Money Minute

Financial Planning & Investing Newsletter

"Smart Ideas for Secure Finances"

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PROVIDED BY

R1 FINANCIAL GROUP

Brad Rodrigues
Financial Advisor

214.628.9100 (office)
Full contact info. on back cover

Inside This Month's Issue:

FEATURE

How Mutual Funds Operate to Get Results

Mutual funds form the foundation for most investors' investment portfolios, whether held in their 401(k)s, IRAs or other retirement/investment accounts. In last month's issue, I looked at everything related to mutual fund fees, what to be aware of, and how they affect fund performance. This month, I'll wrap up this series on mutual funds by highlighting exactly how funds go about the business of making investors money, what you should be aware of, and what to look for as an owner of a mutual fund to determine if it is a good investment or not.

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1) How Many Stocks Does a Fund Own?

You can tell a great deal about a fund by looking at the number of stocks the fund holds, and here's why: the S&P 500 index is a weighted average containing 500 stocks spread across 10 distinct sectors. Truly active fund managers who are trying to add value for investors realize that in order to achieve excess returns above and beyond those of the broad index, they must compose a portfolio that is somehow different than the index. One of the most obvious ways to do this is to own a relatively concentrated portfolio of stocks.

The book Investment Analysis and Portfolio Management by Frank Reilly and Keith Brown showed that 90% of the benefits of diversification come from owning just 12 -18 stocks. You would think that most mutual funds wouldn't want to "water down" their portfolios with marginal ideas instead concentrating their money into their best ideas, but curiously this is not the case. In fact, most domestic stock mutual funds own 80-100+ stocks! In some sense, this is "safer," but it also ensures a degree of mediocrity and makes it far more difficult for the fund the perform much differently than the broader index.

Why do funds "over-diversify?" I believe one primary reason is because fund managers know that just one year of under performance, even if a fund's long-term track record is great, will make near-sighted investors redeem their shares and head to a competing fund. **Fear is a more powerful motivator than greed.** It is better for business to perform roughly in line with the broader index, try to slightly outperform, and not take too

(Continued on page 4)

QUOTE OF THE MONTH

"Defeat is not the worst of failures. Not to have tried is the true failure."

~ G. Edward Woodberry

American Literary Critic and Poet (1855 - 1930)

DID YOU KNOW?

In December 1998, the national average price of a gallon of regular gasoline was $0.993, just under $1.00 per gallon.

Source: U.S. Department of Energy

Ideas for Success

Mutual Funds Part 4: How Funds Operate to Get Results

"Ideas for Success" articles are adapted from conversations with Money Minute readers and R1 Financial Group clients. Strategies mentioned should not be construed as investment advice or offers to purchase any product. Always consider investment risks and your goals before making any financial decision.

SCENARIO:

Over the last 3 months, we've taken a close-up look at mutual fund performance differences and fees, among other things. This month, I will wrap up with the most important characteristic of any mutual fund: how it is managed. A fund's management style and characteristics will determine how it performs over time and how much money it will make for its investors. For bond mutual funds, this distinction is far less important than it is for funds that invest in stocks.

Actively-managed stock mutual funds work on a simple premise: a fund manager uses his/her skill and knowledge to look for investment opportunities and buys and sells stocks on behalf of investors. Exactly <u>how</u> they execute this makes all the difference in terms of what results will be achieved. Some key questions to ask, among other, are:

-How many stocks are held in a particular fund?

-What criteria are used by the manager in looking for companies to invest in? (a.k.a. strategy)

-How long are stocks generally held?

-Does the fund manager adhere consistently to a certain strategy or does this change over time?

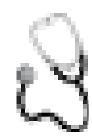
You may recall the article I wrote in this section a couple of months ago that compared a cross section of mutual funds and illustrated just how widely their returns can be over time, which directly results in substantially more or less cash in investors' accounts. The answers to the aforementioned questions go a long way to determining how a fund will perform over time, what returns will be achieved, and what results investors will enjoy (or not enjoy). They are what differentiate one fund from another, and can be looked at to determine ahead of time what funds may be best.

STRATEGY:

Once again I felt that this topic deserved more than the half page usually dedicated to this section; therefore, I've used it for this month's feature section.

YOUR HEALTH

Natural Remedies for Seasonal Allergies Have Promise



If you have seasonal allergies, there are plenty of medications to choose from, but you may not want to take drugs that make you feel listless or wired or simply would prefer a natural remedy. Do they exist? Maybe, experts say. "Finding a good supplement for allergies can be a challenge," says David Rakel, MD, founder of the University of Wisconsin Integrative Medicine Program. "Honestly, the pharmaceuticals often work a little better, but there are some out there that can help."

<u>Butterbur</u>. "Butterbur is the Singulair of the herbal world," says Rakel. "I think of all the allergy supplements, it has the best evidence behind it." The herb appears to work as a leukotriene inhibitor, which blocks some chemicals that trigger swelling in the nasal passages. Some research shows that extracts of butterbur root are just as effective at relieving nasal symptoms as prescription drugs like Zyrtec and Allegra. "Butterbur has the advantage of not causing sleepiness, a common side effect of antihistamines."

<u>Quercetin</u>. Found in wine and many fruits and vegetables, quercetin may work as a mast cell stabilizer. It helps block the release of histamine that causes inflammation. "Quercetin is sort of the herbal equivalent to cromolyn sodium [in the over-the-counter spray NasalCrom]," Rakel says. "The evidence is promising."

<u>Stinging Nettle</u>. Often used as an allergy treatment, this botanical contains carotene, vitamin K, and quercetin. There's some evidence that using stinging nettle after the first sign of allergic symptoms can help. Be sure to choose extracts of stinging nettle (*Urtica dioica*) leaf, not the root, which is used to treat prostate troubles. Consult your physician prior to any use of the above items.

***Source(s): Web MD**

Ask Money Minute

Questions can be e-mailed to: Brad@R1FinancialGroup.com

Q. "What is your opinion of reverse mortgages? My mother is retired, owns her house free and clear, but could very much use some extra income."

-John T. – Dallas, TX

A. Reverse mortgages can certainly make sense in certain situations. They are nothing more than loans taken out by homeowners using ones home as collateral. A homeowner can receive a lump sum up to X% of the value of the home...which will accrue interest. The homeowner can also instead opt to receive monthly payments - making it like an annuity. Importantly - as long as the borrower is living in the home, he or she will not ever have to "pay the loan back." At death or when the borrower does move out, the property is typically sold - allowing the lender to recover the amount borrowed and returning any remaining home equity to the borrower or his/her heirs.

Reverse mortgages have had a stigma attached to them for some time due largely to absurdly high origination fees, high interest rates, and the fear of borrowers that they'd be kicked out of their homes at some point. With a lot of cheap money available to lend by banks, I've seen interest rates in the 6-7% range on such loans with modest origination fees. For a retiree with substantial home equity, perhaps limited retirement account balances and a need for increased cash flow, reverse mortgages are a valid option.

Q. "I'd like to start a small investment account for my daughter and contribute maybe $50 per month. Her grandparents would also like to contribute. What is the best way to do this?"

-Cheryl M. – Plano, TX

A. I love your idea. My parents started a similar account for me when I was in 3rd or 4th grade, invested $50 per month for me into a mutual fund, and gave me the account as a college graduation present - when it was worth over $13,000. It taught me the value of saving and forced me to learn about investing.

You can set this up in several different ways. One way is to set up a custodial account that your daughter would legally own but would have you as a custodian to have the power to make investment decisions, withdraw funds for her benefit, etc. At age 18 (21 in some states), control of the account would automatically pass to your daughter. This arrangement is known as a Uniform Transfer to Minors (UTMA) or Uniform Gift to Minors (UGMA) depending on the state. Another way would simply be to set up a taxable investment account in your name and make a gift of the account assets in the future when you're ready to give the money to your daughter.

The taxation would be more favorable for the custodial account, but you could retain account ownership longer with a regular taxable account.

Money Minute Trivia Question

What country recently proposed taxing bank deposits to raise money for its cash-strapped government?

A) Greece *B) Cyprus* *C) Turkey* *D) Portugal*

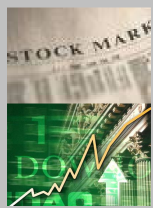
*Please email your answer to **Brad@R1FinancialGroup.com**. Each month one winner is randomly drawn out of all correct responders to receive a **$25 gift card to a local restaurant**!

Last Month's Winner – **Brandon L. of Southlake, Texas**

Question: Olympic sprinter Oscar Pistorius, famous for using prosthetic blades to run, was recently charged with murder. What country is he from?

****A) South Africa*** *B) Netherlands* *C) Belgium* *D) Denmark*

Market and Economic News



The major U.S. stock market indices have broken into all-time high territory some five and a half years after setting previous highs back in October 2007 (see Up Close article on page 5 for details). May – September is a typically weak time of year for stocks, but it remains to be seen whether or not the current optimism and market momentum can be retained throughout the year. The past three years have seen large, abrupt market declines at some point (May/June - 2010, August – 2011, September/October - 2012). Interest rates remain near record low levels as the Federal Reserve has expressed a reluctance to withdraw efforts at stimulating the economy through bond purchases.

At a Glance…

(as of April 10) **DJIA** – 14,826 **S&P 500** – 1,588 **NASDAQ** – 3,298 **10-yr T-note** – 1.78%

How Mutual Funds Operate to Get Results

(Continued from page 1)

much risk by running a concentrated portfolio. For investors looking for true value added, look for funds that own 25-30 or so stocks maximum.

2) What Investment Strategy is Being Used?

Successful fund managers follow some sort of guiding principles and strategy. Whether they are deep value investors who look for undervalued stocks, growth investors looking for rapidly growing stocks, there must be a clear strategy in place. A good fund manager will clearly and enthusiastically communicate his or her strategy to shareholders and will almost always write quarterly updates explaining his/her reasons for buying and selling stocks in the fund. Good fund managers don't care about sector weightings or obsess about macroeconomic or geopolitical events that are unpredictable and out of their control. They simply focus on carrying out their strategy and seeking good investment opportunities on a company-by-company basis. Again - such outstanding fund managers are rare, but they are out there and should be sought after.

3) Does the Fund Manager Have His/Her Own Money Invested in the Fund?

What would you think about a cook or chef who doesn't eat his own cooking? You'd probably have doubts about the food, and rightfully so. The same goes for mutual funds whose managers do not invest a significant amount of money in their own fund(s). A study several years ago by Morningstar highlighted a significant performance advantage for funds where managers had over $1 million of their own money in their fund. Most mutual fund managers are very well paid, and to invest $1 million in a fund is not a tremendous achievement. There may be valid reasons for a lack of investment in a manager's own fund in certain cases, but most of the time I believe it represents a lack of conviction in the fund itself.

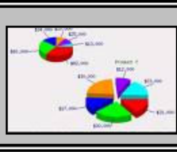
4) Length of Fund Manager Tenure, Turnover and Other Responsibilities?

Many investors look at a fund's past performance to determine if a fund is a suitable candidate for investment. Past performance is important, but it is extremely important to look at how long a fund manager has been at the helm. For example - if you look at a fund's 10-year track record, but the fund has had 3 different fund managers during that time, there is almost no information to be gleaned. I don't believe you need to set a defined "minimum number of years" criterion, but it is nice to know that a manager has a significant amount of experience.

Equally important to know is if a fund manager is being spread too thin. Fund managers will often run multiple funds, and this can potentially be a bad thing. Investment management is a time-intensive activity, and you want to be sure your fund manager is dedicating sufficient time to your fund. Managers at some fund companies will often manage 4-5 funds and fill other executive roles. This is certainly a potential cause for concern and something to be avoided if possible.

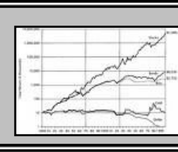
I don't care how much or how little money you have…the money in your 401(k), IRAs, taxable accounts and other investment accounts deserves to be invested well. If you're opting for actively-managed mutual funds, be sure you're getting what you are paying for and use the above list as a starting point. Spend the time and do the research yourself, or work with a financial advisor to guide you toward solid investment options.

As always - carefully consider your personal financial situation, investment goals and risk tolerance before making any investment decisions.



UP CLOSE

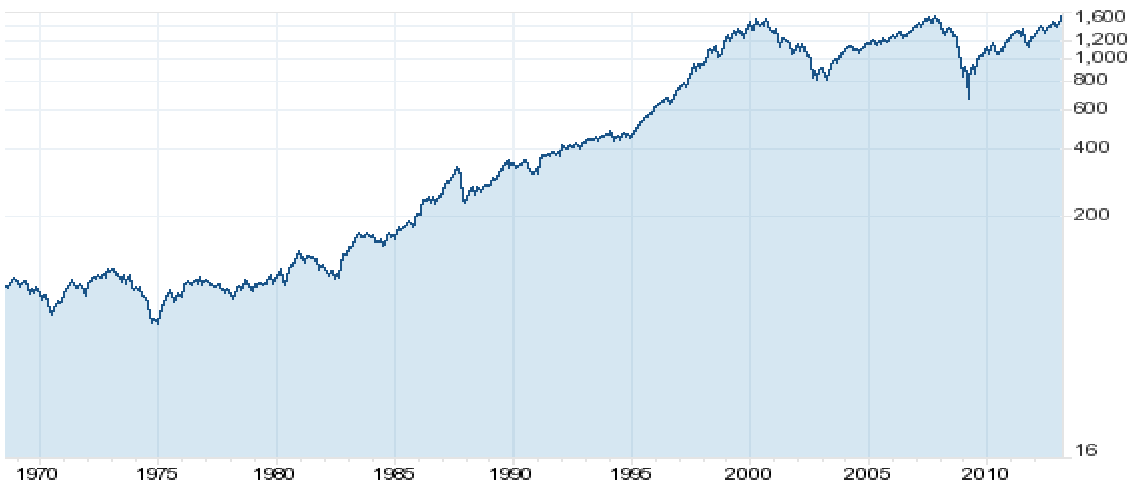
In-Depth Information for Smart Investors



U.S. Stocks Make New Highs, Recover Losses From Great Recession

Many savers and investors still feel stung by the stock market's harsh 50%+ decline from October 2007 - March 2009 and have not regained a trust of financial markets. However, a quick look at the chart below reveals that since March 2009, the U.S. stock market - as measured by the S&P 500 Index - has gone from a low point of 676 to 1,572 as of early April 2013 - an all-time high level. This is a gain of just over 132% and does not include the effect of dividends, which would have increased that total return. The chart below shows the level of the index from 1970 to the present:

S&P 500 Index Finally Exceeds Previous All-Time Highs Set in 2007



Source(s): Yahoo Finance

The chart tracks a stagnant U.S. stock market through the economic malaise of the early to mid-1970s, exceptional market gains amidst huge economic growth and technological advances in the 1980s and 90s, then two huge market collapses of greater than 50%: a tech bubble bursting in 2000 - 2002 and housing/credit bubble burst starting in 2007. The S&P 500 index has approached this level twice before; it closed near 1540 way back in March 2000 and just above 1560 in October 2007. Now - just four years after setting its recent low, it has crossed into all-time high territory.

What does this say about the economic recovery? It says, first and foremost, that U.S. corporations as a whole have weathered the storm and are producing record earnings and profitability. Low interest rates have allowed companies to borrow at low rates, shore up balance sheets, and rebuild. Housing prices appeared to have bottomed out in most markets roughly a year ago and have been on the rise for the past 8-12 months. Indicators like the unemployment rate are still far worse than where they were pre-recession, and inflation is still below the Federal Reserve's target. Overall, the situation is far better than it was just 2-3 years ago, and given the stock market's jump into new high territory - you will likely, for the first time in several years, start to hear enthusiasm from the mainstream media regarding stocks.

Money Minute *Tip of the Month:* Decrease Mailbox Clutter By Opting Out of Pre-screened Offers

Many companies that solicit new credit card accounts and insurance policies use prescreening to identify potential customers. Pre-screened / pre-approved offers are based on information in your credit report that indicates you meet criteria set by the offering company such as minimum credit score. Credit reporting agencies control and sell this data to companies, and if you decide that you don't want to receive these prescreened offers you can opt out of receiving them by calling 1-888-5-OPT-OUT or visiting www.optoutprescreen.com. The phone number and website are operated by the major consumer reporting companies, and you can choose to opt out for five years or permanently. As you consider opting out, consider that prescreened offers can be beneficial if you are in the market for a new credit card or insurance by helping you to learn what's available in the marketplace, compare costs, and find the best product for your needs. Also - because you are pre-selected to receive the offer, you will likely be turned down only under very limited circumstances. Last - some credit card or insurance products are available only through such prescreened offers.

Opting out via this website/phone number will not get rid of all "prescreened" mail solicitations and will only stop those sourced through the major credit reporting agencies (Equifax, TransUnion, Experian, etc.). Also - if you do decide to opt out, you can always use the same toll-free telephone number or website to opt back in. Source: FTC.gov

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Additional Content About Subjects Mentioned in this Newsletter:

Stock investing involves risk including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise, and bonds are subject to availability and change in price.

Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield. The market value of corporate bonds will fluctuate, and if the bond is sold prior to maturity, the investor's yield may differ from the advertised yield. Municipal bonds are subject to availability and changes in price. They are subject to availability and change in price. They are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax.

Municipal bonds are federally tax-free but other state and local taxes may apply. High yield / junk bonds (grade BB or below) are not considered investment grade securities and are subject to higher interest rate, credit and liquidity risks than those graded BBB and above. They generally should be used as part of a diversified portfolio for sophisticated investors.

Government bonds and US Treasury bills are guaranteed by the US Government as to the timely payment of principal and interest, and if held to maturity, offer a fixed rate of return and a fixed principal value.

CD's are FDIC insured and offer a fixed rate of return if held to maturity.

All indices are unmanaged and cannot be invested into directly. All performance reference is historical and is no guarantee of future results.

The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure the performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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7616 LBJ Freeway, Ste. 724
Dallas, TX 75251

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E-mail: Brad@R1FinancialGroup.com

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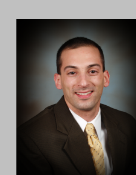

*Advisory services offered through R1 Investment Management LLC, a Registered Investment Advisor.