



Buckingham
Financial
Group, Inc.

September 2011 Financial Planning Strategies:

As financial planners, we often work with our Investment Department in considering alternative options for our clients to ensure their assets are being invested at the best location. In our current interest rate environment, it can be tempting to turn to locations other than high-quality bonds and CD's for higher yielding investments. When considering these alternatives, be aware of the risks and implications of the investment you are making. Many banks are encouraging alternatives such as structured products, high yield bond funds, and annuities to clients dissatisfied with current yields. This trend has led many agencies such as FINRA and the SEC to release warnings reminding consumers of the risks associated with these products.

The category of "structured products" encompasses a wide range of investments. The simplest definition is an unsecured product whose yield is based on another investment. The "other investment" can include other securities, baskets of indexes, options, commodities, or debt issues. This could leave investors still exposed to stock market volatility for their investment return. Even those offering reassuring names such as "principal protection" and "capital guarantee" are not risk-free and often incur the risk the issuer could declare bankruptcy. Additionally, the "protection" is usually conditional even if the issuer does not declare bankruptcy. Internal costs associated with these types of products tend to be relatively high and erode true return as well.

High yield bond funds can be tempting in this low-interest rate environment. These types of funds offer higher yield due to the lower credit quality of their holdings, which translates to a higher risk of default. With high yield mutual funds and ETFs it is often difficult to determine the actual underlying holdings to assess the actual risk being incurred for a higher yield. Investors' recent "flight to quality" has resulted in negative price movement, increasing volatility in an asset category often intended to bring stability to a portfolio.

Investors have also turned to annuities for a sense of security during the recent increased stock market volatility. It is important to review the terms closely when evaluating these products. Keep the liquidity constraints in mind when making your decision. Contracts often include surrender penalties for time periods ranging between 3 and 16 years. They also frequently have high embedded fees while paying out commissions to agents as high as 12%. Although the downside protection can be attractive, performance caps often limit upside potential. Additionally, any growth in the contract is taxed at ordinary income tax rates, higher than more attractive capital gains rates taxpayers incur on long-term capital gains and qualified dividends. Those under the age of 59 ½ incur an additional 10% tax penalty on withdrawals.

As stressed in the past, it has been our policy to maintain 1-2 years of projected future liquidity needs for our clients in cash as well as an additional 3-5 years in fixed income. Keeping our office informed of your cash needs will allow us to take full advantage of your portfolio's yield potential while maintaining liquidity for your individual needs. We have also been shifting to a high-quality dividend yield focus for the equity portion of our managed portfolios. Please contact our office if you are considering a new location for your fixed income exposure and keep in mind products that appear too attractive often are.

Sincerely,

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Vice President of Financial Planning

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