



THE FINANCIAL FORMULA

Giving You The Financial Information You Need

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Hello my wonderful clients!
Please enjoy this month's
newsletter and let me know if you
have any questions - enjoy!

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Inheriting a Loved One's Retirement Assets

Your options in managing retirement assets depend on whether the deceased was your spouse and also on the type of retirement account (401(k)/403(b) plan, IRA, or annuity) that you inherit.

Ten-Year Treasury Yields No Match for Inflation

As new developments in the euro zone raise concerns about global contagion, the market for 10-year U.S. Treasury securities is feeling some effects.¹ In a trend that some observers describe as an attempt to reduce perceived risk, investors are buying 10-year U.S. Treasury securities in large numbers, sending prices up and yields down.

On Thursday, May 17, 2012, the yield of 10-year U.S. Treasury securities was 1.70%. By comparison, the yield averaged 3.98% between January 1, 2001, and May 21, 2012.² As with all bonds, investor demand influences prices and yields, and it is important to understand this dynamic when considering U.S. Treasury securities.³

Supply and Demand

The market for U.S. Treasury securities is likely to be robust when investors perceive that a recession or higher inflation could be imminent. In this type of scenario, investors may appreciate the constant rate of return and the backing of the U.S. government that U.S. Treasury securities offer. When large numbers of investors purchase U.S. Treasury securities, investors bid up prices and yields fall. The Federal Reserve also influences prices and yields when it buys and sells U.S. Treasury securities.

When market conditions are unfavorable, the opposite situation can occur, with investors selling securities, which causes prices to decline, and yields to rise. In this type of scenario, when the U.S. Treasury issues new bonds, it is forced to offer higher interest rates to entice investors to buy.

In the current market environment, the rate of inflation has exceeded the yield of 10-year U.S. Treasury securities. Inflation as measured by the Consumer Price Index was 2.3% for the 12-month period ending April 30, 2012.⁴ If this situation continues, investors with large allocations to 10-year U.S. Treasury securities could earn a return that is below the rate of inflation, and this scenario would diminish long-term purchasing power.

Factors to Consider

When evaluating the risk and potential return associated with U.S. Treasury securities, it may be beneficial to keep the following points in mind.

- Because market conditions can change quickly, some investors diversify their allocation to fixed-income securities with corporate bonds, municipal bonds, or other fixed-income securities that may react to a different set of value drivers.⁵
- Combining bond investments with assets such as equities may reduce long-term volatility because equities historically have not moved in tandem with bonds in response to market or economic developments.⁶ Past performance does not guarantee future results.

The backing of the U.S. government and a constant rate of return historically have presented benefits for investors in U.S. Treasury securities. When reviewing a potential allocation, opportunities for diversification, current low yields, and long-term purchasing power also may be important factors to consider.

¹Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

²Source: The Federal Reserve.

³Bonds 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.

⁴Source: Bureau of Labor Statistics, May 15, 2012.

⁵Municipal bonds are subject to availability and change in price. They are also 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.

⁶Investing in stocks involves risks, including loss of principal. Stocks are measured by the S&P 500, bonds by the Barclays Aggregate Bond Index. The historical tendency of two assets to move in tandem is measured by standard deviation. Returns are for the 20-year period ending December 31, 2011. You cannot invest directly in an index. Past performance does not guarantee future results.

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There is an inverse relationship between yields and bond prices. When more investors purchase U.S. Treasury securities, prices increase and yields decline.



Emerging Markets: Looking Beyond BRICs

As emerging markets captured the attention of growth-oriented investors, focusing on the BRICs (Brazil, Russia, India, China) has been a frequent theme in recent years.¹ But as these countries have developed distinct economies, some investors are digging deeper to select investments within one of the BRIC countries or are scouting elsewhere for emerging economies.

BRIC Growth May Level Off

According to a recent report from Standard & Poor's Financial Services LLC, growth within the BRICs remains healthy but has slowed. China has revised its forecast for growth in gross domestic product (GDP) for 2012 to 7.5% from 8%. Since China is the largest exporter of manufactured goods, and also invests significantly in Africa, some observers believe that economic growth below 7% could be problematic for the global economy.² Growth in India also has leveled off from 8.5% to 7%, and economic expansion in Russia and Brazil have experienced similar trends.

As growth in the BRICs has eased, some observers are looking to Central and Eastern Europe to pick up some of the slack. UniCredit, a global bank, has expressed interest in expanding operations in the Czech Republic, Poland, and Turkey.

Risks and Rewards

Emerging markets historically they have been more volatile than developed markets, although past performance does not guarantee future results. The potential rewards and risks can be seen from the experience of investors in Asia from late 1997 to 1999.

A major collapse in emerging markets began in July 1997, when the Thai government dramatically devalued its currency, the baht, in the face of a very large currency account deficit, foreign debt, and a government budget shortfall. The result ricocheted throughout Asia as currencies in the Philippines, Malaysia, and Indonesia came under attack from speculators. Despite the International Monetary Fund's rescue package directed at Thailand, and promises of economic reform from Indonesia's government, investor confidence did not return to emerging markets until 1999, when signs of economic recovery began to appear.

Implications for Investors

What does the potential growth and volatility of emerging markets mean for investors? There may be several factors to consider:

- Pooled assets, such as mutual funds, may offer greater diversification compared with individual securities.³ It may be difficult for U.S. investors to access securities of companies domiciled outside the United States.
- Corporations headquartered in the United States and other developed markets may earn a portion of their revenue from emerging markets. This type of indirect investment may be suitable for certain investors.
- Currency risk can present another risk factor for emerging-market investors. As the currency exchange rate fluctuates, so does the value of an investment in U.S. dollar terms. Many emerging countries have their local currencies pegged to the dollar, which can result in a relatively constant exchange rate.

After the Asia crisis, many investors realized that the high return of emerging-market investing comes with high risk. For those prepared to ride out short-term volatility, investing in emerging markets may help to diversify a portfolio weighted to more-developed economies.

¹Consider the market risk associated with emerging markets carefully before investing. Investors in international securities may be subject to higher taxation and higher currency risk, as well as less liquidity, compared with investors in domestic securities.

²Standard & Poor's MarketScope[®] Advisor, "Emerging Market Investors Look Beyond BRICS," May 8, 2012.

³Investing in mutual funds involves risk, including loss of principal.

Central and Eastern Europe are capturing investor attention.





Inheriting a Loved One's Retirement Assets

If you recently inherited retirement assets from a deceased loved one, it is important to pay attention to IRS rules that govern this type of bequest. Your options in managing this money typically depend on your relationship to the deceased and the type of retirement account (401(k) or 403(b) plan, IRA, or annuity) that you inherited.

Employer-Sponsored Plans

When inheriting a deceased spouse's assets within an employer-sponsored plan, you are not required to pay federal estate or income taxes if the assets are left intact within the estate. After age 70½, you must begin required minimum distributions (RMDs) based on your life expectancy. The formula for calculating the RMDs, which are taxed as ordinary income, is available in IRS Publication 590. This withdrawal schedule typically is preferred to cashing out the entire bequest at once, which is likely to trigger higher tax payments.

If the deceased was not your spouse, the plan's rules generally determine your course of action. Depending on the plan, you may have one or more of the following options: Leave the money in the plan, transfer the money to an IRA created for this purpose, or elect a cash distribution.

Some employer plans offer nonspousal beneficiaries the option of completing a trustee-to-trustee transfer from an employer-sponsored plan to an IRA established for this purpose. The nonspousal beneficiary is required to take annual distributions based on the beneficiary's life expectancy. Note that in this type of scenario, the IRA is opened in the decedent's name for the beneficiary's benefit, and assets transferred to the IRA cannot be comingled with other IRAs that the beneficiary may have established.

In other instances, employer plans can default to a five-year payout rule and require nonspousal beneficiaries to empty the account within five years of the death of the deceased. Distributions taken by nonspousal heirs are taxed as ordinary income.

Before taking any action, it is critical to determine the rules of the deceased's retirement plan and consult a financial advisor or a tax advisor to make sure that you avoid unnecessary taxes.

IRAs

When inheriting a traditional IRA from a deceased spouse, you may designate yourself as the account owner and treat an inherited IRA as your own. This means you can transfer the assets to an existing IRA. These transfers typically do not trigger tax payments as long as you follow the rules for trustee-to-trustee transfers. You may also begin taking distributions, which are taxed as ordinary income. With a traditional IRA, after age 70½, you are mandated to take annual RMDs, which are based on your life expectancy and are taxed as ordinary income.

If the deceased was not your spouse, you cannot transfer assets within an inherited IRA to your own existing IRA. Instead, you have two options: You may take all distributions within five years of the decedent's death or take annual distributions determined by the life expectancy of you or the decedent, whichever is longer.

Annuities

If you receive a survivor annuity, the tax status of periodic payments to you is determined by how much the decedent paid for the annuity contract, which is known as the cost basis.¹ If the decedent did not pay for the contract (for example, if it was provided by an employer), periodic payments to you are taxable. Assuming the deceased had a cost basis, the amount up to the cost of the contract is not taxable, but amounts in excess of the deceased's cost are taxed as ordinary income.

Because determining the tax status of annuities and other inherited retirement assets can be complicated, you may want to consult an estate planning attorney or a financial advisor to answer any questions you may have.

¹An annuity is a long-term, tax-deferred investment vehicle designed for investment purposes and contains both an investment and an insurance component. They are sold only by prospectus. Guarantees are based on the claims-paying ability of the issuer and do not apply to an annuity's separate account or its underlying investments. The investment returns and principal value of the available sub-portfolios will fluctuate so that the value of an investor's unit, when

Understanding an employer-sponsored plan's rules for beneficiaries is critical when making decisions about the bequest.

redeemed, may be worth more or less than their original value. Gains from tax-deferred investments are taxable as ordinary income upon withdrawal.

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