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MENTOR
CAPITAL

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Mentor Monthly Missive

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- Do you really know your risk tolerance?
- Roth IRA contributions – what you need to know
- Our summer intern has returned to school

Investing disconnect

So, how much risk are you comfortable with?

It's a question we ask all our clients. But how they answer is only the preface to the story, because most people either:

A.) Don't really know how much risk they're comfortable with; or
B.) Say they have a certain level of risk tolerance, then do something different with their money.

Investment risk is almost as important as investment return, but it's an issue that individuals spend far too little time assessing. (In fact, individuals spend far too little time assessing investment return, too, but that's an issue for another day.) Having access to prudent advice about investment risk is one of the values of working with a professional adviser. As part of our thorough evaluation of a client's tolerance for risk and time constraints, we can show the expected worst and best returns of any given portfolio. We can rein in clients who are taking too much risk and nudge other clients toward more growth-oriented investments when appropriate.

We measure risk by assessing an investment portfolio's volatility. A factor called standard deviation tells us how much a portfolio's return over time deviates from its mean. The higher the standard deviation, the higher the volatility and the higher the risk. Investment classes that have high historical returns tend to have high volatility.

What's wrong with volatility? A certain amount of it can be expected in any portfolio. But left out of control, it's an enemy of investment success. Long-term investors benefit when they limit volatility. Consider two portfolios, one with a high standard deviation of returns, the other with a low standard deviation. Each produces an average return of 8 percent per year over five years. After five years, it's possible that the portfolio with high volatility will be worth less than the one with low volatility. Although the portfolio with lower volatility can lose money too, it's a lot less likely.

That doesn't mean that investors should eliminate volatile investments from their holdings. On the contrary, volatile investments are essential in providing the growth that investors need to keep up with and beat inflation. The key is balancing a portfolio among asset classes whose returns are not highly correlated –so that while one asset class declines, others may rise. That evens out returns and reduces risk. The goal is to generate superior returns while taking less risk. We have been very successful accomplishing this for our clients.

In these days of turbulent markets, we're hearing a lot of: "I want to get a good return but I don't want to take any risk." Forget about it! If someone is promising high returns without risk, run for the hills.

Sooner is usually better than later for IRA contributions

Investing in a Roth IRA is one of the most powerful ways to save for retirement. Although you invest in a Roth IRA with after-tax dollars, the IRS allows you to withdraw that money plus any earnings and growth tax-free when you reach age 59 ½. Over time that tax-free growth can create a sizable nest egg, especially if you maximize your contributions each year.

It makes sense generally to make Roth IRA contributions for the current tax year as soon after Jan. 1 as possible. This gives you the greatest tax benefit possible and, assuming your investment returns are good, the greatest amount of time to grow your money. Although you can make your Roth IRA contribution on Jan. 1, make sure to view new guidelines on the IRS website first. The IRS normally posts information about contribution guidelines long before the new year.

If you know there is a chance that you won't qualify to make a Roth contribution based on income (2011 adjusted gross income of $107,000-$122,000 single, $169,000-$179,000 married filing jointly), it's best to wait until you have all your income information at hand. Even if you already know what your salary will be, other sources of income, like interest and dividends, can be less certain. If you believe you will be close to the income limit for Roth eligibility, wait until all your income figures are in before making your annual contribution. If you contribute to your Roth at the beginning of the year and then find you don't qualify due to income, you will need to withdraw that contribution, plus any earnings on that money, to avoid a tax penalty.

While making your Roth IRA contribution as soon as possible has a number of benefits, including giving your money extra time to grow tax-free, don't neglect your other investment goals or stretch yourself too thin to make a contribution. If you need to build up an emergency fund, for instance, you might want to focus on that and make your Roth IRA contribution only after you have saved sufficient short-term money in that fund.

Call the advisers at Mentor Capital to discuss maximizing your 2011 Roth IRA contribution before April, or setting up a savings plan starting in January.

Mentor had an intern

Michael Howlett, a Purdue University financial counseling and planning major, served as Mentor Capital's intern over the summer. Michael applied impressive analytical skills to his work.

Having an intern on staff for the summer was an educational experience for everyone. We would like to thank Michael for his service and wish him the best of luck as he completes his senior year at Purdue.

If you know of anyone who is interested in the field of financial planning as a career and is interested in an internship, please have them contact John Davis at our office.

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