CEDARPOINT
Investment Advisors, Inc.

Just How Risky Is Your Portfolio?

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If you're like most people, you probably evaluate your portfolio in terms of its return. However, return isn't the only factor you should consider; also important is the amount of risk you take in pursuing those returns. The term "risk" is often understood to mean the risk of loss. However, a portfolio is generally a means to an end, such as paying for retirement or a child's college tuition. In that context, "risk" also means the risk of not meeting your financial needs.

Risk-adjusted return

Let's say that Don's portfolio earns an average of 7% a year for 10 years. However, his annual returns have been very uneven; one year his return might be 11%, another year it might be down 10%. Meanwhile, Betty's portfolio also has averaged a 7% annual return in the same time, but her returns have been more even; she hasn't had spectacular years, but she has avoided any negative annual returns.

You might think both would end up with the same amount of money after 10 years, but that's not necessarily the case. It depends in part on the timing and size of the declines in Don's portfolio. A big loss in the first year or two means he'll spend valuable time recovering rather than being able to make the most of compounding; that can affect future growth. That's why it's important to consider an investment's risk-adjusted return.

Volatility measures

One of the most common measures of volatility is standard deviation, which gauges the degree of an investment's up-and-down moves over a period of time. It shows how much the investment's returns have deviated from time to time from its own average. The higher the standard deviation of an investment or portfolio, the bumpier the road to those returns has been.

Another way to assess a portfolio's volatility is to determine its beta. This compares a portfolio's ups and downs to those of a benchmark index, such as the S&P 500, and indicates how sensitive the portfolio might be to overall market movements. An investment or portfolio with a beta of 1 would have exactly as much market risk as its benchmark. The higher the beta, the more volatile the portfolio. (However, remember that investments also have unique risks that are not related to market behavior. Those risks can create volatility patterns that are different from the underlying benchmark.)

The risk of not achieving your goals

Another way to evaluate risk is to estimate the chances of your portfolio failing to meet a desired financial goal. A computer modeling technique known as Monte Carlo simulation generates multiple scenarios for how a portfolio might perform based on the past returns of the asset classes included in it. Though past performance is no guarantee of future results, such a projection can estimate how close your plan might come to reaching a target amount.

Let's look at a hypothetical example. Bob wants to retire in 15 years. A Monte Carlo simulation might suggest that, given his current level of saving and his portfolio's asset allocation, Bob has a 90% chance of achieving his retirement target. If he chose to save more, he might increase his odds of success to 95%. Or Bob might decide that he's comfortable with an 85% chance of success if that also means his portfolio might be less volatile. (Be aware that a Monte Carlo simulation is a projection, not a guarantee.)

Are you getting paid enough to take risk?

Another approach to thinking about portfolio risk involves the reward side of the risk-reward tradeoff. You can compare a portfolio's return to that of a relatively risk-free investment, such as the inflation-adjusted return on a short-term U.S. Treasury bill. Modern portfolio theory is based on the assumption that you should receive greater compensation for taking more risk (though there's no guarantee it will work out that way, of course). A stock should offer a potentially higher return than a Treasury bond; the difference between the two returns is the equity's risk premium. While understanding risk premium doesn't necessarily minimize risk, it can help you evaluate whether the return you're getting is worth the risk you're taking.

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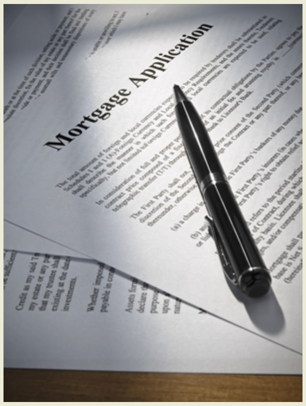
Financial Tips for Obtaining a Mortgage Loan



You're entitled to a free copy of your credit report once a year from each of the three major credit reporting agencies. Visit www.annualcreditreport.com for more information.

In January 2013, the Consumer Financial Protection Bureau released a new mortgage regulation, which sets forth stricter underwriting requirements for mortgage lenders. The regulation requires lenders to ensure a borrower's ability to repay a loan by taking a variety of underwriting precautions, including verifying income and assets and increasing debt-to-income ratios.

The regulation implements sections of the 2010 Dodd-Frank Act, and is aimed at protecting consumers by providing for a standardization of the mortgage loan underwriting process. However, some mortgage-industry experts fear there's a chance that the regulation may end up making obtaining a mortgage loan more difficult than it has been in the past. And while lenders have until January 2014 for final compliance with the regulation, some have already begun to tighten up their mortgage lending requirements. As a result, you may want to consider the following tips when applying for a mortgage loan.

Clean up your credit report

A borrower's credit history is the cornerstone to any lender's underwriting process. As a result, it's important to make sure that your credit report is in good shape before you apply for a mortgage loan. Your credit report contains information about your past and present credit transactions and is used by mortgage lenders to evaluate your creditworthiness. A positive credit history will not only make it easier to obtain a mortgage loan, but can also result in a lender offering you a lower interest rate.

You should review your credit report and check it for any inaccuracies. If necessary, you may need to take steps to improve your credit history. To establish a good track record with creditors, make sure you always pay your monthly bills on time. In addition, try to avoid having too many credit inquiries on your report, which are made every time you apply for new credit.

Improve your debt-to-income ratio

In the past, lenders looked for borrowers to have a debt-to-income ratio of no greater than 36%. The new mortgage regulation suggests that borrowers have a debt-to-income ratio that is less than or equal to 43%. That means you should be spending no more than 43% of your gross monthly income on longer-term debt payments. If you find that your debt-to-income ratio is too high, there are a couple of steps you can take to lower it.

Your first step should be to look at your long-term debt payments. These include student loans, credit cards, and car payments--any loans that won't be repaid within a year. Try to make it a priority to pay down your long-term debts as quickly as possible. This may require you to review your budget and make adjustments. If you are having trouble coming up with the extra money, take a look at your discretionary spending. By cutting back on discretionary expenses (e.g., going out to eat or to the movies), you may be surprised at how quickly you can free up money to put towards paying down your debt.

Another way to improve your debt-to-income ratio is to increase your income. Perhaps you can earn extra income by taking a second job or performing part-time consulting work in your chosen profession or field of expertise. If you are married and either you or your spouse is currently not working, you or your spouse may want to consider the possibility of reentering the workforce.

Increase the size of your down payment

While it is possible to obtain a mortgage with a minimal down payment--for example, Federal Housing Administration (FHA) mortgages require down payments of as little as 3.5% of the home's purchase price--a larger down payment will usually assure you a more attractive mortgage loan. In addition to requiring private mortgage insurance (PMI), lenders generally offer lower loan limits and higher interest rates to borrowers who have a down payment of less than 20% of a home's purchase price.

If you find that you don't have enough for a down payment, you may want to consider holding off on purchasing a home to give you time to increase your down payment fund. In the meantime, you can invest your down payment in a low-risk, interest-bearing account such as a money market deposit account.

Or, consider looking into alternative ways to fund your down payment, such as:

- Converting/liquidating assets to cash.
- Using gifts.
- Borrowing from a cash value life insurance policy or employer-sponsored retirement plan. (Keep in mind, however, that if you take a loan against your cash value, the death benefit available to your survivors will be reduced by the amount of the loan. In addition, policy loans may reduce available cash value and can cause your policy to lapse. Finally, you could face tax consequences if you surrender the policy with an outstanding loan against it.)

Portability allows a surviving spouse to use the unused applicable exclusion amount of the spouse who dies first to shelter property from federal gift and estate taxes. Portability of the exclusion between spouses would seem to make estate planning easier for many estates, but that may not always be the case.

Now that portability and the increased exclusion, which had been scheduled to expire in 2013, have been made permanent, it is probably a good time to review your estate plan and documents.

Portability of Applicable Exclusion Amount between Spouses

Transfers of property during life or at death are generally subject to federal gift or estate taxes. However, each taxpayer has an amount of property that can be sheltered from federal gift and estate taxes by the unified credit, called the "applicable exclusion amount."

Prior to 2011, each spouse was entitled to his or her own applicable exclusion amount, and any amount that a spouse did not use would be lost; so special planning was often used to insure neither spouse's exclusion was wasted.

In 2011 and later, the estate of the first spouse to die can elect to transfer any applicable exclusion amount that is not used to the surviving spouse. This is known as "portability." The applicable exclusion amount is redefined as equal to the sum of the basic exclusion amount of the surviving spouse and the unused applicable exclusion amount of the predeceased spouse, and the basic exclusion amount is equal to $5 million as indexed for inflation each year ($5,250,000 in 2013).

Now that portability and the increased exclusion, which had been scheduled to expire in 2013, have been made permanent, it is probably a good time to review your estate plan and documents. Portability of the exclusion between spouses and an increase in the basic exclusion amount should make estate planning easier for many estates.

Simple planning with portability

If you're planning today, you could transfer everything to your spouse at your death, and your estate can elect to transfer your unused applicable exclusion amount to your surviving spouse. Your spouse will then have an applicable exclusion amount equal to the sum of his or her own basic exclusion amount and your unused applicable exclusion amount, which your spouse can use for gift or estate tax purposes. For example, if you transfer your $5,250,000 unused applicable exclusion to your surviving spouse, who also has a $5,250,000 basic exclusion amount, your spouse then has a $10,500,000 applicable exclusion amount in 2013 to shelter property from gift and estate tax. Such simple planning might be very practical for some married couples, especially where the spouses' combined estates are expected to be less than their combined applicable exclusion amounts.

Potential need for more complex planning

There are a number of reasons why such simple planning with portability may not always produce the desired or best results. These might include (among others):

- You have family members or individuals other than your spouse who you would like to benefit prior to the death of your spouse.
- You have grandchildren or later generations who you would like to benefit. The $5,250,000 (in 2013) generation-skipping transfer (GST) tax exemption is not portable between spouses.
- State exclusion amounts may be different than the federal applicable exclusion amount and may not be portable between spouses.
- The unused exclusion is not adjusted for inflation after the first spouse's death, and may not fully protect appreciating property from estate tax in the surviving spouse's estate.

Use of A/B trust arrangement

Prior to 2011, many married couples with estates that were greater than the applicable exclusion amount would set up an A/B (or A/B/C) trust arrangement. In general, the first spouse to die would transfer an amount equal to the applicable exclusion amount to the "B" or credit shelter bypass trust. The B trust could benefit the surviving spouse and their children, but the B trust would be designed to bypass the surviving spouse's estate. The balance of the estate would be transferred to the surviving spouse, either outright or using an "A" marital trust, and qualify for the marital deduction. In some cases, a "C", "Q", or QTIP marital trust was also used if the first spouse to die wanted to control who received the marital trust property at the second spouse's death. The A/B trust arrangement typically assured that there would be no estate tax at the first spouse's death and that neither spouse's applicable exclusion amount was wasted.

An A/B trust arrangement may still be useful, even with the availability of portability. For example, the B trust can be used to provide for family members or individuals other than your spouse (and even your spouse) prior to the death of your spouse. You could also allocate your GST tax exemption or state exclusion to the B trust. Also, appreciation of property after the transfer to the B trust should not be subject to estate tax at your spouse's death. The A trust could use your spouse's applicable exclusion amount, GST tax exemption, and state exclusion.

The use of trusts can also provide other benefits, such as control over who receives your property and when, investment management of trust property for trust beneficiaries, avoidance of probate, and asset protection.

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I already have health insurance. Will I have to change my plan because of the new health-care reform law?

For the most part, no. The Patient Protection and Affordable Care Act (ACA) does not require you to change insurance plans, as long as your plan, whether issued privately or through your employer, meets certain minimum requirements. In fact, the ACA may add benefits to your existing plan that you have not had before.

Your present insurance plan may be considered a grandfathered plan under the ACA if your plan has been continually in existence since March 23, 2010 (the date of enactment of the ACA), and has not significantly cut or reduced benefits, raised co-insurance charges, significantly raised co-payments or deductibles, and your employer contribution toward the cost of the plan hasn't significantly decreased. However, if a grandfathered plan significantly reduces your benefits, decreases the annual dollar limit of coverage, or increases your out-of-pocket spending above what it was on March 23, 2010, then the plan will lose its grandfathered status.

Some provisions of the ACA apply to all plans, including grandfathered plans. These provisions include:

- No lifetime limits on the dollar cost of coverage provided by the plan
- Coverage can't be rescinded or cancelled due to illness or medical condition
- Coverage must be extended to adult dependents up to age 26

The ACA doesn't apply to all types of insurance. For example, the law doesn't apply to property and casualty insurance such as automobile insurance, homeowners insurance, and umbrella liability coverage. The ACA also doesn't affect life, accident, disability, and workers' compensation insurance. Nor does the law apply to long-term care insurance, nursing home insurance, and home health-care plans, as long as they're sold as stand-alone plans and are not part of a health plan. Medicare supplement insurance (Medigap) is generally not covered by the ACA if it's sold as a separate plan and not as part of a health insurance policy.

I just bought a vacation home. Do I need to purchase a specific type of insurance?

Insuring a vacation home is different from insuring a primary residence. As a result, you'll want to purchase insurance that is specifically geared to provide coverage for this type of property.

When insuring a vacation home, the type and cost of coverage will vary, depending upon the insurance company and the state in which your vacation home is located.

Most insurers offer at least some type of insurance that is specifically designed for second/vacation homes. Coverage under these types of policies can range from standard coverage that protects against certain named perils, to more comprehensive coverage that protects against all perils unless specifically excluded in a policy.

Keep in mind that, depending on what is covered under the policy, you may need to obtain additional protection (e.g., property or liability coverage) through either an endorsement or separate policy. In addition, if your vacation home is located in an area that is susceptible to flood damage--which is not covered under a standard vacation home policy--you'll want to look into obtaining separate coverage for that peril as well.

Due to some of the unique circumstances surrounding vacation homes (e.g., high-risk location, not being occupied for long periods of time), vacation home insurance premiums are usually much higher than those for a primary residence. However, you may be able to save money by insuring your vacation home with the same company that provides coverage for your primary residence (some insurers may require this). In addition, you may be eligible for other discounts, such as those offered for newly built homes, nonsmokers, and homes that have a security system installed. Policy discounts will vary by state and insurer.

Because of the vast array of vacation home insurance products on the market, you'll want to be sure to shop around for the best coverage and rates. You may also want to contact the state department of insurance where your vacation home is located for additional information on the coverage and rate options that may be available.