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Large Stock Dividend Yield Versus 10-Year Treasury Yield

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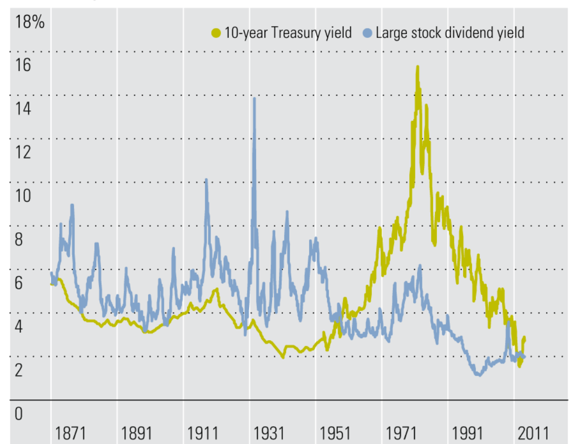
In the recent context of likely-to-rise-at-any-time interest rates, it may be interesting to take a look at the historical relationship between stock and bond yields. As illustrated in the image, stock dividend yields were much higher than 10-year government-bond yields before 1957, with dividend payouts a form of compensation for the additional risk of investing in stocks.

In the more modern period, this relationship has changed. As capital appreciation became a bigger driver of stock performance, bonds became the main engine for potentially steady income generation. After 10-year Treasury rates significantly declined following the 2008 financial crisis, stocks yielded more than 10-year Treasury bonds for the first time since 1957. Recent rising interest rates, however, have pushed government yields above stock dividends once again.

Stock and Bond Yields
January 1871–March 2014



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Stocks are not guaranteed and have been more volatile than the other asset classes. Dividends are not guaranteed and are paid solely at the discretion of the stock-issuing company. Government bonds and Treasury bills are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest. U.S. government bonds may be exempt from state taxes and income is taxed as ordinary income in the year received. With government bonds, the investor is a creditor of the government. In general, the price of a debt security tends to fall when interest rates rise and rise when interest rates fall. Securities with longer maturities and mortgage securities can be more sensitive to interest-rate changes.

Data: Large stock dividend yield is represented by monthly S&P Composite Index. 10-year Treasury yield is based on the monthly yield of 10-year government bonds. Both indexes are from Robert J. Shiller's Data Library

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Advisor Corner

Mr. Kennedy's investment philosophy is the same that he has practiced over the last decade: securities markets are efficient and advisors primarily add value by coordinating the asset allocation for clients based upon risk tolerance, objectives, and time horizons. The firm has constructed 5 models for clients that vary in risk to meet the goals of each client. The firm primarily uses passive mutual funds in each model and uses select actively managed funds for bond, commodity, and real estate exposure. ITI uses several research resources, including many that were used over the last 20 years, to assist with the recommended asset allocation and the appropriate funds to utilize in each model. Mr. Kennedy is an Investment Advisor Representative of ITI Financial Management, LLC.

Investment services are offered through ITI Financial Management, LLC, a registered investment adviser with the state of Missouri

Maxing Out a 401(k) … or Not?

ITI Financial Management/Troy E. Kennedy

▸ ITI Financial Management is a fee only, non commissioned registered investment advisory firm headquartered in Springfield, Missouri. We presently manage approximately $65 million for over 175 accounts. In November 2009, Springfield Trust & Investment Company sold to a large out of town bank holding company. After 17 years as a shareholder/executive vice president with Springfield Trust & Investment Company, Troy Kennedy founded ITI Financial Management to continue to provide the highest level of personalized investment management and financial planning services. There are no fees to hire ITI nor are there any fees to terminate the relationship. It is truly a partnership with each client.

Maxing out a 401(k) is an article of faith for many higher-income workers. Unlike IRAs, where income limits may curb contributions, employees can generally contribute the maximum allowable amount to their 401(k)s regardless of how much they earn. In 2014, people under age 50 are able to contribute $17,500, and those over age 50 can make a $23,000 contribution. That's a significant amount that is eligible for the tax-deferred compounding that 401(k)s afford.

However, an IRS regulation referred to as nondiscrimination testing may limit the 401(k) contributions of highly paid workers, especially for smaller companies with a lot of executives and a small number of lower-level employees. Nondiscrimination testing is an IRS rule intended to ensure that highly compensated employees, or HCEs, aren't benefiting disproportionately from the tax breaks that come along with investing in 401(k) plans, while non-HCEs are not taking advantage of them. For 2014, an HCE is defined as someone who had compensation of more than $115,000 during the year or who owns 5% or more of the company. The tests are performed by the plan sponsors by counting contributions by both HCEs and non-HCEs and performing a few mathematical calculations. If, based on these numbers, a company's 401(k) plan fails the nondiscrimination tests, employees who are classified as HCEs may not be able to make the maximum allowable contribution.

When a 401(k) plan fails the nondiscrimination tests, the company needs to take corrective action. In most cases, the company chooses to return a portion of HCEs' contributions. The refund amount would be taxable in the year in which it was received, along with any investment earnings on that excess contribution amount. Unfortunately, some plans fail nondiscrimination testing year after year, meaning that some employees can't take full advantage of all of their tax-sheltered options. For employees in this situation, there are a few options to explore, including the following.

Work to Enact Change: It is important to make the higher-ups in the company aware that employees are not happy when their retirement contributions are being curtailed. The possibility exists that the benefits administrator isn't properly categorizing HCEs and non-HCEs, which in turn can affect the plan's ability to pass the nondiscrimination tests. Employees can also lobby for improved non-HCE participation. The benefits administrator can be asked to consider an auto-enrollment feature and to step up educational efforts in order to encourage participation.

Maximize Other Options: For participants who have gotten a refund of a 401(k) contribution due to the failure of a nondiscrimination test, the next step may be to put that money to work elsewhere. Funding an IRA is a place to start. Married employees may also want to make sure their spouse is taking maximum advantage of his or her options by fully funding a 401(k) and/or IRA. In addition, a reasonable level of tax efficiency may be obtained (albeit without the benefit of tax-deductible contributions) by investing in a taxable account.

Ask for a Heads-Up: If a company's plan has a history of failing nondiscrimination testing, employees may want to ask the benefits administrator for midyear guidance on whether the plan is likely to pass or fail for that particular year. If it appears that the plan won't pass, it may be better to stop contributing preemptively rather than risk an excess contribution and refund. After all, participants might be paying an extra layer of fees to invest inside of the 401(k) and might not have tax-efficient investment choices within that 401(k).

401(k) and IRA plans are long-term retirement-savings vehicles. Withdrawal of pretax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty. Please consult with a financial or tax professional for advice specific to your situation.

Investing in Real Estate

ITI Financial Management/Troy E. Kennedy

- The firm's investment philosophy is the same that Mr. Kennedy practiced at Springfield Trust & Investment Company, that the securities markets are efficient and that advisors primarily add value by coordinating the asset allocation for clients based upon risk tolerance, objectives, and time horizons. The firm has constructed 5 models for clients that vary in risk to meet the goals of each client. The firm primarily uses passive mutual funds in each model and uses select actively managed funds for bond, commodity, and real estate exposure. ITI uses several research resources, including many that were used over the last 18 years, to assist with the recommended asset allocation and the appropriate funds to utilize in each model.

Investors can gain access to commercial property through real estate investment trusts, or REITs. These trusts have attained attractive returns over the past 30-plus years, providing investors with the income earning potential of bonds and the price appreciation of stocks. With REITs, you may get the best of both worlds.

There are three types of REITs: equity, mortgage, or a hybrid of the two. Equity REITs invest in, or own, commercial real estate and use property rents as revenue. Mortgage REITs invest in loans secured by real estate, earning income through mortgage interest and fees. This article will concentrate on equity REITs, which make up a great majority of listed REITs, according to the National Association of Real Estate Investment Trusts (NAREIT). In fact, if you are interested in learning more about REITs, NAREIT can provide a lot of useful information.

A company must satisfy certain criteria before it can be classified as a REIT. First of all, the company has to be in the real estate business, and at least 75% of its assets must be real property. At lest 75% of the company's revenue must come from real estate, and (this is rather important for investors) at least 90% of taxable income must be distributed annually to shareholders. For this reason, REITs can be considered good income-producing investments.

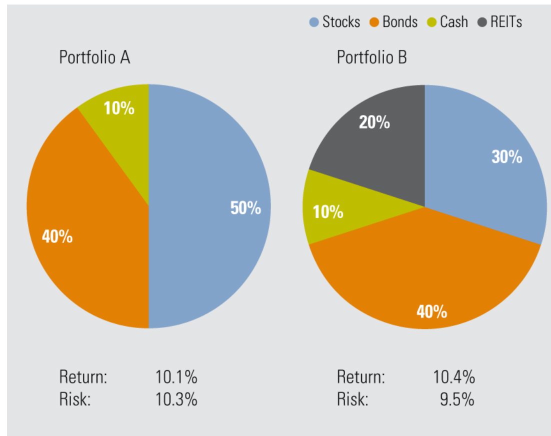
A portfolio of stocks, bonds and cash improves through the addition of REITs, due to the power of diversification. Because each type of asset does not react identically to the same economic or market events, combining them can often produce a higher return with less risk.

Take the example below. Portfolio A consists of stocks, bonds and cash. The portfolio's total return from 1972 to 2013 was 10.1% with a risk of 10.3%. Now look at Portfolio B, which had a 20% allocation to REITs over the same time period. Not only was its return higher at 10.4%, but its risk was also lower, 9.5%.

Nowadays, REIT investing does not have to be limited to the United States anymore. It's true that the U.S. still holds the largest percentage of the global real estate market capitalization, but more and more countries are introducing REITs, especially in Europe and Asia, creating more investment opportunities. Hong Kong, Japan, and Singapore are growing real estate markets in Asia, while the United Kingdom, France, and the Netherlands are developing in Europe.

Do keep in mind that diversification does not eliminate the risk of investment losses, and that REIT investments are not suitable for all investors.

Potential to Reduce Risk and Increase Return: Stock and Bond Investors 1972–2013



Government bonds and Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while returns and principal invested in stocks and REITs are not guaranteed. An investment cannot be made directly in an index. Past performance is no guarantee of future results. The average return and risk are represented by the arithmetic annual return and annual standard deviation, respectively. Standard deviation measures the fluctuation of returns around the arithmetic average return of the investment. The higher the standard deviation, the greater the variability (and thus risk) of the investment returns. Portfolios are rebalanced annually.

Source: Stocks are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds are represented by the 20-year U.S. government bond, Treasury bills by the 30-day U.S. Treasury bill, and REITs by the FTSE NAREIT All Equity REIT Index®.

Financial Aid for College: A Few Tips

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Key to understanding financial aid eligibility is learning how financial aid formulas work. They're rather complex and vary from school to school, but they basically use answers to questions about family income, assets, and size to help arrive at a special number known as the expected family contribution, or EFC. The EFC represents the amount of tuition, fees, and other college costs the family is expected to cover based on its financial situation and other factors. Not all assets are counted when calculating the EFC (for example, assets held in retirement accounts don't count).

However, income plays a far greater role than assets in determining EFC. As much as 47% of income may be used in calculating a family's EFC, whereas parental assets are assessed at a maximum of 5.64%, and student-owned assets at a maximum of 20%. Financial -aid awards are based on the previous calendar year's income, so some families use strategies to reduce income the year before applying. For example, if one parent is considering retiring or going back to school, doing so will likely reduce the family's income, thus increasing aid eligibility. A parent also may ask that a work bonus be postponed to reduce income that counts against aid.

One common mistake families make is selling securities the year before the student enrolls as a way to cover college costs. But any capital gains from the sale count as income in the following year's financial aid calculation, so it may be best to sell securities the year before the base year (in other words, two years before the student enrolls), when the proceeds won't be counted as income.

This should not be considered tax or financial planning advice. Please consult a tax and/or financial professional for advice specific to your individual circumstances.