SAMALIN INVESTMENT COUNSEL

# FINANCE FOCUS

*Finance Focus* is published quarterly by Samalin Investment Counsel

Volume VI, Issue I

# The Many Faces of Risk, Part One

There is no question that risk carries a negative connotation for investors. But the simple fact about risk is that it's ever-present. There is more to risk than market volatility, and trying to avoid risk is like trying to avoid the oxygen in the room. You might think you're avoiding it by sticking with safer investments, such as bonds. But when you make moves like this, you're usually just swapping one kind of risk for another. In this case, you may have reduced short-term volatility risk, but you likely increased long-term shortfall risk: With a heavy emphasis on lower yielding "safe" investments, your portfolio may not grow enough to meet your retirement needs or overcome inflation over the long term.

On the flip side, we may also mistake an upward trend in the market for the absence of risk. A strong performance streak doesn't mean there was no risk. It just means that risk didn't bite hard during that time period. Don't confuse being lucky with being risk-proof.

So, we can't avoid risk. But neither should we be oblivious to it. What we need to do is understand the risks we're taking, and remember risk's traveling companion: reward. This keys in on an important point: Risk isn't inherently bad. When you take risk, you can have good outcomes, too. Risks should have related and commensurate potential rewards. We invest in the market not because risk is bad and we expect to lose money, but because taking risk can be profitable. So, the question is not whether to take risk. Instead, it's what risks do you want to take, and how much?

## Types of Risk

As suggested above, there is more than one kind of risk, and to manage risk well, you need to consider the different types. For instance, investing risk is not all (or even mostly) about the market's volatility (the Dow's daily ups and downs on Fed talk, China's latest data, or any number of global worries).

When thinking about investment risk, you need to consider company fundamentals (what will cause this firm to succeed or fail), because that will ultimately drive the stock price over time.There is also price risk.

Even if the company is poised for tremendous success, how much are you paying to own a piece of it? If you overpay, you can still lose money, because stocks tend to revert to their fair value over time, even if they occasionally become under- or overvalued.

You also have to consider your own shortfall risk. Conceivably, you're investing in the market to fund some future expense (for instance, college or retirement). If you take money out of the market, or move money from stocks to bonds, what does that mean for your long-term earning potential, given the types of returns bonds tend to produce over long periods of time? Remember, funding that future expense is your primary objective, not avoiding every little dip in the market along the way.

But instead of fundamental, price, and shortfall risk, we investors tend to focus on short-term volatility because that's the thing we see every day, in real time. It's the most apparent and seemingly uncontrollable risk. Make no mistake, volatility may reflect real changes in a company's fundamentals, and that can mean a real loss of money for you. But volatility is often just noise, reflecting worries that won't have any lasting or appreciable effect on a company's operations. In these cases, we shouldn't let volatility risk leave the realm of paper losses.

That's easier said than done, of course, especially during a market crisis or correction. But one way of getting around that is by considering another type of risk: liquidity risk. That's the risk that you can't sell an asset (or at least can't sell it for a reasonable price) when you need to sell it. The upshot: If you have a short-term need for cash, then have cash on hand. That allows you to ride through the volatility risk of your other assets.

# Retirement Distribution Pitfalls: Income-Producing Securities

Accumulation is a key facet of reaching your retirement goals. However, we tend to see far less about portfolio drawdown, or decumulation—the logistics of managing a portfolio from which you're simultaneously extracting living expenses during retirement. This can be even more complicated than accumulating assets.

**Pitfall:** One of the big mistakes of retirement distribution can be relying strictly on income producing securities to meet income needs. Sticking exclusively with income distributions can leave retirees beholden to the current interest-rate environment. We've seen that problem in sharp relief during the past several years, as income-oriented investors have been forced into riskier areas, such as emerging markets bonds, to scare up the income they need.

**Workaround:** The bucket approach to retirement income is essentially a total-return approach that relies on regular rebalancing to provide income for living expenses. Using such a structure, a retiree would own bonds and dividend-paying stocks but would also own other stock types, including those that don't pay dividends. Such a strategy could potentially provide a better-diversified portfolio than the income-only approach for some retirees, and may also allow a retiree to enjoy a fairly stable standard of living.

All investments involve risk, including the loss of principal. There can be no assurance that any financial strategy will be successful. Diversification is an investment method used to help manage risk. It does not ensure a profit or protect against a loss. This is for informational purposes only and should not be considered tax or financial planning advice. Please consult tax and/or financial professional for advice specific to your individual circumstances.

# Not All Index Funds Are the Same

The choice to use index funds rather than actively managed funds is a significant one. Index funds tend to be rather straightforward, easy-to-own, and cost effective investment vehicles. But, just like actively managed funds, index funds also have their differences that investors should be aware of.

**Cost Still Counts.** Different index funds can charge different fees. Funds that are otherwise virtually identical (meaning they track the same index) can nonetheless produce different returns based on their fees, because fund fees are deducted from returns. This cost difference can have a significant effect on fund performance when compounded over time.

**The Challenges of Tracking an Index.** Tracking error is the degree to which an index fund fails to mirror its benchmark's performance during a given time period. As the components and weightings of an index change over time, the fund must buy and sell holdings in an attempt to match it, and some funds may do this better than others.

**Subtle Index Differences.** Index funds within the same category may not track the same index. Consequently, two index funds that may sound very similar could actually have very different portfolios and performance numbers.

The investment return and principal value of mutual funds will fluctuate and shares, when sold, may be worth more or less than their original cost. Mutual funds are sold by prospectus, which can be obtained from your financial professional or the company and which contains complete information, including investment objectives, risks, charges and expenses. Investors should read the prospectus and consider this information carefully before investing or sending money.

# The Many Faces of Risk, Part Two

## The Risks You Do Take Are Manageable

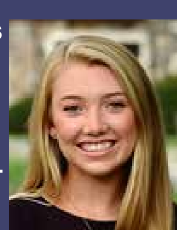
The good news is, even if you have to take some short-term risks you'd rather not, you can take the edge off in a number of ways. Diversification among asset classes may reduce marketwide or so-called systematic risk. In 2008, the bond market held up just fine even though stocks uniformly fell on their face. Holding assets that move in different directions at the same time makes for a smoother ride overall and gives you more options should you need to liquidate a portion of your holdings for some reason.

You may also want to consider diversification within one asset class. Holding several stocks (as opposed to just one) from the same industry and other industries may reduce company-specific risk (such as product launch failure) and sector-specific risk (such as ebooks and e-mail taking a bite out of paper company profits). Another way to manage fundamental risk is to invest in companies that have sustainable competitive advantages.

Dollar-cost averaging, or putting your money to work in smaller chunks over time, may reduce that risk. It also happens to be the de facto way that most people end up investing—with a little bit of money coming out of every paycheck. Another way to potentially reduce price risk is requiring a margin of safety before buying. All else equal, if you like a stock at $50 per share, you should love it at $30. Buying at a discount means you have room for error in your analysis, a buffer in case of an unforeseen complication, or the chance for extra return if everything goes as planned.

## Meet the SICounsel 2015 Summer Interns

**Caroline Chmiel** is a rising sophomore majoring in Mathematics and Economics at Claremont McKenna College in Claremont, California. She enjoys working with numbers and challenging her analytical skills. Caroline came to SICounsel to see the application of her math and economic studies in financial planning. Caroline also spends her summer working as a sales associate at Anthropologie in Greenwich.


Caroline Chmiel


Liana Festo

**Liana Festo** returns to us for her second Summer with SICounsel. She has been continuing her studies in Marketing and Finance at Western New England University in Springfield, MA. Her interest in working with people to effectively manage their finances drew her to SICounsel and the financial planning world. Liana is from Somers, NY and enjoys traveling and spending time with family and friends.

## Don't Let Risk Take You

Unlike the familiar risk of going to work for an immediate reward (a paycheck), when it comes to investing, the reward is typically delayed, while the perceived risk (specifically market volatility) is immediate. Because of short-term market gyrations, investors may also feel that they can't control or moderate their investment risk. So, there is a disconnect between perceived high and uncontrollable present risk on one side, and an uncertain future reward on the other. That just doesn't sound like a good trade-off.

But that story is not complete. You also have to think about shortfall risk and the opportunity cost of not investing (in other words, the money you could have made over time but didn't because you weren't invested). You have to think about the cost of inaction, because not taking any action is potentially risky, too, just in a different way.

When you look at it this way, you should realize you can't avoid risk. So, don't let risk just happen to you. Since you'll end up taking risk in one form or another, you might as well take control, and take smart risks. Take risks in a way that you choose, in a form that you manage to reach your goals—knowing the trade-offs and the consequences and the rewards.

There is no guarantee that diversification, asset allocation and dollar-cost averaging will protect against market risk. These investment strategies do not ensure a profit or protect against loss in a declining market. In addition, since investing by dollar-cost averaging involves continuous investment in securities regardless of fluctuating prices, investors should consider their financial ability to continue purchases through periods of both low and high price levels.

Returns and principal invested in stocks are not guaranteed, and stocks have been more volatile than bonds. Investing does not ensure a profitable outcome and always involves risk of loss.

This is for informational purposes only and should not be considered financial planning advice. Please consult a financial professional for advice specific to your individual circumstances. This article contributed by Christine Benz, Director of Personal Finance with Morningstar.

# SICounsel Crown House Memorial Day Celebration 2015 Recap

On May 25th, The Crown House (SICounsel's main location at 297 King Street, in Chappaqua, NY) hosted its 4th Annual Memorial Day Celebration. In honor of our fallen American heroes, the Chappaqua Memorial Day Parade marched down King Street, and included veterans, former President Clinton and former Secretary of State Hillary Clinton, revolutionary war re-enactors, area fire and rescue organizations, and local high school bands. As word has spread, SICounsel's Annual Memorial Day Celebration attendance has become standing room only! Friends and families enjoyed live music, patriotic face painting, Maurice's Magic Show, food, refreshments, and prime seating along the parade route and of course great breakfast foods like popcorn and snowcones.

***Mark your calendars for next year!***

# SICounsel featured
## in multiple speaking engagements

**Andrew Samalin** *has recently been featured in multiple speaking engagements. His unique expertise which blends financial planning, divorce financial planning, and real estate investment analysis has been gaining attention from both national publications and professional organizations.*

In May, *Investment News* invited Andrew to present at their 2015 Retirement Income Summit. His presentation to 350 investment professionals, titled "Gray Divorce", explored a myriad of planning hurdles raised when retirement-aged clients unexpectedly find themselves facing divorce. Investment News is a national weekly publication which delivers news and analysis essential to the business of financial advisors and combines comprehensive news with accurate, independent reporting on the entire financial services industry. *(Source: InvestmentNews.com)*

Andrew also recently spoke at the Association of Divorce Financial Planners New York City Chapter Meeting. Being that his December 2014 ADFP University Webinar presentation, "Real Estate and Divorce", was so well attended and replayed, the ADFP's NYC Chapter invited Andrew to present in-person. The Association of Divorce Financial Planners (ADFP) is an interdisciplinary association whose members include Financial Professionals, Attorneys, and Mental Health Professionals. Members collaborate to research and analyze personal, business, and tax issues related to divorce in order to help individuals, couples, matrimonial attorneys and divorce mediators achieve financially workable settlements. *(Source: DivorceandFinance.org)*

SAMALIN INVESTMENT COUNSEL
FINANCE FOCUS

# KEY REASONS WHY A TAXABLE ACCOUNT MAY BE UNDERRATED, PART ONE

Tax-sheltered savings vehicles offer tax-deferred compounding, meaning investors won't pay any taxes on a year-to-year basis as long as they don't withdraw any assets. And depending on the vehicle, they may also receive a tax break on contributions and/or withdrawals, too. Those tax breaks can help enhance take-home return.

With all the attention paid to accumulating money in those tax-sheltered accounts, many investors see saving in a taxable account as a last resort—something to be considered only after they've fully funded their tax-sheltered accounts.

But investing via a taxable account can be a sensible maneuver, and not just if you're running out of tax sheltered receptacles for your money. In fact, investors may want to consider simultaneously funding their taxable and tax-sheltered accounts, and the current tax and interest-rate environment make saving in a taxable account particularly sensible. Here are six key reasons why.

## Reason 1: Flexibility.

Investing via a taxable account carries two key advantages, both of which make the taxable account more flexible.

First, liquidity: If you have near-term income needs or are simply building an emergency fund, a taxable account will allow you access to your money without any strings attached (though you may owe taxes if your investments have appreciated). True, a Roth IRA allows you to tap your contributions (not your investment earnings) at any time and for any reason, which is one reason it's a suitable vehicle for younger investors who are conflicted between saving for near term financial goals and retirement. But for higher income folks who need to use their tax-advantaged options for retirement savings, putting money for liquidity needs into a taxable account may be the way to go.

The other reason investing in a taxable account is so flexible is that you can invest in literally anything. You'll have to choose from a preset menu if you're investing in a company retirement plan, for example. And while you may have more leeway when investing in an IRA, there are still a few investment types that are off limits. A taxable account is the one account type that gives you carte blanche. (Of course, it also gives you more opportunity to make mistakes!)

## Reason 2: Compounding and potentially minimizing taxes if you plan carefully.

When investing inside of a taxable account, it may not be all that difficult to simulate the tax-deferred compounding you get with many tax-sheltered vehicles. The key is to choose investments that kick off limited taxable income and capital gains distributions. For example, income from municipal bonds is exempt from federal and in some cases state income taxes. Choosing tax-efficient securities can make it possible to buy and hold a basket of securities for years inside a taxable account while owing very little in taxes on that portfolio during your holding period.

It's also worth noting that income is low on an absolute basis right now, so the tax hit associated with owning securities that produce income that is taxed at your ordinary income tax rate is also going to be pretty low, at least in dollar terms. (That will change if yields go up, though.)

## Reason 3: You can use tax losses to reduce your tax bill.

In addition to the ability to have your assets grow without owing a lot in taxes, investing in a taxable account also gives you the ability to harvest losses, something that is not easy to do with investments held inside tax-sheltered accounts. You can sell securities that are trading below your purchase price and use your loss (the difference between your purchase price and your sale price) to offset capital gains or, if you still have excess losses, up to $3,000 in ordinary income.

SAMALIN INVESTMENT COUNSEL

WESTCHESTER
297 King Street
Chappaqua, NY 10514

MANHATTAN
410 Park Avenue
15th Floor
New York, NY 10022

# Home Prices on the Rise Amid Low Inventory Levels and High Demand

The latest report from CoreLogic showed that home prices continued to rise at a much faster pace than previously expected, growing 2.0% in March. On a year-over-year basis, the growth stood at 5.9%, the fastest pace since last July. CoreLogic predicts that prices will rise 0.8% in April, and that the year-over-year growth will tick down to 5.4%.

Unusually low inventory levels and a coinciding increase in demand are driving the prices of existing homes higher. Faster-growing prices are both good and bad news. The bad news is that the higher pace of home price increases may put a dent in the affordability of existing homes, which is something that has the potential of slowing down the housing recovery. The good news is that it is reassuring to see many new buyers who feel financially secure and confident enough to buy a home, even at higher prices. Faster price growth also helps existing homeowners to emerge from their underwater mortgages. According to CoreLogic, current home prices are still 11% below their April 2006 peak. More important, as faster growing prices hurt the affordability of existing homes, the demand might shift toward new homes. The gap between existing-home prices and new home prices had grown unusually wide and declines in that gap could bolster the construction sector. That, in turn, could provide a direct boost to the GDP and employment. CoreLogic predicts that the price growth of existing homes may moderate later this year and that the prices may increase by about 5.1% from March 2015 to March 2016.

This article contains certain forward-looking statements which involve known and unknown risks, uncertainties, and other factors that may cause the actual results to differ materially from any future results expressed or implied by those projected statements. Past performance does not guarantee future results.

## ABOUT SICOUNSEL

Samalin Investment Counsel, LLC (SICounsel) is a fee-only, nationally recognized SEC registered investment advisory firm. With offices in Chappaqua NY and NYC, we specialize in wealth management, pre and post divorce financial planning, retirement planning, and other related financial services.