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Money Minute

"Smart Ideas for Secure Finances"

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When is the Right Time for Bonds or Bond Funds in Your Portfolio?

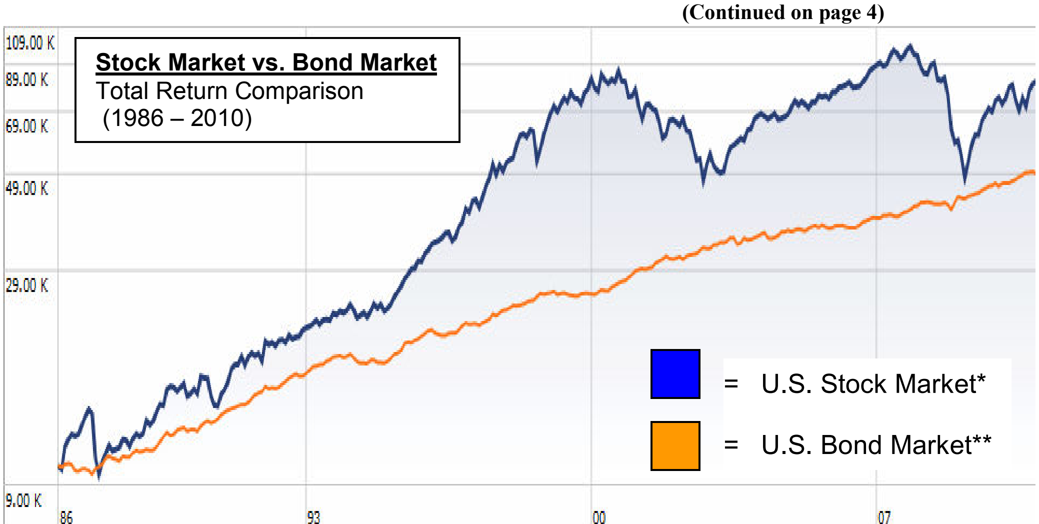
This month will be the first of a multi-part feature story on all things related to bonds. The first question many people consider when it comes to bonds or bond funds is when to think about including them in their 401(k), IRA or other investment accounts. Bonds are usually considered a "safe" alternative to stocks and good for retirees, and while there is some truth to this statement, there is much more to consider.

The first thing to consider when pondering this question is the general character of stocks compared to bonds. The chart below shows a hypothetical investment of $10,000 into a U.S. stock index fund compared to a $10,000 investment into a U.S. bond index fund from 1986 through 2010. The chart shows that the stock fund investment (blue line) displays several big ups and downs along the almost 25-year period. 10% - 20% declines along the way were common occurrences, and this period included two huge temporary declines of roughly 50%.

The orange line (representing the investment in the bond fund) shows a far steadier journey higher, with 2-4% dips being common and 6-7% dips happening a handful of times in this 25-year period. The final tally shows that the hypothetical stock fund investment finished with a roughly $30,000 greater value than the bond fund during this period.

The contrast in the lines below is what leads people to believe that bonds are "safe" compared to stocks. There were no 20% declines present and certainly no instances of 40-50% declines with the bond fund investment as there were with the stock fund investment. A better term to describe bonds relative to stocks is "less volatile." Put simply, the range of yearly outcomes with investments in bonds has historically varied far less than the range of outcomes for bonds. In this sense, bonds may be considered to provide a somewhat more predictable return in any given year compared to stocks. They may also be considered "less risky" in the sense that they historically have not delivered large negative returns

(Continued on page 4)



*S&P 500 Index Fund VFINX, **Barclay's Capital Aggregate Total Bond Index Fund VBMFX.
Dates shown are Jan. 1, 1986 through Nov. 15, 2010. Source: Morningstar

QUOTE OF THE MONTH

The secret to staying young is to live honestly, eat slowly, and lie about your age.

~Lucille Ball
Actress / Comedian
(1911 - 1989)

DID YOU KNOW?

The percentage of college students who use marijuana on a daily or near-daily basis (5.9%) is now greater than those who use cigarettes (5.2%) or alcohol (4.3%). Just 3.5% reported using marijuana on a daily or near-daily basis in 2007.

Source: University of Michigan

Potpourri ---Stock, Company & Market News and Notes---

Beer and Drug Store Mergers, Coke's Big Tax Bill, Tesla's New Car, etc.

Anheuser-Busch InBev, brewer of Budweiser and global market share leader, made a $104 billion takeover proposal to buy rival **SABMiller**, brewer of Miller and other beers and the world's 2nd largest brewer by sales. U.S. tobacco company Altria, maker of Marlboro cigarettes, owns more than 25% of SAB Miller. The tie-up will likely require divestments of several brands owned by the two companies. Regulators in the U.S. and abroad want to maintain a competitive marketplace, and AB InBev has a 45% market share in the U.S. Budweiser, Stella Artois and Corona are owned by AB InBev. The combined company would have an estimated 30% market share and a whopping $64 billion in annual sales after the merger. The next largest brewer is Heineken, which currently has a 10% global market share.

Coca-Cola was informed by the IRS that it may owe an additional $3.3 billion in federal income taxes over what is known as transfer pricing. The disputed amount relates to how Coke reports income from foreign licensing of manufacturing, distribution, marketing, sales and promotion of products in foreign markets. Essentially, the IRS is accusing Coke of transferring profits to affiliates in countries with lower tax rates. The IRS has filed numerous cases of this sort against global pharmaceutical and technology companies, with taxes owed believed to total in the tens of billions of dollars.

McDonald's reported its first quarter of same store sales growth in the U.S. after seven straight quarters of declines. It also reported a 4% jump in global same store sales after reporting declines in six of the previous seven quarters. The company fired its CEO earlier this year. The company's breakfast-all-day initiative, which started in mid-October, did not factor into these results, but the company reported that it has been a success.

All-electric car company **Tesla** is finally ready to start delivering its Model X sport-utility vehicle. The company began taking deposits for the vehicle in 2012 with the promise that deliveries would begin in late 2013. Two years of delays later, the company says it has worked out all issues and will begin delivering soon. 30,000 buyers put down deposits of up to $40,000 to reserve their Model X, and prices start at $75,000 and top out at $132,000. The company's first car, the Model S, sold 21,537 units in the first six months of 2015. The company aims to sell 500,000 vehicles annually by 2020. Tesla will begin selling a lower-priced mid-size sedan called the Model 3 and aims to start deliveries in 2017. The Model 3 will start at $35,000 and reach as high as $50,000 with options, and the car will be unveiled in March 2016. The success of the Model 3 is key to the company reaching its 500,000 vehicle sales goal.

FanDuel and **Draft Kings**, the two largest companies in the daily fantasy sports industry, announced they would ban employees from playing in their contests after it was revealed a FanDuels employee won $350,000 playing in a contest on the site. Employees with inside knowledge of other players' selections could use this information to their advantage.

Walgreen's announced it would buy smaller rival **Rite-Aid** for $17.2 billion, combining the second and third largest drug store operators. Walgreen's is paying $9 per share for Rite-Aid, which was a 48% premium to Rite-Aid's stock price per share the day before the deal was announced. The deal would leave just two national brands in the pharmacy/drug store space. CVS has 58.1% market share based on revenue and would remain number one. Walgreen's has 31% market share, and Rite-Aid has 10% market share. The combined company will have almost 18,000 stores.

ATM fees hit another record high this year. The average cost to use an out-of-network ATM jumped to $4.52 this year, up from roughly $3.00 in 2007. The increase in fees is due almost entirely to the fee charged by the ATM owner. The total fee a user pays is the sum of what the user's bank charges and the fee the ATM owner charges. The average fee user's banks charged in 2007 was roughly $1.35 and is just over $1.60 today. ATM usage has declined significantly in recent years, though banks don't expect ATMs to go the way of the pay phone anytime soon.


YOUR HEALTH


Pill May Offer Cancer-Fighting Benefits of Vegetables

A new dietary supplement may offer the same benefits as eating cruciferous vegetables like broccoli, Brussels sprouts and cauliflower. Supplements of diindolylmethane (DIM), a substance produced by the body when consuming these vegetables, have shown signs of offering the same benefits as eating the vegetables. Lab studies involving DIM have shown that it slows the growth of prostate and breast cancer cells in a Petri dish. It has also been shown to slow the growth of prostate tumors in mice. DIM acts to decrease the production of a certain type of estrogen that stimulates cell division, and it also seems to activate genes that protect against cancer and suppress genes that help cancerous tumors grow.

Human studies involving DIM have produced somewhat encouraging results. Small studies showed that some prostate cancer patients who took a course of DIM showed a slowing of the progression of their cancer. DIM also activated a tumor-suppressing gene in some women at high risk for developing breast or ovarian cancer, but both of these studies were not done on a scale large enough to be considered conclusive. Currently, DIM is being used in high doses to treat plantar warts which grow in clusters on the feet. These warts cannot be cut or frozen off due to their size, and a four-month course of DIM generally clears up the warts in adults.

Another plant-derived substance with health benefits is lutein, an anti-oxidant found in spinach and kale. It has been shown to play a role in maintaining good vision and recommended as a daily supplement by the National Eye Institute. Supplements containing lutein and DIM are both sold commercially and may indeed provide health benefits to those who consume them regularly. Though easy to consume in pill form, the challenge for health professionals with these supplements will likely be the same as with the foods from which they are derived: getting people to consume them on a regular basis.

*Source(s): WebMD.com, Wall Street Journal

Readers' Q&A

Questions? E-mail to Brad@R1FinancialGroup.com

Q. "Is there any reason I shouldn't roll over my old 401(k) into an IRA when I leave my current job at the end of the year?"

-Robyn – Farmers Branch, TX

A. There are a few specific reasons why a person would choose not to roll over an old 401(k). First, if you will be between the ages of 55 and 59 1/2 when you leave your job, you will be able to access your account balance without the normal 10% early withdrawal penalty that applies to IRAs. (With IRAs, that penalty applies to withdrawals below age 59 1/2, with some exceptions.) If you are moving to a new job that has a 401(k) plan, and you want to retain the ability to take a loan from your account, you may be able to roll your account into your new 401(k) plan. You are allowed to take a loan of up to 50% of your account balance up to $50,000. Of course, it's probably best to avoid taking such loans since they hamper account growth, but it the event of an emergency a loan may be a good option.

Absent these situations, most people are better off rolling over their account to an IRA. The most compelling reason to do so is that you'll be able to invest in a far greater variety of mutual funds, plus individual stocks, bonds and exchange-traded funds (ETFs) in an IRA, whereas most 401(k)s have 10-15 investment choices. Contact my office and we can guide you through the rollover process, assist you with all of the necessary paperwork, and make recommendations to get your account re-invested after the rollover is complete.

Q. "I'm in my 30s, my wife and I both work and we have one young child. I know we need life insurance. What is the right amount to have? ($500K, $1 million, more?)"

-Tom – Dallas, TX

A. First, I'd consider what items you'd like the insurance to cover immediately should you or your wife pass away unexpectedly. For example, consider enough to liquidate any debt you have like credit cards, student loans and your mortgage. Then consider what dollar amounts it would take to pay for child care and perhaps to set up an education fund for your child. Next, you may want to think about additional funds to make up for lost income to help pay for regular spending needs. Many life insurance companies suggest a figure of 70% of combined current income is sufficient for a surviving spouse if the above needs are taken care of.

A simpler method to figure out how much coverage to obtain is to look at getting 7 - 12 times your current income. This rule of thumb doesn't account for any differences in an individual's situation, but it can serve as a basis of comparison.

Overall, getting and keeping a sizeable amount of coverage is the most important thing. A level term life policy that lasts 20 or 25 years should fit your needs nicely and should be relatively inexpensive assuming you and your wife are in good health. Feel free to contact my office if you'd like help coming up with coverage amounts or for a price quote.

Financial Planning Corner

*Personal Finance *__*Insurance Planning*__ *Investments *Retirement Savings *Education Savings *Retirement Income Planning

Highlighted Topic: **Term Life Insurance**

What You Should Know:

- Term life insurance, as the name implies, provides a death benefit for a defined period of time (*e.g.* 10 years, 20 years, etc.) In almost all cases, premiums for term coverage are guaranteed not to increase during the term.
- Term life coverage is good for people with larger but temporary insurance needs, like parents with dependent children. Coverage amounts of $1-3 million dollars are not uncommon for working parents. (See Q&A question above right.) Once kids are grown up, there is a significantly lower need for parents to have life insurance.
- With term life insurance, you can get a lot of coverage for a relatively small cost. For example, a 40-year old male can obtain a $500K 20-year term policy for $25 - $40 per month. Like with all life insurance, premiums are based on age, gender, height/weight, current health and health history.
- Other types of life insurance (whole life, universal life, etc.) are considered permanent life insurance and are designed to be kept for life. They are more costly because they are guaranteed to pay a death benefit when the insured dies.

Brad's Opinion: Term life insurance is generally the best option for young families who need larger amounts of insurance but for a limited time period. Older individuals and individuals who want to have life insurance for their entire lives should consider the various types of permanent life insurance.

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(Continued from page 1)

to investors in any given year. To be sure, there have been many instances of bond investors experiencing negative returns in a given calendar year.

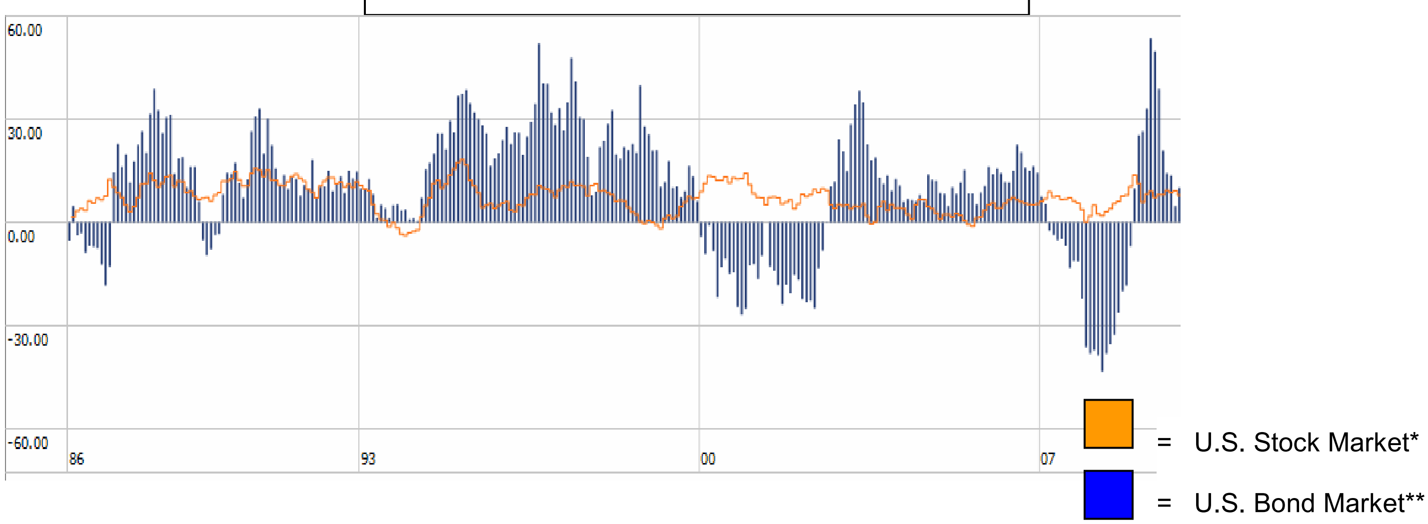
The chart below reinforces this idea and compares rolling 12-month returns for the same two funds referred to on page 1. The blue bars above the line indicate positive returns, and the blue bars below the line indicate negative returns for the stock fund in that particular 12-month period. The orange line represents the bond fund, and we can clearly see its track, while varying up and down from year to year, is almost always above the mid-point line. This indicates that the bond fund almost always delivered positive returns in 12-month periods.

The charts presented here suggest a well-accepted strategy: investors thinking about how to allocate funds in their 401(k)s and IRAs should think about bonds as they approach the time they will begin to make withdrawals from their account. Depending on personal preferences, investors within 5 to 12 years from retirement may want to consider adding bonds to their portfolio's mix. Of course, these guidelines are very loose. There are valid reasons why an investor may want to start including a portion of bonds in retirement. Very conservative and risk-averse investors may fall into this category. There are also valid reasons why an investor may not need to consider bonds until after retirement (or at all). An investor who will have a large pension or who anticipates the sale of a home at retirement, for example, may feel comfortable with little to no allocation to bonds.

An important item to note is that bonds are fixed income investments that pay regular income. **Many bond funds pay a monthly dividend**, which is typically the primary source of the funds' total return. Stock funds often pay dividends as well, but the primary motivation with stocks is to "buy low" and "sell high," making a profit in the process. The primary goal with stocks is capital appreciation, or an increase in value, not income. This distinction further makes a case for bonds being well-suited for retirees who wish to generate cash flow from their investment accounts.

Next month, I'll dive deeper into how bonds create income and highlight several types of bond funds investors of various ages should be familiar with.

Volatility Comparison - <u>Rolling 12-month Returns</u>



<u>Market and Economic News</u>

-Economic growth (measured by gross domestic product - GDP) for the 3rd quarter of 2015 was reported to be rather sluggish +1.5%. This follows a +3.9% final reading for the 2nd quarter of 2015.

-September's Bureau of Labor Statistics employment report showed a gain of just 142,000 jobs. The labor participation rate, which measures the percentage of individuals 16 years old or older who are in the workforce or actively looking for work, fell to a 40-year low of 62.4%. The unemployment rate remained at 5.1%.

-The major U.S. stock market indices all gained ground during the month of October and made up a good portion of their losses suffered in late August and September.

At a Glance…
(as of October 29) **DJIA** – 17,755 **S&P 500** – 2,089 **NASDAQ** – 5,074 **10-yr T-note** – 2.17%

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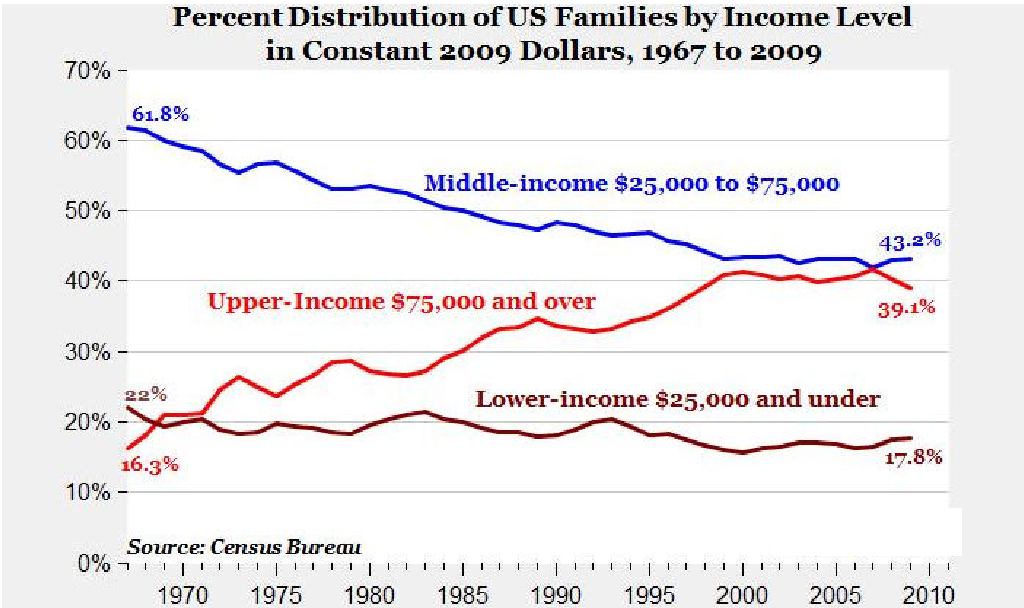
In-Depth Information for Smart Investors

A Different Perspective on the Shrinking Middle Class

Much has been said and written over the past several years about income inequality and the disappearance of the middle class, but Census Bureau data found in the graph below may suggest a somewhat different take on this issue. The chart below shows the percentage of U.S. families that fall into three income groups - under $25,000, $25,000 - $75,000, and above $75,000 annual income - from 1967 through 2009. Figures are shown in constant 2009 dollars to account for inflation.



Source(s):
Census Bureau

In discussions about the shrinking middle class, I had always assumed that the percentage of households earning lower incomes and those earning higher incomes had climbed over the years, leaving families earning a middle income nowhere to be found. The figures above reveal something different. It shows that the percentage of families earning a "middle income" has indeed fallen - from 61.8% to 43.2%, and that the percentage of families earning above $75,000 has climbed from just 16.3% to 39.1%. But it shows a small decrease in the percentage of families earning the lowest incomes - $25,000 and below. These figures suggest that the phenomenon of the disappearing middle class should be considered a positive development, not a negative. They show that many families have "moved up" into a higher income range, not down into a lower income category. In fact, a smaller percentage of households are earning the lowest annual incomes today than in 1967.

A study published earlier this year by sociologists Thomas Hirschl and Mark Rank tracked the fluidity of income using government data from 1968 through 2011. It showed that by age 60, 70% of the population experienced at least one year within the top 20th percentile of income, and 53% experienced at least one year within the top 10th percentile. 11% found themselves in the top 1% of earners for at least one year. The study showed that 54% of Americans will experience at least one year of poverty by age 60, and that 45% of Americans will utilize a need-based welfare program like food stamps or Medicaid.

The truth about income inequality, class and the shrinking middle class in this country is more nuanced and complex than many in the media and most politicians would have us believe.

Editorial: *What is the Right Response to Sky-High Prescription Drug Costs?*

The complaints related to high-priced prescription drugs are growing louder, and Democratic presidential candidates are promising to take action to curb prices if elected. For many individuals, a recent incident brought this issue to a head. Turing Pharmaceuticals recently bought the rights to drug Daraprim for $55 million, then increased the price of the drug from $13.50 to $750 per pill. No company made a generic version of the drug at the time of the price increase. The drug, developed 50 years ago and long out of patent, is used primarily to treat toxoplasmosis and malaria. The news sparked backlash against the company and its founder. (Within weeks another company (Imprimis Pharmaceuticals) announced it would begin making a similar version of the drug for $1 a pill.) Also, the FDA announced it has approved cancer drugs made by Bristol-Meyers Squibb which cost $250,000 per patient per year and treat advanced melanoma. Novartis has a

Editorial: *What is the Right Response to Sky-High Prescription Drug Costs?*

similar drug that cost $18,869 for a 30-day supply, or $226,000 per year. Many cancer drugs with $100,000+ annual price tags exist. Some of these drugs extend patients' lives by only a few months, making their high price tags unjustifiable according to critics.

Hillary Clinton recently released a broad proposal to deny federal dollars for companies that make excessive profits or spend heavily on direct-to-consumer marketing. Her proposal also limits out-of-pocket spending by families/individuals on prescription drugs, and she proposed increasing funding to the FDA to clear out the backlog of companies trying to come to market and make generic drugs. The proposal lowers the exclusivity period on new, expensive drugs to 7 years from 12 years. It prohibits "pay-for-delay" arrangements, where brand name drug companies pay generic drug makers not to produce copies of their drugs. Perhaps most notably, it would allow imports of prescription drugs from abroad, which typically sell for far less in other industrialized nations due to price controls in those countries. Finally, it would allow the federal government and Medicare to negotiate prices directly with drug companies, a practice that is currently banned by law. Several states have introduced legislation to make pharmaceutical companies justify the prices of the drugs they sell, though no major bills have passed at this point.

The most commonly-cited argument from pharmaceutical companies is that the high cost of development, which can run into the hundreds of millions, and the large amounts of money spent on drugs that never make it to market, are needed to compensate drug companies for the financial risk they take. Any attempt to control prices would stifle innovation and result in the development of fewer breakthrough treatments. They also argue that competition in the marketplace will ensure that the prices charged to consumers are fair. Last, drug companies argue that while prices may be high, the value that their products deliver justifies the price and that even an extra few months of life is worth a high price tag.

Who is right on this issue, and should any action be taken by lawmakers to curb high drug prices? For starters, we need to acknowledge that the prices of virtually all goods and services in a free market is based on supply and demand, and that in most cases a business will charge prices that they believe will yield the highest profit. Prices are generally set based on "what the market will bear." This is capitalism. It is not realistic to expect the management teams of publicly-traded drug companies to act in an altruistic way when their shareholders (owners) expect them to act in a way that maximizes profits and shareholder value. Clearly, these are competing interests. Government intervention to limit the profitability of businesses is, in theory, not part of a free market system. But, should medicine, where it is truly a matter of life and death be different? It is hard to say.

As with all of these articles, I have little desire to impress my own opinion upon you, the reader, but one thing that seems clear is that if doctors' pay when providing treatment to Medicare patients is negotiated by Medicare, it makes sense that the price of prescription drugs should also be negotiated directly with drug companies if this would yield lower prices for recipients. Currently, the private insurance companies that administer the prescription drug benefit (Part D) each negotiate their own prices with drug companies. Additionally, there seems to be no valid reason why Americans are forbidden (in most cases) from purchasing cheaper, identical drugs intended for other markets like Canada and Mexico. This law seems anti-competitive and serves only to generate extra profits for drug companies when selling their products in the U.S.

Comments? Send e-mail to Brad@R1FinancialGroup.com.

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