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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

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The first 2 months of 2012 have been very good to many investors. Enjoy this month's newsletter - please let me know if you have any questions!

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Is Increased Inflation on the Horizon?

Economists and market watchers have been warning investors about the prospect of increased inflation since the housing bubble burst in 2007.

Worries about inflation have been cropping up more frequently lately, largely due to escalating commodity prices, which are pushing up consumer prices, both in the United States and abroad. At the beginning of 2011, the inflation rate stood at a paltry 1.6%. By the end of the year, it had more than doubled to 3.4%.[1] And this could be just the start of a longer-term inflationary cycle. With an improving economy and soaring federal deficits, many experts feel that prices in the United States will inevitably pick up their pace even further.

Inflation Rates Around the World (as of December 31, 2011)[2]

Country	Rate
Brazil	6.5%
Canada	2.9%
China	4.1%
France	2.5%
Germany	2.1%
Greece	2.4%
India	9.3%
Italy	3.3%
Japan	-0.5%
Mexico	3.8%
Russia	7.0%
United Kingdom	4.8%
United States	3.4%
Venezuela	28.9%

Staying Ahead

For investors, staying ahead of inflation means choosing investments that are most likely to provide returns that outpace it. Here's a look at how a climbing inflation rate could impact various investment types and asset classes.

- **Domestic Stocks --** Although past performance is no guarantee of future returns, historically, stocks have provided the best potential for long-term returns that exceed inflation. An analysis of holding periods between 1926 and December 31, 2011, found that the annualized return for a portfolio composed exclusively of stocks in Standard & Poor's Composite Index of 500 Stocks was 9.83% -- well above the average inflation rate of 2.99% for the same period. However, over shorter time periods the results are not as appealing. For the 10 years ended December 31, 2011, the S&P 500 returned an average of only 2.92%, compared with an average inflation rate of 2.50%.[3]
- **International Stocks --** During the same 10-year span that ended December 31, 2011, the Morgan Stanley Capital International (MSCI) EAFE, which is composed of established economies such as Germany and Japan, outpaced U.S. inflation with an average return of 5.12%. The MSCI Emerging Markets index, which tracks developing world economies such as Brazil and China, was even more stellar, returning an average of 14.2%.[4]
- **Bonds --** Historically, investors have turned to shorter-term corporate and high-yield bonds for protection in rising-rate environments.[5] There are two types of bonds that receive a lot of investor interest when inflation starts to rise: Treasury Inflation-Protected Securities (TIPS) and I Savings Bonds. Both TIPS and I bonds are types of fixed-interest rate bonds whose value rises as inflation rates rise.
- **CDs and Other Cash Instruments --** The Federal Reserve is still keeping a tight lid on interest rates, forcing investors who hope to keep pace with inflation by investing in cash instruments facing a harsh reality. The rates on a one-year CD are averaging under 1%, while a five-year CD is yielding an average of under 2%, according to *Bankrate.com*. Money market and other bank savings accounts are also averaging well under 1%.[6]

Although many economists project overall U.S. inflation to remain modest in the near future, most see an uptick down the road. For investors, a well-rounded portfolio may be your best weapon. The key is to consider your time frame, your anticipated income needs, and how much volatility you are willing to accept, and then construct a portfolio with the mix investments with which you are comfortable. Consult your financial professional to discuss your specific needs and options.

[1] *Source: U.S. Bureau of Labor Statistics, January 2012.*

[2] *Sources: TradingEconomics.com; U.S. Bureau of Labor Statistics, January 2012.*

[3]Sources: Standard & Poor's; U.S. Bureau of Labor Statistics. The S&P 500 is an unmanaged index. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

[4]Source: Morgan Stanley. The MSCI EAFE and MSCI EM are unmanaged indexes. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

[5]Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.

[6]Source: *Bankrate.com*, January 20, 2012.

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In Volatile Markets, Investors May Find Comfort in Dividends

Dividend payouts are often seen as a sign of a company's financial health and management's confidence in future cash flow.

As uncertainty at home and abroad roils the financial markets, income-minded investors seeking protection from the bumpy road ahead may find dividend-paying stocks offer an attractive mix of features and warrant a place in their equity portfolios.

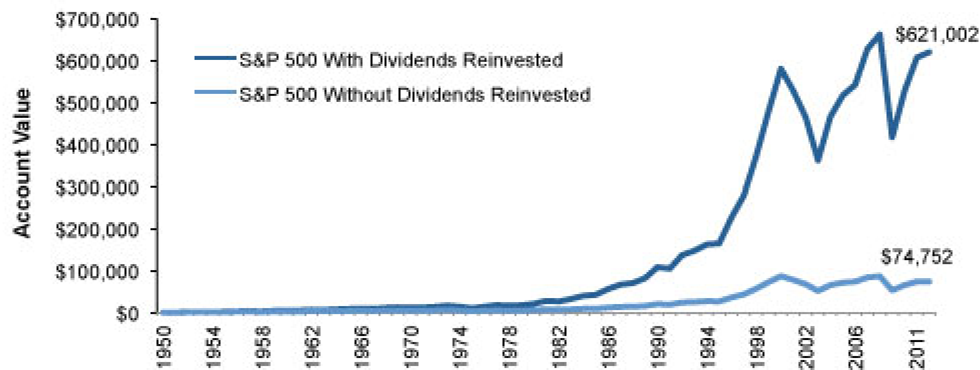
The appeal is simple: Dividend-paying stocks can provide investors with tangible returns on a regular basis regardless of market conditions.

The Benefits of Dividend-Paying Stocks

If you own stock in a company that has announced it will be issuing a dividend, or if you are proactively considering adding an allocation to dividend-paying stocks, history provides compelling evidence of the long-term benefits of dividends and their reinvestment.

- **A sign of corporate financial health.** Dividend payouts are often seen as a sign of a company's financial health and management's confidence in future cash flow. Dividends also communicate a positive message to investors who perceive a long-term dividend as a sign of corporate maturity and strength.
- **A key driver of total return.** There are several factors that may contribute to the superior total return of dividend-paying stocks over the long term. One of them is dividend reinvestment. The longer the period in which dividends are reinvested, the greater the spread between price return and dividend reinvested total return.
- **Potentially stronger returns, lower volatility.** Dividends may help to mitigate portfolio losses when stock prices decline, and over long time horizons, stocks with a history of increasing their dividend each year have also produced higher returns with considerably less risk than non-dividend-paying stocks. For instance, since 1990, the S&P 500 Dividend Aristocrats -- those stocks within the S&P 500 that have increased their dividends each year for the past 25 years -- produced annualized returns of 11.04% vs. 8.23% for the S&P 500 overall, with less volatility (14.14% vs. 15.22%, respectively).[1]

The Growth of Dividend-Paying Stocks, 1950-2011[2]



If you are considering adding dividend-paying stocks to your investment mix, keep the following thoughts in mind.

- **Dividend-paying stocks may help diversify an income-generating portfolio.** Income-oriented investors may want to diversify potential sources of income within their portfolios. Given current realities present in the bond market, stocks with above-average dividend yields may compare favorably with bonds and may act as a buffer should conditions turn negative within the bond market.
- **Dividends benefit from continued favorable tax treatment.** The extension of the Bush-era tax cuts helps to reinforce the current case for dividend stocks. The tax bill that passed in late 2010 extended the 15% tax on qualifying dividends and other forms of investment income through December 31, 2012.

Note that dividends can be increased, decreased, and/or eliminated at any time without prior notice.

[1] *Volatility is measured by standard deviation. Past performance is no guarantee of future results.*

[2] *Source: Standard & Poor's. Stocks are represented by the S&P 500, an unmanaged index considered representative of the broad U.S. stock market. For the period January 1, 1950, through December 31, 2011. Past performance is not indicative of future results. Investors cannot invest directly in any index.*

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Many preretirees falsely believe that there is nothing they can do to build retirement assets, and as a result, do nothing.

Retirement Planning Tips for Fifty-Somethings

Entering your 50s and behind in your retirement planning goals? Don't fret. You've still got time to get your financial plan back on track.

There are many steps that older investors can take to better prepare themselves financially for retirement. Here are six tips that may help you make the most of your final working years.

1. **Catch up.** If you have access to a 401(k) or other workplace-sponsored plan, make the $5,500 catch-up contribution that is available to participants aged 50 and older. Note that you are first required to contribute the annual employee maximum, $17,000 for 2012, before making the catch-up contribution.
2. **Fund an IRA.** Investors aged 50 and older can contribute $6,000 annually (the $5,000 annual contribution plus an additional catch-up contribution of $1,000). An investor in his or her 50s who contributes the maximum amounts to both a 401(k) and an IRA could accelerate retirement savings by more than $25,000 a year.
3. **Consider dividends.** If you do not have access to a workplace-sponsored retirement plan, or you already contribute the maximum to your qualified retirement accounts, consider stocks that offer dividend reinvestment.[1] Reinvesting your dividends can help to grow your account balance over time.
4. **Make little cuts.** Consider how you can trim expenses while continuing to enjoy life. Some suggestions for quick savings: Eliminate or reduce premium cable channels that you do not watch, memberships that you do not use regularly, and frequent splurges on dining out or coffee runs. An extra $100 a month saved today could make a big difference down the road.
5. **Review strategies for postponing retirement.** You may be able to learn new skills that could increase your marketability to potential employers. Even a part-time job could reduce your need to deplete retirement assets.
6. **Don't give up.** Many preretirees falsely believe that there is nothing they can do to build retirement assets, and as a result, do nothing. Remember that you control how much you invest, and in many areas, how much you spend. Make a plan -- and stick with it.

[1] *Investing in stocks involves risk, including loss of principal.*

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