The FINANCIAL SUCCESS Library

Money Minute

Financial Planning & Investing Newsletter

"Smart Ideas for Secure Finances"

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Inside This Month's Issue:

PROVIDED BY

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FEATURE

Accumulating Through Investing: 3 Follow Up Misconceptions

You may recall that in last month's feature story, I highlighted the results of investing over long time horizons (20 - 30 years) - with an initial lump sum only and with periodic contributions - while achieving various average rates of return. The potential long-term growth one can achieve over long periods of time, as shown in various examples last month, is remarkable, however this month I want to clear up some misconceptions that may have arisen from that article. Here they are...

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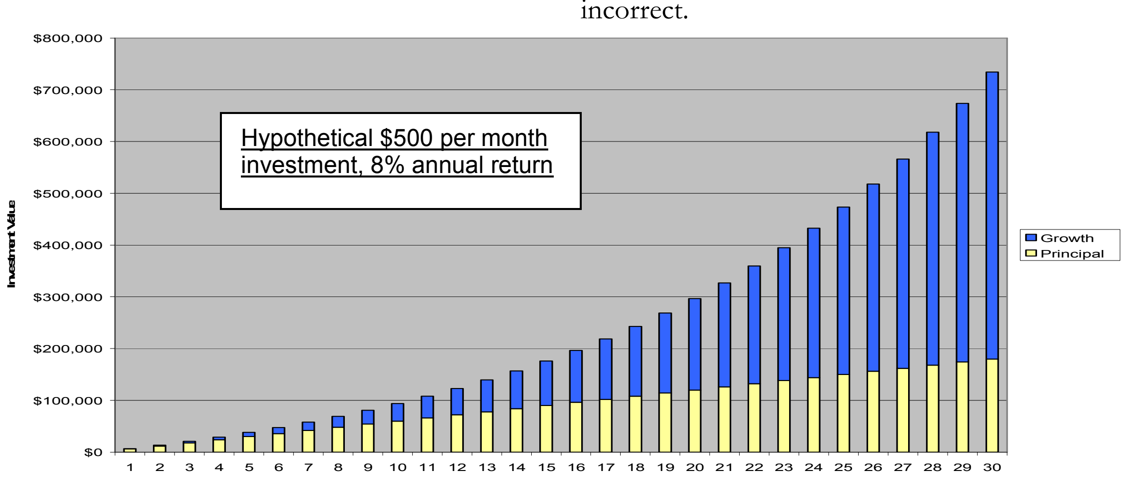
1) Saving for College: Lower Your Expectations

If you are a parent saving (or thinking about saving) for your kids' college tuition, it would be reasonable to assume that last month's hypotheticals were a relevant starting point for estimating what you might be able to save for your kids' college. For example, they showed that saving $500 per month at an 8% average annual return would accumulate roughly $734,000 after 30 years. It would be reasonable to assume that the same scenario played out over 15 years would accumulate roughly $367,000, half the previous dollar amount and a more appropriate timeframe when saving for college. However, that assumption is incorrect.



(Continued on page 4)

QUOTE OF THE MONTH

"I am patient with stupidity, but not with those who are proud of it. "

~ Edith Sitwell
British Poet / Critic
(1887 - 1964)

DID YOU KNOW ?

According to the World Bank, 36% of world's population lived in extreme poverty in 1990, By 2011, this number had dropped to only 15%.

Source: World Bank

Sears to Sell Stores, Hyundai/Kia Fined Over MPG Claims, Starbucks Delivery, etc.

Struggling retailer **Sears (SHLD)** announced it is considering forming a real estate investment trust (REIT) with 300 of its most valuable corporate-owned stores in an effort to raise money. Sears would then lease back the stores and continue to operate. It owns 712 of its 1,870 full line stores in the U.S., which operate under the Sears and Kmart names. The company lost $630 million in its most recent quarter and has lost over $6 billion since early 2011. Sears shares rose over 30% on the news, as investors have long believed that the company's best asset was its vast real estate holdings, not its retail business.

South Korean automakers **Hyundai Motor Co.** and **Kia Motors Corp.** agreed to pay a combined $300 million penalty for overstating fuel economy claims on vehicles it sold. The companies are both affiliates of Hyundai Motor Group and will pay $100 million in civil fines while forfeiting $200 million in regulatory credits to settle the charges. The company previously settled a $400 million class action suit in 2013, paying buyers of affected vehicles roughly $353 each. Hyundai-Kia overstated the fuel economy of about 1.2 million vehicles produced from 2011 - 2013 and overstated mpg ratings by 1 to 6 mpg. The company's claims of its vehicles achieving 40 mpg on the highway were a cornerstone of its marketing efforts during those years.

Citigroup (C) and **JPMorgan Chase (JPM)** were among six large banks that agreed to settle charges that they colluded with counterparts at other firms to rig benchmarks used by fund managers to determine what they pay for foreign currency. Fines have so far totaled $4.3 billion, with over $1 billion each to be paid by Citi and JP Morgan to regulators in the U.S., UK and Switzerland. HSBC, RBS, UBS and Bank of America are among the other banks involved. These fines come just over two years after a dozen firms were fined roughly $6.5 billion in relation to allegations of manipulating the London Interbank Offered Rate, better known as LIBOR. LIBOR is a key benchmark interest rate used to set rates for home loans, short-term bonds, and other financial products.

Redbox recently raised prices on its DVD rental service. The company raised prices by $0.30 to $1.50 per night for DVDs and by $0.50 to $2.00 per night for Blu-Ray discs. The company is a unit of Outerwall Inc., whose shares climbed 12% on the news. Redbox offers mostly recently-released movies in its ubiquitous red kiosks located inside and outside many grocery stores and pharmacies. The company recently renewed deals with Paramount, Universal Pictures, Sony Pictures and Lions Gate Entertainment. It posted $1.4 billion in revenue and $153 million in operating income during the first nine months of 2014, 5% and 9% lower than in 2013.

Starbucks (SBUX) announced it will begin offering food and beverage delivery in the second half of 2015. The service will be piloted in certain markets first, with plans to roll out nationwide to follow. The company recorded $4.18 billion in revenue in its most recent quarter, up 10% from the same quarter last year.

Airbag manufacturer **Takata** is under fire after reports that five people have died and over 100 people have been injured after their airbags deployed during accidents. The defect is in the inflator and propellant devices within the airbags which causes metal fragments to shoot into vehicle occupants. Roughly 7.8 million vehicles made by 10 manufacturers are potentially affected in the United States. Recalls started in July and were centered on cars in high humidity areas like Florida and Hawaii. The airbags were installed in over 5 million **Honda/Acura** vehicles as well as several hundred thousand vehicles each made by **Toyota**, **Nissan/Infiniti**, **Dodge**, **Chrysler** and **BMW**, among others. Executives from Takata along with NHTSA officials and automaker executives appeared before Congress on Dec. 3 to discuss the situation. ConsumerReports.org is a good resource to check if your car is potentially affected and to learn more.

Market and Economic News

-Economic growth (measured by gross domestic product (GDP)) for the 3rd quarter of 2014 was revised upward to +3.9% from the initial reading of +3.5. This is the highest GDP growth reading since 1999.

-This month's Bureau of Labor Statistics employment report showed blowout numbers for the month of November. 321,000 jobs were added in the month, a huge reading, while the unemployment rate remained at 5.8%.

-Global stock markets rebounded in late October amidst talk from the European Central Bank and Japanese central bankers about fresh economic stimulus measures and better than expected earnings from U.S. companies.

At a Glance…
(as of December 9) **DJIA** – 17,801 **S&P 500** – 2,059 **NASDAQ** – 4,766 **10-yr T-note** – 2.22%

Readers' Q&A

Questions? E-mail Brad@R1FinancialGroup.com

Q. "Is there any reason not to contribute to a 529 college savings plan that my son set up for his daughter? Could I assist them in a better way?"

-Jim – Garland, TX

A. Kudos to you for helping your son and grand daughter. I don't share personal stories in this newsletter often, but I think one here will give you another option to consider. When I was in 3rd grade, my parents set up a small brokerage account for me and began contributing $50 – 100 per month to it. I didn't know about this until the day I graduated from college, when my parents handed me an account statement with my name on it, a few mutual fund holdings, and an account value of $14,000 or so. I knew very little about stocks, investing, mutual funds or any related topics at the time, but acquiring this account forced me to learn. My parents told me to resume the monthly contributions, and I did so after getting my first job. Looking back, not only did the money provide me a nice cushion as I transitioned to adulthood, it taught me to save and invest.

Setting up a small investment account to give to your grand daughter when she finishes college might provide similarly valuable lessons to her. Also – consider the following situation. Let's say she takes out student loans to pay for school. My opinion is that on graduation day, she'd rather be in a position where has, say, $10,000 in investments (from your gift) and $30,000 of student loans (that can be paid off over 10-15 years) as opposed to no cash and $20,000 of student loans in the case you put that $10,000 towards her tuition. I know I would.

Your contributions to your grand daughter's 529 plan would also be much appreciated I'm sure, but I think the other option I described provides greater financial flexibility along with the accompanying life lessons. She is free to use your gift to pay down her loans on graduation day (I'm fairly certain that won't happen), continue to save/invest, use the funds as a down payment on a house or for a wedding, etc…all good uses. There is also a chance that she squanders the money, and if you feel there's a good chance of that later on, you could simply give the money to your son to pay tuition and not ever make the gift to your grand daughter. Or you could also do some combination of the above.

Whatever you choose to do, be sure to check with a financial and tax advisor to be sure there won't be gift tax implications or any problems with how you choose to title accounts, etc. Good luck!


YOUR HEALTH

Are Farmed Salmon and Tilapia Good for You?

Salmon and tilapia are the two most widely consumed fresh fish in the U.S. 70% of salmon and virtually all tilapia consumed domestically are farmed as opposed to wild caught, and the vast majority of this farmed salmon and tilapia (over 95%) come from overseas. Farmed salmon comes from Canada, Scotland, Norway and Chile, and farmed tilapia comes mostly from China, with Ecuador, Canada and the U.S. rounding out the top four suppliers. Are these farmed fish inferior to their wild caught counterparts in any way?

As for tilapia, as mentioned previously, tilapia is almost exclusively farmed so there is no wild counterpart. Farmed salmon has about 35% more fat and therefore contains more omega-3 fatty acids, which are heart-healthy fats, but they also contain higher concentrations of environmental contaminants, which are predominantly stores in fat cells. (Wild caught salmon contains much higher amounts of mercury, however.) Wild caught salmon contains 50% more potassium and 3 times as much iron as farmed salmon, but farmed salmon contains more B vitamins. From a health perspective, farmed seafood does not seem to be inherently inferior to wild caught seafood in most cases, particularly in the case of salmon.

Fish farming can create significant negative effects on the environment. It can leach pesticides, viruses and antibiotics into surrounding waters. Fish that escape from farming nets mate with local / native fish, damage local gene pools and create infertile spawn. Fish farming also spreads sea lice to surrounding native fish populations. In the case of farmed salmon, it is estimated that up to 80% of local salmon die from sea lice believed to have originated from fish farms.

The website SeafoodWatch.org recommends tilapia raised in Ecuador, the U.S. or Canada, and salmon farmed in Chile as the most environmentally friendly. *Source(s): SeafoodWatch.org, Yahoo Health, FishWatch.gov

Money Minute
Trivia Question

The European Space Agency recently landed a probe named Rosetta on a celestial body after traveling over 9 billion miles and 10 years. On what type of body did the probe land?

A) Moon *B) Comet* *C) Planet* *D) Meteor*

Last Month's Question – Thomas Eric Duncan, the man who exposed several people in the United States to the Ebola virus, acquired the disease while working and caring for individuals in what African country? *A) Nigeria* *B) Chad* ******C) Liberia*** *D) Angola*

Accumulating Through Investing: 3 Follow Up Misconceptions

(Continued from page 1)

The chart on page one shows that after 15 years, just under $176,000 would be accumulated, well short of the $367,000 one might have reasonably assumed. Why is this so? Simple: compound growth is calculated using an exponential function, not a linear function (think back to high school Algebra if you dare), and the large yearly dollar gains take a while to "build up steam." Looking at the chart, you can see that particularly large yearly increases in value seem to begin after year 15 or so.

What does this mean for parents and grandparents setting aside money each month for college savings? First, temper your expectations as far as potential investment growth from your periodic contributions. Also, parents must recognize that going all in to save for college, exhausting all of those funds on tuition, then starting to save for retirement at 45-50+ years old and after your kids are out of college is not a good plan. Doing so will guarantee your savings never reach the later stages of the graph on page 1...where the majority of the investment growth occurs.

2) Playing Catch Up: Possible, but Expensive

By looking at the chart on page 1 and reading the previous hypothetical, it would be reasonable to conclude that playing catch up with respect to retirement savings is a lost cause. For example, a person starting to save for retirement at age 45 may think he has no chance of accumulating a significant nest egg since, by age 65 , he has only 20 years to save and will never get to the later part of the graph on page 1. The numbers, however, show that starting late makes the task of accumulating a nest egg more expensive, but not impossible.

Using the previous hypothetical, roughly $734,000 was accumulated after 30 years of saving $500 per month, assuming an 8% annual return. Of that amount, $180,000 represents principal and a whopping $554,000 represents investment growth.

> <u>How could our fictitious 45-year old man accumulate the same $734,000 by retirement age?</u>
>
> Earning the same 8% average annual return, he could:
>
> a) Invest $1,238 per month for 20 years (starting at $0)
>
> b) Invest a lump sum of $94,000, then contribute an additional $500 per month for 20 years
>
> c) Invest a lump sum of $49,500, then contribute an additional $850 per month for 20 years
>
> d) Invest $775 per month for 25 years (starting at $0) and retire at age 70 instead of age 65.
>
> e) Finally, invest $1,098 per month for 20 years earning 9% average annual returns instead of 8% (starting at $0)

All of these hypothetical scenarios would generate a $734,000 nest egg. To compare the "cost" of each, one can look at how much principal was contributed in each scenario. Those figures are:

a) $297,000
b) $94,000 + $120,000 = $214,000
c) $49,500 + $204,000 = $253,500
d) $232,500
e) $263,520

All of these scenarios take significantly more cash on the part of our fictitious 45-year old man compared to the $180,000 in total contributions necessary if the saving/investing process had been started 10 years earlier and had been done over 30 years. Not only that, option a), for example, requires a much larger cash commitment ($1,238 per month vs. $500 per month) each month and in total. Options b) and c) take big chunks of cash to help them catch up, and option d) - waiting to retire and investing for 5 more years - is likely the easiest to do for most people but probably not very desirable. Interestingly, option e) - obtaining a full 1% greater annual return - only slightly lessens the burden as compared to option a).

The bottom line is that it will take some combination of more cash each month (or quarter, year, etc.), a significant lump sum of cash, more time and/or better returns in order to make up for a later start toward retirement savings. Regardless of age, it makes sense for everyone to take stock periodically of where they are, where they'd like to be in terms of retirement savings (and when), and calculate exactly what they may need to save in order to get there.

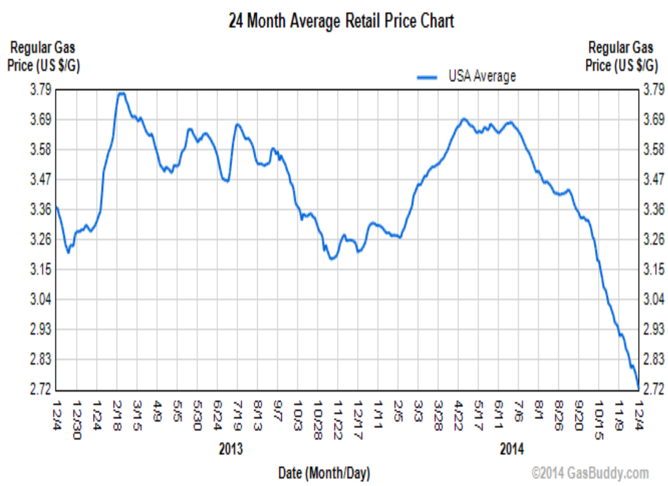
3) Small amounts - Why Bother?

Whether it is the start of an investment plan or an additional amount added to ones existing investment plans, it is reasonable to assume that smaller dollar amounts (for example, $100 per month) are insignificant when it comes to investing. I disagree. Saving $100 per month for 20 years and earning an 8% average annual return would accumulate just under $60,000. Whether this is the first $60,000 of ones retirement savings or simply another $60,000 added to the pot, I don't know many people who consider $60,000 a trivial amount of money. Small increases in periodic savings plans will become significant over time.

Price of Oil Continues to Plummet, Airline Stocks Soar

As of early November (when I wrote last month's 'Up Close' article), the price of oil hovered around $80 per barrel after a 30% decline from its recent peak in June. Since then, price declines have gathered steam and taken the price of a barrel of oil to under $70. Gasoline, which is derived from crude oil, has seen a freefall in price since peaking this summer, and the fall has accelerated dramatically over the past couple of months. The national average for a gallon of regular is $2.73 as of December 4th, a level not seen since 2010.

Price of Gasoline
(Dec. 2012 - Dec. 2014)



Airline Stock Index (^XAL)
(Dec. 2013 - Dec. 2014)

Source(s): Gasbuddy.com, NASDAQ

Low gas prices are a positive for consumer spending this holiday season, as individuals and families will likely feel like they (and actually will) have more money in their pockets as they do their holiday shopping. Retailers are expected to reap the benefits of these more free-spending consumers. A less obvious beneficiary of the drop in oil / gasoline prices is the airline industry. Fuel costs are a very substantial part of airlines' operating expenses (34% according to a recent Boston Globe story), and U.S. carriers will burn roughly 16 billion gallons of fuel in 2014. When fuel costs decreased throughout the back half of the year, the savings went straight to the bottom line as opposed to resulting in lower fares for customers. The chart above shows the XAL airline stock index and shows that airline stocks as a group have been among the very best performers in 2014, in part due to falling fuel prices. Energy company stocks, as one might assume, have been among the worst performers over the second half of the year. Many smaller oil and gas drillers operating in the U.S., particularly those who acquired significant debt to fund their operations, have been hard hit by these price decreases.

How far will the price of oil and gasoline fall? That is anyones guess, but what seems clear now is that the Organization of the Petroleum Exporting Countries (OPEC) will not cut production in an attempt to stabilize prices. What is clear is that the drop in gasoline prices will likely result in stronger economic growth numbers as measured by gross domestic product (GDP) since roughly 70% of domestic GDP measurements rely on consumer spending. This drop in gasoline prices may just be the catalyst that kicks the current economic recovery into a higher gear.

Editorial: *Grading the Affordable Care Act (a.k.a. Obamacare)*

The mandate that individuals obtain health insurance kicked in under the Affordable Care Act, a.k.a. Obamacare, in 2014, and individuals will start to face fines - collected from tax return refunds - in 2015. The Congressional Budget Office estimates that of the 30 million plus Americans without health insurance, roughly 90% will not pay the penalty, mostly because they qualify for one of the law's numerous exemptions. How has Obamacare done so far in getting the uninsured covered and in other ways?

As for getting more people insured, the law is working. The percentage of uninsured adults (18 and over) has dropped from 16.5-18% since 2010 to 13.4% as of the end of the first quarter of 2014, according to Gallup. The

Editorial: *Grading the Affordable Care Act (a.k.a. Obamacare)*

number of people without insurance fell by 10-12 million according to various polls by Gallup, the Urban Institute and the Commonwealth Fund - which includes young adults under 26 who were allowed to stay on their parents' insurance plans. Also, individuals with pre-existing conditions can no longer be denied coverage or forced to pay more.

What about people who were forced to change their individual health insurance plans due to the law's requirement that all plans provide comprehensive benefits? According to a Kaiser Family Foundation survey, 46% of people who switched from non-compliant to compliant plans (non-group) said they are now paying less, 39% said they are paying more, and 15% said they are paying about the same as before. That is a fairly even split, and even better considering that many non-compliant plans had annual and lifetime caps and offered fewer coverage features than compliant plans. (President Obama consistently told Americans, "If you like your existing plan, you can keep it," though that was not the case.)

The online exchanges (a.k.a. marketplaces) are seeing more companies join in to offer plans this year, and pricing compared to last year for the second lowest cost silver plans in each state have actually fallen by 0.8% for 2014 compared to 2013. There is great variation between carriers, and customers may have to change plans from year to year to realize savings or avoid paying more, but such features are part of a healthy, competitive marketplace. Overall increases in the cost of health insurance for group plans have slowed, and yearly premiums for group plans are up 3% on average from 2013 to 2014 (Kaiser FF).

The law's architects can claim some measure of success to be sure, but were there losers as a result of Obamacare? Certainly.

-Anyone who wanted to retain a cheap, high-deductible plan to cover only catastrophic scenarios was forced to buy a plan they didn't want. The costs of plans for younger people are likely inflated the most to help offset the cost of covering those with pre-existing conditions, older individuals, etc. More broadly, anyone paying more now due to the ACA is undoubtedly (and understandably) upset.

-Businesses that will eventually be forced to offer workers coverage or face stiff penalties are definitely a big loser here, though the mandate's implementation has been delayed multiple times now. Related to this, individuals whose hours have been cut to fewer than 30 per week (to make them ineligible for health care coverage) are definite losers as a result of the law. This is currently one of the most hotly-contested provisions of the law. It is hard to estimate how many people have been and will be negatively affected by this provision, and an increase in the minimum number of hours to be considered full time is very likely if a Republican wins the White House in 2016.

In terms of getting more people insurance coverage, all statistics suggest that the law is working. After weighing the individual winners and losers created by the ACA, to judge whether or not the law was an overall net positive for Americans as a whole will be difficult to answer and will take many more years to fully assess. A full repeal of the ACA is extremely unlikely at this point, so we will likely see a majority of the law's provisions play out over the next 5-10+ years. What the law has not done is address the relatively high cost of healthcare, address the fact that we are programmed to treat the cost of healthcare as a free lunch, and the largely absent element of consumerism in our current system. Health insurers and healthcare providers are the only two parties negotiating the cost of care and have little motivation to control costs since the ultimate cost is passed on to those paying the premiums - businesses and individuals. In fact, both of those parties has every motivation to inflate the cost of care and insurance premiums, as each increases their respective profits. Until this fundamental dynamic changes, until individual consumers more directly bear the cost of their healthcare (at which point, they would actually shop around, compare prices, and act like consumers), expect no significant change in the cost of healthcare. If anything, the ACA has even more firmly solidified the existing healthcare delivery structure in the U.S.

Please send comments via e-mail to: Brad@R1FinancialGroup.com

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