Pettinga Insights and Outlook

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Should Your Asset Allocation Be More Tactical?

Our Take on Tactical Rebalancing.

- Tactical rebalancing makes sense in those infrequent cases where unique economic or geopolitical events may cause significant harm to a client portfolio and their financial security. Beyond those rare cases, we view tactical reblancing as a form of market timing, for which no manager has a demonstrated track record.

The market downturn of 2008-2009 was hard for all investors, especially retirees, many of whom questioned their game plan amid huge losses. Investors questioned the value of long-term strategic asset allocation, in particular the buy-and-hold strategy. Many investors also began thinking about being more tactical. Market volatility tests buy-and-hold investors and in many cases increases the appeal of tactical asset allocation.

Tactical asset allocation is an active portfolio management strategy by which portfolio composition and weighting are altered in the short-term to take advantage of perceived differences in relative values of various asset classes. While tactical asset allocation may look appealing on the surface, it is best left to investors who understand its complexity. Otherwise, this strategy could leave investors stuck with an asset allocation that may be unsuitable for their goals, risk, and liquidity requirements. It is also important to keep in mind that active trading increases both taxes and transaction costs.

The bottom line: Pick a strategic portfolio plan with an appropriate asset allocation for your time horizon. Your individual portfolio should address both your immediate and intermediate needs. With the right plan in place, your portfolio will be better equipped to handle volatility, allowing time to smooth out the choppy returns.

There is no guarantee that strategic or tactical asset allocation will protect against market risk. These investment strategies do not ensure a profit or protect against loss in a declining market. Please keep in mind that diversification does not eliminate the risk of experiencing investment losses. Please consult with a financial professional for advice specific to your situation.

Pettinga

Get there.

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Our Firm

Pettinga Financial Advisors, LLC is an independent, fee-only financial services firm serving clients across the nation from our office in Evansville, Indiana.

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Because you receive our services on a fee-only basis, you pay no sales commissions for our investment counsel. Nor do you deal with sales people tied to transaction commissions. Instead, you enjoy a personal relationship with a knowledgeable, unbiased advisor.

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Monthly Market Commentary

Although several bellwether stocks, such as Intel, Texas Instruments, FedEx, Norfolk Southern, and Caterpillar announced earnings warnings, investors mostly shrugged-off weaker fundamentals and placed their hopes on growth through coordinated easing. Investors were not disappointed, as additional quantitative easing (QE3) was announced on September 13th. Riots in Spain caused markets to react negatively, durable goods orders took a dive because of airline orders, and income and consumption numbers were hit hard by a quick spike in inflation rates. However, year-over-year data for almost every report continued to look a lot better than the volatile month-to-month statistics.

GDP: Second quarter real GDP growth was unexpectedly revised downward in September to 1.3%, after initially being revised upward to 1.7% from 1.5% in August. Adjustments were across the board, which included a slowdown in personal consumption, inventory growth, and negative net exports.

Employment: The recent jobs report revealed a surprise drop in the unemployment rate to 7.8%, down from 8.1% in August. In September, 114,000 jobs were added, but more importantly, the job numbers were revised substantially higher for July (+40,000 jobs) and August (+46,000 jobs). These revisions are likely to produce meaningful increases in both personal income and consumption growth.

Housing: Housing data was mixed as house prices rose but pending home sales seemed lighter than expected. The Case-Shiller 20 City Index rose 1.2% sequentially and is now 7% to 8% above lows reached this spring. The relatively consistent improvement in prices over the past few months should help the appraisal process that has kept many pending homes that went under contract from actually closing. Consistent price increases, along with near-record low mortgage rates and skyrocketing rents, could push potential buyers off the fence.

Manufacturing: New orders for durable goods were down a whopping 13%. A major air industry show in July often causes a huge boom for airline orders in that month, followed by a collapse in August. If volatile categories such as airliner orders and other transportation equipment are ignored, new orders were down a modest 1.6% in August. Morningstar economists believe that while the export news looked particularly bleak, a combination of ramp-up in jetliner productions from Boeing and continued improvements in the auto industry (auto sales hit a new recovery high in September) should prevent a rout of the manufacturing industry in the U.S.

Quarter-end insights: The initial fears at the end of the second quarter that the U.S. would be pulled back into a recession because of slowdowns in Europe and China, has not come to pass. Markets were surprisingly strong in the third quarter, mainly from actions by central banks around the world that drove markets higher. Although the housing recovery has been improving for most of 2012, it has yet to have any significant impact on overall economic activity since residential housing only represents 2% to 3% of GDP. This excludes spending that typically follows home purchases, such as new furniture and landscaping. Morningstar sector analysts' quarter-end outlook highlighted lackluster fundamentals that showed no definitive signs of either a collapse or a boom. During the third quarter, cyclical and more economically sensitive stocks generally did well while more staid industries, such as utilities, generally underperformed the market. There is also concern of a stronger dollar undercutting sales growth with a general fear that the higher dollar may likely depress margins in the months ahead. High margins and conservative capital spending have resulted in higher levels of cash at major corporations, which is finding its way into the mergers and acquisitions space. Much of the merger and acquisition activity as well as general corporate growth stories continue to be built around emerging-markets growth, despite near-term pressures in some of those markets.

Risk Calibration for Retiree Portfolios

Retiree Investment Models Revisited.

- Traditional portfolio models employed allocations tied to the investors age. A 30 year old for example would have 30% fixed income, 70% stocks.
- Modern portfolios employ an investment model focused on TOTAL return and risk of loss. Today's portfolios are less tied to age-based percentages of bonds versus equities. An eighty year old may, therefore, have far less than 80% in bonds in an effort to achieve the return he or she needs to meet living needs.

Managing risk during retirement has changed a lot during the past few decades. In the past, retirees enjoyed the luxury of much higher interest rates as well as pensions, which meant they could lower their equity holdings during retirement. For today's retirees, however, staying invested in low-return assets is a luxury they may not be able to afford. Instead, they should keep their eyes on the following risks.

Longevity: Longevity risk is the risk of outliving your assets. Given a long portfolio life span, retirees need more growth from their portfolios than cash and bonds can afford. Holding stocks is important for growth; however, the question remains: what’s the right amount? In addition to considering a higher equity weighting, pre-retirees and retirees can also consider options such as deferring Social Security, working longer or part-time, and decreasing in-retirement spending, particularly after market downturns.

Long-Term Care: A year in a private room in a nursing facility now averages $78,000, according to a Genworth survey*, and long-term care in urban settings can be far more costly than that. If you are concerned that long-term care could eat away your retirement nest egg, you may want to consider purchasing a long-term care insurance policy. These policies are pricey, particularly if you buy one with an inflation component and/or if you're over 65, but they can provide invaluable peace of mind, too.

Inflation: Retirees living off of their investments don't receive cost-of-living adjustments (except for their Social Security and possibly their pension income), so inflation can readily translate into declining purchasing power and a reduced standard of living. Treasury Inflation-Protected Securities (TIPS) are the most direct way to hedge against an unexpected increase in inflation, providing an adjustment to an investor's principal to keep pace with inflation. Stocks are another, indirect way to guard your portfolio against the threat of inflation. They have the potential for higher returns than bonds, and inflation will take a smaller bite out of your future purchasing power. Owning companies with a demonstrated history of dividend growth is another way to help offset the effects of inflation on your portfolio.

Higher Taxes: Massive government spending and unfunded liabilities could translate into higher taxes across the board. Investors may be able to reduce tax liabilities by including tax-loss selling, Roth conversions, and municipal bonds. Roth 401(k)s and IRAs are also good options for tax-conscious investors seeking at least some tax-free treatment of their retirement assets.

*Report cited: “Genworth 2012 Cost of Care Survey, Home Care Providers, Adult Day Health Care Facilities, Assisted Living Facilities and Nursing Homes,” April 2012.

Why You Need a Financial Advisor

Pettinga Financial - Thank You.

- We are well aware of the challenges the markets pose to your financial security.
- We acknowledge our responsibility to protect your financial security.
- Thank you for your continued trust and confidence.

After dismal portfolio returns during the "lost decade," investors may be wondering why they are still paying their advisors' fees. Until recently, the generally accepted (and expected) premise was that the advisor would deliver returns in excess of the market. But since many advisor-managed portfolios lost value with the market during the two major crises of the decade, many clients have begun to question the advisors' role and their justification for receiving fees even during periods of poor performance.

An advisor's value, however, may go beyond returns that beat the market. Of course, return is the first thing investors tend to think about, but there are other factors that influence the investing process and need to be carefully considered, as well. This is where an advisor can help you. Many investors do not align their portfolios with their risk tolerance; they overweigh in stocks expecting high returns and then can't sleep at night when the market fluctuates. An advisor can help manage your expectations and build a portfolio that's best suited for your risk tolerance level.

Another area where an advisor's expertise can be valuable is goal-oriented investment. Instead of accumulating all your savings in one place and investing them irrespective of a goal or timeline, an advisor can help you identify various investment goals (retirement, child's college fund, income-oriented investing) and then reorganize your portfolio according to these goals.

In addition to risk/return management and goal-oriented investment, wealth preservation, tax management, and the prevention of rash decisions are some of the additional benefits you may gain from the client-advisor relationship. When you evaluate your advisor's performance, think about how an advisor's value may extend beyond returns that outperform the market.

Pettinga
Get there.

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