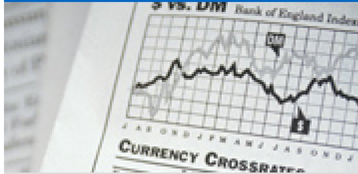

December 2010 Market Recap

(For the month ended December 31, 2010.)

The U.S. stock market ended the year on a high note, as positive economic news pushed the major indexes to levels not seen in more than two years. The Dow rose 5.2% during the month and was up 11.0% overall in 2010. The S&P 500 gained 6.5% on a monthly basis and 12.8% during the year, while the Nasdaq climbed 6.2% and 16.9%, respectively. A steady stream of encouraging reports about the domestic economy gave investors hope that the recovery is gaining momentum and lifted equities, but helped contribute to a difficult month for the bond market. The prospect of a larger federal budget deficit stemming from the tax cut compromise also pressured fixed-income investments. Yields climbed throughout December, and investors pulled billions of dollars out of bonds. This happened despite the Federal Reserve's efforts to keep rates low by purchasing long-term Treasuries.

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Through 12/31/10*	December	1-Year	3-Year	5-Year	Closing Value
S&P 500	6.5%	12.8%	-5.0%	0.1%	1,257.64
Dow Jones Industrials	5.2%	11.0%	-4.4%	1.6%	11,577.51
Nasdaq Composite	6.2%	16.9%	0.0%	3.8%	2,652.87

Source: Standard & Poor's. The S&P 500, Dow Jones Industrials, and Nasdaq Composite are unmanaged indexes. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

*Price only. Does not include dividends.

Bond woes The larger deficit created by the tax cut extension added to upward pressure on bond yields in December. The extension of the tax cuts and relief on the alternative minimum tax (AMT) accounts for $544 billion of the tax deal's cost, while the Social Security tax rate cut amounts to $112 billion, and the extended jobless benefits cost $57 billion. The bill also retains the 2009 tax treatment for estates (a 35% rate and a $5 million exemption), which adds $68 billion to the total cost, according to Standard & Poor's analysts. The rise in yields was also caused by stronger economic data, although dividing the causality between the two is very difficult, given the extremely low level of yields. For the week ending December 15, bond funds had estimated outflows of $8.62 billion, after an estimated outflow of $1.66 billion the previous week. Taxable bond fund outflows were estimated at $3.77 billion, while municipal bond funds had estimated outflows of $4.85 billion, according to the Investment Company Institute.

Fed intentions The rise in bond yields has come in spite of the Fed's reiteration of its intent to continue to buy long-term Treasuries. The Federal Open Market Committee (FOMC) said that it "intends to purchase $600 billion of longer-term Treasury securities by the end of the second quarter of 2011," continuing the policy set at the November meeting. The December press release seemed a bit more upbeat than the November statement, however, dropping the "pace of recovery...continues to be slow" language.

Treasury notes Falling Treasury prices continued to drive up yields in December, despite the Fed's ongoing Treasury purchases.The 10-year Treasury yield was 3.32% at the end of the month, versus 2.80% after November. Yields on 30-year issues rose to 4.33%, from 4.11%.

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As a first step, keep track of your typical monthly expenses for three months to find out where your money is going.

Four Steps to Help Reduce Debt

With continued concerns about the falling value of homes, rising health care costs, and an uncertain outlook for the economy, now more than ever, Americans need to set a new course with regard to managing their household finances.

If you are ready to face up to your own financial realities and set a plan of action, the time to act is now. The following four-part strategy may help you control your cash flow, pay off debt, and encourage saving so you can better handle the expenses that may have gotten you into debt in the first place.

Step 1: Track Your Spending
As a first step, keep track of your typical monthly expenses for three months to find out where your money is going. Also try to estimate unexpected expenses for a year's time -- auto and home repairs, gifts, vacations, etc. -- and divide that number by 12. Once you have a record of your spending, compare your monthly outlay with your monthly income. If you have a surplus, this is the amount you can apply each month to paying down debt and building savings. If you have a shortfall, you'll need to examine your expenses more closely to see what you can potentially cut back or cut out.

Step 2: Build Your Savings
A key to establishing good saving habits is to make saving even easier than spending. One tip is to set up separate savings accounts with separate goals attached to them. If you open them with the same bank, you can easily transfer money back and forth. Suggested account purposes:

- "Emergency Account" to pay for unexpected life events. Your goal for this account should be to build up at least three to six months of living expenses. This way, if you lose your job or need a lump sum to pay for a significant expense, you may not have to tap into your other savings or ring up more debt. If you can direct 5% of your pay each month to this account, you'll build up a nice cushion in about three to four years.
- "Family Account" to help fund your children's school expenses (such as class trips and team uniforms) or family vacations. Let's face it: If you have children, you are always paying for something. Even if you don't have kids, putting away money for a specific short-term goal, like a vacation, is a worthy savings strategy.
- "Investment Account" to be put toward general or long-term saving goals. Hopefully, you already have a retirement savings account (either through your workplace or on your own) and perhaps a college savings plan. But having another account to save for other longer-term goals -- maybe a nest egg to start your own business -- can be a smart move.

Step 3: Stop Abusing Your Credit Cards
If you've accumulated significant credit card debt, you've first got to stop the bad behavior. Paying off debt is easier once you stop using your credit cards. Pay off your highest interest credit card debt first, making sure you avoid the "minimum balance trap." Paying more than the minimum can make a big difference.

Then work on consolidating your debt by transferring outstanding balances to lower-rate cards. If you don't want to transfer your balances, you may be able to get your current credit card company to match the interest rate of a competitor. Additionally, it's advisable to cancel all cards except for the one that offers the lowest interest rate.

Finally, set up a realistic payment timetable and stick with it. If you need to readjust your timetable, do so. If you have trouble, talk to a professional. The counselors at the nonprofit National Foundation for Credit Counseling can develop a more structured plan for you, if needed. To find the nearest location, call 800-388-2227 or visit www.nfcc.org.

Step 4: Put Time on Your Side
You may not be able to solve your debt problem overnight, but you can solve it over time. Not only will a combined debt reduction and saving strategy begin to lighten the load now, it will help you feel better about your future.

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The new banking and credit card reform regulations -- which reined in excessive overdraft fees and set stricter rules on how and when lenders could raise interest rates -- have left many financial institutions scrambling to make up those lost profits. As a result, consumers may find themselves paying more for other services.

Exhibit A is free checking. For years, many large and small banks offered free checking, along with a variety of other perks, including online bill payment, check ordering, and out-of-network ATM transactions. It appears as though those days may be ending. Over the past year, a number of large institutions, including Wells Fargo and HSBC, announced they would no longer provide free checking services. Wells Fargo's policy applies to new accountholders, but HSBC's extends to current customers who don't keep a balance of at least $500 in their accounts.

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Many consumer advocates are alerting bank customers to pay close attention to any notices or communications that come in the mail or show up in your email inbox. Don't mistakenly assume it's an unsolicited credit card offer or privacy policy update. Your bank could be writing to tell you that your free services will no longer be free.

The fees for these formerly free services can be exorbitant. HSBC slaps its customers with a monthly fee of between $8 and $50 a month, depending on the type of account they maintain. Fifth Third Bancorp has a $15 monthly fee if certain dollar-based and transactional minimums are not met.

What Can You Do?

If your bank has already dropped free services or has sent you a communication signaling that changes are on the way, you do have some options. Your first option is to shop around and take your cash to another bank or credit union that still offers free services. However, if you have multiple accounts with one institution or don't have any other banks near you, this may not be the most practical or convenient option.

Your second option is to review your bank's new terms carefully. You may already satisfy all of its requirements to keep your services free. But you need to be aware of the guidelines going forward: If your balance dips too low or you don't make enough debit card purchases over the course of a billing cycle, you may be paying a stiff penalty.

Your third, and least satisfactory option is to maintain your account and suffer the consequences. No matter what your decision, be sure to stay vigilant when it comes to your accounts. Those new fees could be coming your way soon.

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If your parents work with a financial advisor, try to arrange a joint meeting where all parties can review the situation.

Stepping In When Your Parents Can No Longer Manage

It's a decision most adults dread: having to take over the financial and day-to-day living decisions for parents who can no longer manage on their own. When caring for your parents, you may need to plan on three levels: managing finances, making health care decisions, and making sure their daily household needs are met. Finding qualified experts who can advise you in these areas may make it easier to manage the situation.

Managing Finances

If your parents currently are able to communicate, try to initiate a conversation about how they would like their money to be managed. Rather than telling them what to do, be clear that you would like to help and to make sure that their wishes are met. Access to bank and brokerage statements, insurance policies, and other financial documents may help you to safeguard your parents' assets.

If your parents work with a financial advisor, try to arrange a joint meeting where all parties can review the situation. If you pay your parents' bills and manage their checkbook, arranging for direct deposit of Social Security or pension benefits, as well as electronic delivery of recurring bills, could expedite the process.

Arranging for Health Care

If your parents are mentally competent, ask them about consulting a lawyer who can draft a health care proxy, a legal document designating you (or another person) to make decisions about medical care when they are no longer able to do so. If your parents have opinions about end-of-life care, their wishes can be incorporated into a living will, another legal document.

Even without these documents, the medical establishment is likely to look to you or other siblings to make decisions about health care, which could include arranging for long-term care or making end-of-life decisions. As part of this process, determine the type of medical insurance that your parents have and what it covers.

Overseeing Daily Living Activities

If your parents are able to remain in their home, you may need to consider helping them to manage medication, to conduct daily tasks such as bathing or meal preparation, and to make arrangements for assistance with household chores. A visiting nurse and home care agency may provide assistance in these areas.

You may want to consider consulting a Professional Geriatric Care Manager, a professional who may help arrange for home care, provide crisis intervention, and help you identify solutions to potential problems. You can learn more at www.caremanager.org.

Managing a parent's affairs can be complicated, but arranging for support from qualified people may help you care for parents in a way that meets their needs and does not create too much stress on you.

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