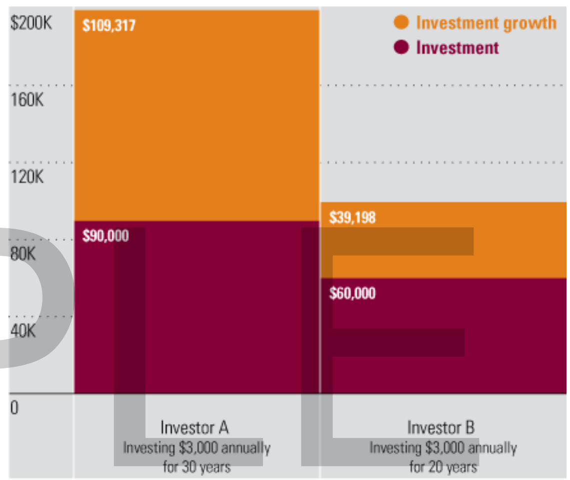
May 2011 | Issue 32 | Quarterly Insights

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.

A Message from Chase, Thomas, & Peters

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Market Performance
1/1/2011 – 1/31/2011
S&P 500 ^ 3%
DJIA ^ 1.5%
NASDAQ ^ 2.2%

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The Many Faces of Inflation

During the recent 2007–2009 recession, it seems all we've seen and heard about the economy was bad news: the housing market collapsing, 401(k)s suddenly being worth much less than before, a lifetime of savings almost disappearing in a few months, rising unemployment, and fluctuating prices. Now that the recession has officially ended in June 2009 and we're on the road to recovery, inflation may become a concern once again. In this uncertain economic climate, it may be helpful to learn about the different types of inflation and their immediate effects.

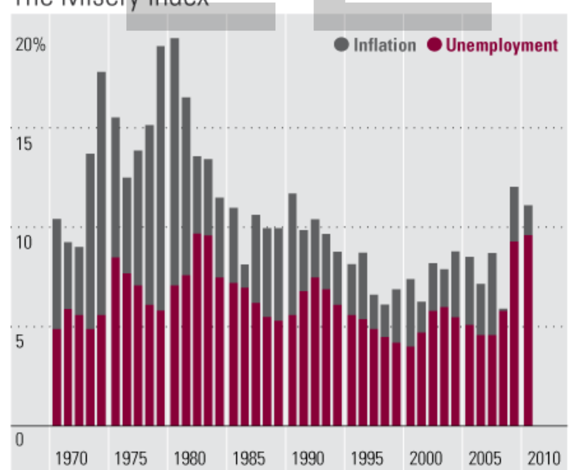
Inflation: Inflation is defined as a continuing rise in the general prices of goods and services. Simply put, if prices, on average, are going up in an economy, then you've got inflation. With a set amount of money in an inflationary environment, consumers are able to buy less and less over time. High rates of inflation can generate uncertainty, lower productivity and discourage investment. The leading measure of inflation in the United States is the Consumer Price Index (CPI). The government can change its monetary policy to control the money supply and keep inflation in check, although this is not the only variable affecting inflation. In November 2010, the Federal Reserve announced it would buy back long-term Treasuries in order to inject money into the economy, a policy called quantitative easing, which can trigger higher inflation.

Hyperinflation: Hyperinflation is extremely high, out of control inflation, caused by a steep increase in the money supply without a corresponding increase in the output of goods and services. Well-known examples include the German hyperinflation after World War I and the hyperinflation in Hungary after World War II. It appears that such an extreme phenomenon occurs mainly as a result of radical changes and prolonged economic instability.

Deflation: Deflation is the opposite case: a general decline in the prices of goods and services. In the U.S., deflation occurred as recently as 2008 and 2009: The change in CPI was negative in the third and fourth quarters of 2008 and in the fourth quarter of 2009, a clear indicator of deflation. The obvious positive effect here is lower prices—many argue that deflationary periods are good times to buy. The problem with deflation, though, is that consumers reduce spending and businesses stop growing, which is not good for the economy.

Stagflation: This is the worst-case scenario: high inflation and slow growth simultaneously. Normally, there is an inverse relationship between inflation and unemployment; if the economy is able to tolerate a higher rate of inflation, lower unemployment can be achieved, and vice versa. But during a stagflation period, both inflation and unemployment go up. An interesting measure for stagflation is the misery index, which, as illustrated in the image, combines the unemployment and inflation rates. The U.S. experienced severe stagflation in the 1970s, when unemployment and inflation reached a combined high of almost 20%. There has been talk of stagflation during the recent crisis as well, but the potentially encouraging news is that the misery index is not nearly as high now as it has been in the past.

The Misery Index



Source: Inflation is represented by the Consumer Price Index, and unemployment by the national unemployment rate, not seasonally adjusted, from the Bureau of Labor Statistics.

The New Tax Package and Your Portfolio

On Dec. 16, 2010, Congress approved $801 billion in tax cuts and $57 billion for extended unemployment insurance. It includes other tax breaks, such as college tuition credit for some families, an expanded child tax credit, and the earned income tax credit. Here is how some of these changes may impact your portfolio.

Social Security Tax: The one-year payroll tax cut would reduce the Social Security tax to 4.2% from 6.2%. Although this was intended to increase consumer spending levels and stimulate the economy, a better option would be to increase your contribution to your 401k plan to match your employer's contribution, at a minimum, if you do not need extra cash in the near future. The contribution limit for 401k plans remains at $16,500 for those under 50, and $22,000 for those age 50 or older.

Dividends/Capital Gains Tax Rates: Dividend and long-term capital gains taxes will remain at 15% for the next two years. Many had suggested selling securities in your portfolios that were projected to have huge capital gains before the end of 2010, since the capital gains tax rate was projected to increase to 20%. Now, you can sell your securities if your investment strategy dictates.

Estate Taxes: The new tax package sets new estate tax parameters with an exemption of $5 million per person, or $10 million per couple, and a maximum rate of 35% for the next two years. You should speak to your financial advisor about creating an estate plan that will detail how you would like your assets distributed after you are gone, and who should act on your behalf should you become disabled.

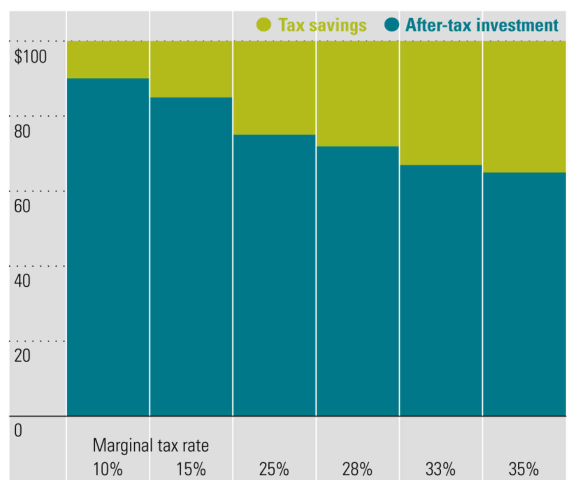
Dividends are not guaranteed and are paid solely at a company's discretion. Please consult with your tax professional for specific tax advice.

401k Contributions and Tax Savings

A commonly-overlooked benefit of 401k investing is that contributions can be made pre-tax, so that even a small contribution can go a long way. In this situation, 401k contributions are not taxed until you retire. Therefore, the more you contribute to your retirement account, the smaller your taxable income becomes, and the more federal taxes you are able to defer.

The image presents the tax savings (reduction in tax liability) achieved by a 401k contribution of $100 for six marginal tax rates. For example, if you are subject to a 35% marginal tax rate and you choose not to contribute, you will pay $35 in taxes and only have $65 available to invest in another account. If, however, you invest pre-tax in your 401k, you will have $100 that is yours and can grow tax-deferred until you retire.

Tax Savings from Investing in a 401k Plan



This is for illustrative purposes only and should not be viewed as tax advice. Be sure to consult with a financial advisor or tax professional for the latest rules and regulations.

How to Choose a Financial Advisor

Choosing a financial advisor is a process that must be conducted with the utmost care and only after meticulous planning. After all, this will be the person managing your life's savings, your retirement portfolio, or your children's college money. While referrals from trusted friends or loved ones are usually one of the safest ways to find a good advisor, that path might not be available to everyone. Those looking for a financial advisor might want to follow the steps below.

First of all, beware of investment gurus who promise that by using their "secret method" you will be able to beat the market by some ludicrous amount. If it sounds too good to be true, it probably is. Look for reliable credentials, such as the Certified Financial Planner (CFP), Chartered Financial Analyst (CFA), or Chartered Financial Consultant (ChFC) designations. These certifications require passing a series of exams and a certain number of years of experience in the financial field. A Registered Investment Advisor (RIA) must file Form ADV with their state or the Securities and Exchange Commission—ask to see it. It will show the planner's professional history and any legal problems their practice has had.

Once you ensure an advisor's legitimacy, you can start the interviewing process. The National Association of Personal Financial Advisors' Web site has an excellent questionnaire called "The Comprehensive Financial Advisor Diagnostic" that you can use to interview potential planners. Ask about track record, past performance and experience, fees, and commissions.

Also, ask the financial professional what type of clients he or she sees most often to determine if the other clients' financial situations are similar to yours. You can ask to speak with some of these clients as well—are they satisfied with the way the advisor handles their finances? Your financial advisor will have to be someone you can trust and whose skills are a good fit for your financial needs.

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