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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

September 2015

Hello FF readers! Halloween is almost here! Please enjoy the articles in this month's newsletter, and share it with people who would benefit from it - thanks so much!

Martin A. Federici, Jr.
MF Advisers, Inc.
CEO
marty@mfadvisers.com
570-760-6524
Fax: 570-675-7105
91 Franklin Street
Dallas, PA 18612
http://mfadvisers.com

In This Issue

When More Risk Equals Less Risk

Before you can decide what types of investments are appropriate from a risk perspective, you need to evaluate your goals.

If I asked you to name the most risky asset class, which would you pick?

- Emerging markets[1]
- Commodities[2]
- High-yield bonds[3]

Each investment has unique risks, but volatility of returns is one measure that can be applied to all.

At its simplest level, volatility is the likelihood that an investment's return will change from one period to the next. It is often represented by a statistic called standard deviation.

When the standard deviation is large, the investment is considered relatively risky because it can vary a great deal from time to time. When it is small, the investment can be considered stable because its returns show relatively little variation.

Comparing Standard Deviations

For example, the standard deviation for the S&P 500, a broad measure of U.S. equities, was 14.67% for the 10-year period ending December 31, 2014.[4] In comparison, the standard deviation for the MSCI Emerging Markets index for the same span was 23.74%.[4] That means that during good years in stock markets in China, India, Brazil, and other developing economies, investors could reap rewards that outpace U.S. stocks. However, the potential for losses in emerging markets is generally higher than for domestic companies. On the other end of the market continuum, the standard deviation for fixed-income securities like those tracked by the Barclays Aggregate Bond index was 3.22% for the same time period, a fraction of that of stocks.[4]

Of course every investment is unique and there is no guarantee that any investment will perform as it has in the past. But each investment can also move up and down at different times. This suggests that adding a risky investment to an individual portfolio may not necessarily be bad and may actually prove beneficial over many years.

Match Investments to Goals

Before you can decide what types of investments are appropriate from a risk perspective, you need to evaluate your goals. Is your primary goal preservation of principal? Generating income for current expenses? Building the value of your principal over and above inflation? How you answer these questions will enable you to find an appropriate balance between the return you hope to achieve and the risk you are willing to assume.

Examine your time horizon for meeting your goals, and consider how comfortable you may be riding out short-term losses in the value of your investments. Remember, the longer your time horizon, the more volatility you may be able to tolerate in your portfolio. At the same time, long-term investors need to be concerned about inflation.

For example, if you are pursuing long-term goals (such as retirement) your portfolio may be more heavily weighted in stock investments, as these have historically provided the highest long-term returns and outpaced inflation by the widest margin, although past performance does not guarantee future results.[5] On the other hand, people already in retirement may need to rely heavily on the income from their portfolios. Therefore, they may seek to maximize income and minimize risk of short-term losses. Their portfolios may be weighted in high-quality, lower-risk bond and money market investments, with some stocks in the mix to maintain growth potential.[6]

The Risk of Not Investing Appropriately

When thinking about how to balance risk and return in your portfolio, don't forget that the risk of loss is not the only kind of risk. Give some thought to the risk of investing too conservatively and not reaping a high enough return to provide for your financial future. Also be aware of investing in instruments that may be too risky for your shorter-term goals. A financial advisor can help you select vehicles that are suitable for your goals.

Using Risk to Its Full Potential

In life, almost every attempt at success involves some risk -- and your investment strategy is no different. By devoting time to examining your goals, conducting some research, and working with a financial advisor, you can learn how to manage risk in your portfolio by choosing appropriate investments.

[1]Emerging markets are generally more volatile than the markets of more developed foreign nations, and therefore you should consider this increased market risk carefully before investing. Investors in international securities may be subject to higher taxation and higher currency risk, as well as less liquidity, compared with investors in domestic securities. Returns are in U.S. dollars and reflect effects of currency fluctuations.

[2]*Exposure to the commodities market may subject investors to greater volatility as commodity-linked investments may be affected by changes in overall market movements, commodity index volatility, changes in interest rates or factors affecting a particular industry or commodity.*

[3]*Lower-quality debt securities involve greater risk of default or price changes due to changes in the credit quality of the issuer. They may not be suitable for all investors.*

[4]*Wealth Management Systems Inc., Morgan Stanley Capital International, and Barclay's Capital. For the period indicated. The Standard & Poor's Composite Index of 500 Stocks is an unmanaged index that is generally considered representative of the U.S. stock market. The MSCI Emerging Markets Index is a free float?adjusted market capitalization index that is designed to measure the equity market performance of 23 emerging market country indexes. The Barclays U.S. Aggregate Bond Index is a broad-based index that is considered to be generally representative of investment grade bonds being traded in the United States. It is not possible to invest directly in an index. Past performance is not a guarantee of future results.*

[5]*Investing in stocks involves risks, including loss of principal.*

[6]*Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund.*

Retirement Planning for Dual-Wage Earning Households

Like any investment portfolio, retirement accounts should work as a unit to help you pursue a specific accumulation goal.

With job changes so prevalent throughout our society, it is likely that a couple may have multiple retirement accounts, including 401(k), 403(b), or 457 plans, rollover IRAs, and possibly defined benefit plans. Because of the variety of investment options offered under such plans, it is important for couples to understand the possible detrimental effects that an uncoordinated retirement nest egg can have on reaching financial goals. Potential red flags include:

Inappropriate investment strategy

Like any investment portfolio, retirement accounts should work as a unit to help you pursue a specific accumulation goal. Success requires a coordinated investment strategy. Is the overall asset allocation appropriate for a couple's objectives and risk tolerance? Are the portfolios adequately diversified? Are they overweighted (or underweighted) in any one asset class or individual security? Do the portfolios complement a couple's taxable investment accounts, real estate, and other assets?

Poorly timed distribution strategy

Couples nearing retirement or already retired must consider the timing of their distributions in light of their income needs, tax situation, and market dynamics. For instance, should they begin taking distributions earlier than the required age to avoid a potentially higher income tax hit later? Should they take periodic distributions; annuitize; or take a lump sum and pay the taxes, then reinvest the proceeds elsewhere? Might it make sense to convert a traditional IRA to a Roth IRA to put off distributions as long as possible and/or receive tax-free income? Which accounts should they tap first, and in what order should the others follow? What if the market is in the midst of a downturn when required distributions must begin?

Fees

Couples should consider the fees associated with all of their retirement accounts and how they might affect returns. Would it make sense to consolidate some accounts to help minimize fees?

Estate planning

Couples planning their estates will face a number of questions surrounding their retirement plans. A key concern centers on the naming of beneficiaries and the income and estate tax treatment of the proceeds. Should the spouse be the beneficiary, or would naming children or a trust as beneficiary be more appropriate?

These are just a few of the questions that couples must grapple with when managing their individual retirement plan accounts. Yet no two couples' financial situations are alike. There is no set formula or mathematical equation that can be applied easily to all circumstances. Keeping track of the range of investments involved is necessary to successfully pursue long-term financial goals -- but doing so is no simple task. It often requires objectivity and professional insight. If you are part of a dual-income family, speak with your financial advisor about how you and your spouse can review and coordinate your separate retirement investments to create an effective, comprehensive plan.

This communication is not intended to be tax advice and should not be treated as such. Each individual's tax situation is different. You should contact your tax professional to discuss your personal situation.

Same Sex Marriage Ruling Raises New Tax Issues

On the matter of income taxes alone, there is much that needs to be reviewed and acted upon.

In a move that reinforces the rapid shift in public sentiment regarding same-sex unions, the Supreme Court ruled earlier this year that all marriages -- and "the constellation of benefits" that are linked to marriage -- must be recognized and enforced in all 50 states.[1]

While the law brings happiness and relief to those affected, it also introduces new legal, tax, and financial issues that must be navigated. On the matter of income taxes alone, there is much that needs to be reviewed and acted upon. Here is a quick summary of some of the major tax planning issues to consider.

Factoring Taxes

For those who intend to tie the knot, marriage generally tends to lower many couples' income tax burden, especially if one spouse earns a lot more than the other. However, couples who earn about the same -- especially high-earning professionals -- may face a marriage penalty. For instance, if both parties earn $300,000 a year individually, they could each be in the 33% tax bracket. When their income is combined, $300,000 becomes $600,000 and they could be bumped into the 39.6% bracket.

For previously married couples living in states that did not recognize same-sex unions prior to the Court ruling, there are myriad income tax issues to review. *Financial Planning* recommends that couples work with their advisors and/or CPAs to assess:[2]

- Prior-year federal and state income tax returns. While all married couples were required to file joint or married-but-separate federal returns from 2013 onward, many states still required some couples to file state tax returns as if they were single. Filing amended state returns for prior years now might reduce past state taxes retroactively. But the amended filings could also effectively increase prior-year federal tax liabilities. Consult your tax advisor to determine whether the potential costs of amended filings might outweigh the desired benefits. You might also consider whether retroactive filing changes could alter the amounts used to figure eligibility for various tax deductions and credits you might have claimed in those years.

- Current-year federal and state income tax planning opportunities. Consider revising 2015 Form W-4 to decrease the number of personal allowances to mitigate withholding penalties, if applicable.

- Roth conversion strategies, financial aid assistance for children going to college, health savings account (HSA) contributions, and other employee benefits. Determine the most tax-efficient strategies going forward.

- The ability to file both federal and state taxes jointly as a couple, and to take advantage of any state-level tax breaks offered to married couples.

If you need help making sense of the new ruling and what it means for you and your spouse's tax situation, contact your financial and/or tax professional.

[1]*Supreme Court of the United States, Syllabus Obergefell. v. Hodges, Director, Ohio Department of Health et al. (Full text of Justice Anthony Kennedy's decision), June 26, 2015.*

[2]*Financial Planning, "Smart Tax and Estate Planning Tips for LGBT Couples," July 1, 2015.*