BWFA

Retirement & Estate Planning,
Investment Management
& Tax Services

Advisor

JULY 2012

Baltimore-Washington Financial Advisors

BWFA Moving Forward

By Saxon Birdsong, MBA

Friday, June 29, 2012, marked a watershed date in BWFA's history. At approximately 7 p.m., Rob Carpenter joined BWFA as the new president. Please join me in welcoming Rob to the firm.

From my perspective, Rob is the crucial link to the "business continuity plan" that BWFA has been implementing over the last few years. He's 46 years old, enthusiastic, and exactly what BWFA needs to serve you well in coming years. During his successful 23-year career, he has served as Regional Director, Regional Manager, Complex Manager, Regional Sales Manager, Training Director, and Financial Advisor at some of the largest wealth management firms in the country.

Soon, we will schedule a series of events at which you can meet Rob and hear his (and our) plans to keep BWFA serving all of your financial needs. If you can't wait for a formal event, please feel free to stop by the office in Columbia, and we will accommodate your visit.

We first met with Rob in June 2011. During the past year, we considered many alternatives for BWFA going forward. We engaged with several prospective partners, including four individuals, a bank, and two other Registered Investment Advisory firms. After evaluating all the options, we ended up where we started—with Rob. It was a unanimous choice by our staff.

Saxon Birdsong (age 67) will continue on as a consultant to BWFA over the next four years, focusing on the investment area. Bob Cassel will continue as Director of Tax Services. Rob Williams will continue as a Portfolio Manager with his current clients, and he will assume the additional role of Chief Investment Officer. Bob Ray and Chris Kelly will continue as Portfolio Managers/Advisors with their current clients. Mark Stinson will continue as Director of Planning and Portfolio Manager. All other staff members will continue in their current roles.

And finally, we have to address our growing problem with employee names. We have...........

2 Robs
2 Susans
2 Bobs
2 Barbaras

We'll work it out. Thank you for continuing to place your trust in BWFA.

Rob Carpenter

BWFA in the Community

In honor of Columbia's 45th birthday, BWFA purchased a brick paver and added our name to the Town Center's Lakefront. The brick is located on the pathway right in front of Clyde's restaurant. If you attended the festivities on June 23rd, you may have seen some familiar faces of BWFA staff members, who were passing out birthday cupcakes.

BWFA Welcomes New Team Member

Barbara Israel joins BWFA as a part-time member of the tax team.

Fee FO Only ™

Retirement & Estate *Planning*

By Mark Stinson, CPA, MBA

On Target? *Do You Know What Your Target-Date Fund is Doing?*

During a guest appearance on "Live with Regis and Kelly," pro skateboarder Shaun White attempted to jump ("ollie") over Kelly Ripa using his board. Regis was quick to point out that White risked accidentally hitting and injuring his lovely co-host. White agreed. "That," he explained, "is a risk I'm willing to take!"

Apparently, Invesco and Pacific Investment Management Company (PIMCO) are willing to take some risks with your retirement nest egg. Bloomberg reported these two funds are "adding riskier assets and complicated strategies in target-date funds as they seek to gain ground on Fidelity Investments and Vanguard Group in this fast-growing segment of the U.S. retirement market."

Most investors would be surprised to find out that their target-date funds are getting riskier. Their stated purpose is to automatically adjust the investment allocation to reduce risk as the investor reaches a target date, typically retirement.

Risk reduction in a target-date fund is usually achieved by reducing the portion of allocation in stocks and increasing the allocation in fixed-income investments. So, should fund managers be increasing the risk in the fixed-income portion (in an effort to boost returns) through derivatives, credit default swaps, and other strategies?

Let's look more closely at the pros and cons of target-date funds.

We know that many of our clients do not feel qualified to select a fund allocation in their employer's retirement plan. Target-date funds address that anxiety by leaving the decision in the hands of a fund manager. The investor picks a date when he or she plans to retire, and the fund manager makes the appropriate adjustments.

As with most one-size-fits-all approaches, there are downsides to target-date funds. The first issue, as noted above, is that a mutual fund company might use alternate strategies that contain additional risk to obtain additional returns. Target-date fund fees tend to be high, and alternate strategies add further to fund expenses.

The second disadvantage is that there is no industry standard for the ratio of equity and fixed-income investments in target-date funds. In other words, the Fidelity Target-Date 2020 fund might be allocated very differently than Vanguard's 2020 fund, even though both are marketed to people who plan to retire in 2020. A recent Securities and Exchange Commission survey found that few investors understand the differences in the design or risk profile among target-date series.

The third disadvantage is something called "glide paths." This refers to how target-date funds change their allocations within a particular fund. In other words, a 25-year-old (like Shaun White) who invests in the fund today may not have the same allocation as a 25-year-old who invested in the same fund five years ago. Morningstar has found that some managers' glide paths are much less stable than others. Funds with stable glide paths have lower fees.

Finally, disclosure about these differences in strategies, allocations, and glide paths is hard to understand.

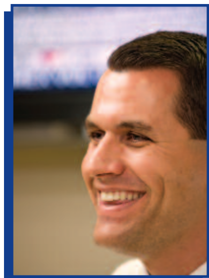
Conclusion

To be fair, the allocation changes implemented by Invesco and PIMCO are not necessarily bad. However, to make an assessment, investors need more information than investment management firms usually provide. Has the allocation or glide path changed for a compelling, supportable, or rational reason? Do the changes benefit investors? Has the fee structure of the fund been affected?

Unfortunately, investors find that it's difficult to get answers through their employer's retirement plan. And they find it even harder to blend their target-date fund investment strategy with their other investments.

Working with BWFA, you know what you're investing in, why, and how much it costs. We'll also help you understand how your money in an employer-sponsored investment account is being handled and how that affects your overall portfolio. Contact us if you would like to review your investment allocation.

Managing Risk Through Asset Allocation



By Chris Kelly, CPA

Each of us is constantly allocating personal resources. We have an umbrella for rainy days and sunglasses for sunny days. We fill our bathroom cabinet with cold and cough medicine for those days we can't get out of bed and headache medicine for those days we can't stand to watch the stock market.

This allocation is constantly shifting, based on what we have and what we anticipate needing to use. But our primary goal stays constant: to reduce our risk of not being prepared on any given day.

The approach we take with investing should mimic the habits we maintain in our personal lives. The means by which this is accomplished is "asset allocation."

Asset allocation is an investment strategy that involves dividing an investment portfolio among different asset categories, such as stocks, bonds, and cash. At BWFA, our first priority is to tailor the asset allocation of investment portfolios to each client's individual circumstances. Two of the primary determinants of an appropriate asset allocation are a client's time horizon and ability to tolerate risk. Using these attributes as a guide, we create portfolios that we believe will provide the greatest possible return given the client's risk tolerance, financial goals, and circumstances.

Asset allocation does not prevent portfolio losses, but it can help to minimize losses and reduce the volatility of returns over the long term. The consequences of volatility, as measured by standard deviation, become more apparent over time. For example, a portfolio that is down 50 percent requires a 100-percent increase just to get back to the original value, but a portfolio that is down 9 percent requires only a 9.9-percent increase to get back to the original value. The more frequently a portfolio experiences severe losses due to volatility, the less advantageous will be the compounding effects of positive returns.

A properly allocated portfolio is one of the most important factors affecting the long-term performance and overall risk of your investments. Appropriately implemented, asset allocation acts as an effective defense against market volatility, inflation, and global economic turmoil.

Please contact a BWFA professional or stop by our offices if you'd like to discuss your specific asset allocation strategy.

Asset Allocation, Balanced Portfolios and the S&P 500 Index

Balanced portfolios like those managed at BWFA include multiple asset classes, each having a unique set of risk and return characteristics. One challenge is to determine what is an appropriate index against which to compare the performance of a portfolio.

Many investors look at the S&P 500 as the best index. In fact, the S&P 500 is commonly referred to as the "market." But equating the S&P 500 with the entire stock market is misleading. The S&P index is made up of only a single asset class: U.S. large-capitalization stocks.

Since risk and return are related, it can be surmised that over the long term a balanced portfolio would be expected to produce a different return from the S&P 500 index. The S&P 500 index would not be a suitable benchmark for comparison to a balanced portfolio, unless the portfolio has a 100-percent allocation to U.S. large-cap stocks.

Congratulations to **Jacob Birdsong** who recently passed the Series 65 exam!!
The Series 65 exam covers laws, ethics and topics such as portfolio management strategies and fiduciary responsibilities.

Tax *Services*

College Education Expenses, Credits, and the New Graduate

By Bob Cassel, EA

Congress and the last two presidents have put legislation into effect that makes the payment of college education expenses a potentially lucrative tax savings tool. Parents and college students should plan carefully so that they maximize these tax savings. Unfortunately, figuring out which credits and deductions are available can be very complex. For example:

1. The three tax credits (American Opportunity, Hope, and Lifetime Learning) are worth as much as $2,000 to $2,500 each year.
2. The Hope and Lifetime credits are not "refundable." That means that you can use them only to the extent that you have a tax liability. This is not much help for a recent graduate who is either earning little or, possibly nothing and therefore has little or no tax liability.
3. If the tax credits are unavailable, then you have the option of reducing your taxable income by up to $4,000 for college expenses. This is valuable because it reduces the exclusions under health and miscellaneous deductions as well as the alternative minimum tax.

In the year a student graduates from college, additional considerations come into play:

1. Who can claim the dependent exemption for the graduate—the parents or the graduate?
2. How does dependent status affect eligibility for each type of education incentive?
3. What should parents do with unused College Savings Plan balances?

The answer to each of these questions is, "It depends." Some of the issues on which answers hinge are:

1. How many months the graduate was a full-time student during the year. The magic number is at least five calendar months for purposes of determining dependency.
2. Is the graduate married, or will he or she be married any time in the current year? If married, will he or she file with a spouse for a refund?
3. How old is the graduate? The magic number is younger than age 24.
4. How much combined income do the parents make? The income phase-out is different for each education credit or deduction. For example, for the American Opportunity Credit a married couple with combined income between $160,000 and $180,000 will see a gradual phase-out of this credit. At $180,000 (2011 numbers), parents will not be able to use any of the American Opportunity Credit.

It's not possible for us to give you simple rule-of-thumb answers to these tax planning issues. We must review your particular situation and plan accordingly. Let us help you. Give your BWFA tax advisor a call at 410-461-3900.

Getting Off to a Great Start After College — Our "High Five" Life Skills Retreat

Offered Especially for Young Adults

Benjamin Franklin once said, "Life's tragedy is that we get old too soon, and wise too late."

Baltimore-Washington Financial Advisors will sponsor a workshop to help young adults "get wise" much sooner. The workshop will help sharpen the critical life skills needed in the workplace – skills they did not learn in high school and college curriculums.

We recognize that it's an increasingly competitive and complex world, and that young adults are finding it difficult to navigate. We all have a vested interest in helping them get off to a great start. That's why we are excited to announce the 2nd BWFA Life Skills Retreat to be held on Saturday, August 11, 2012. **Visit www.bwfa.com/high-five-life-skills-retreat for more details and to register for this free event.**

Baltimore-Washington Financial Advisors

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