Mentor Monthly Missive

Financial Planning News

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Know Your Risks

Risk is the chance that you won't be able to meet your financial goals or that you'll have to recalibrate your goals because your investment comes up short. Investors face many forms of risk depending on the kinds of investments they choose.

Market, industry, and company risk: General market fluctuations can affect securities trading in that market. Stocks tend to fluctuate more than other asset classes, and may pose more risk over short periods of time. Investors looking to time the market run the risk of jumping into the market during the worst times, and out of the market during the best times. Security values can also decline from negative developments within an industry or company.

Credit and interest-rate risk: Credit risk is the possibility of a bond issuer not being able to make timely payments of principal and interest. The value of a bond may also decrease due to financial difficulties or the declining creditworthiness of the issuer. Interest-rate risk relates to how bonds tend to rise in value when interest rates fall, and to fall in value when interest rates rise. Typically, bonds with longer maturity exhibit greater price volatility.

Inflation risk: Inflation is a rise in the general level of prices for goods and services. If investments do not keep up with inflation, an investor’s money will purchase less in the future than it did in the past.

Liquidity risk: Some investments may not be widely held by the public and may be difficult to sell if prices drop dramatically.

Currency risk: Returns achieved by local investors are often different from returns achieved by U.S. investors because of foreign exchange rates, even though both are investing in the same security.

Meet our Wealth Managers

Mentor Capital Management Inc. was founded in response to the belief that a consumer’s best interests are served when his or her financial planner is Fee Only. Advisors of Mentor Capital strive to provide objective, prudent and thoughtful advice to clients based on their personal goals and objectives.

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Don't Let Small Numbers Distract You From the Big Picture

Even though it's all about dollars and cents, the financial industry runs on percentages; dollar signs are few and far between. The use of percentages is an understandable, and helpful, convention when communicating financial information. After all, a headline saying “Company A’s Net Jumps by 16%" is more helpful than one that reads "Company A’s Net Jumps to $1.02 billion.” Providing percentages rather than dollars also allows investors to compare apples to apples: You can readily discern that an investment that has gained 8% during the past 10 years has been a better bet than one that has gained half as much.

Yet dealing in percentages, especially relatively small ones like inflation rates, expense ratios, and long-term annualized returns, can also distract from important information that factors into your financial plan. Those small and innocuous-looking percentage figures, when translated into dollar terms and compounded over many years, can make a huge difference between success and failure.

How Small Numbers Can Make Your Investment Plan…: Say, for example, that you stick with the 3% 401(k) contribution rate that your company uses as the default, contributing $1,500 of your $50,000 salary for 40 years and earning 5% on your money. You'd have about $190,000 at the end of the period; not too shabby. But bumping up your percentage contribution just 2 percentage points (to 5%) would have a meaningful impact on your bottom line, increasing your nest egg to nearly $320,000.

In a similar vein, you might choose to keep your child's college fund in cash. Assuming cash yields stay as low as they are now (which is, admittedly, a big assumption), a $50,000 investment that earns just 1% for the next 10 years will amount to just $55,000 at the end of the period. But by maintaining a 60% stock/40% bond portfolio and assuming a not unreasonable 4% return, you'd be able to grow your $50,000 investment to $74,000. Neither return rate will allow you to keep up with college inflation, sadly, but at least it's better than putting the money under your mattress. However, keep in mind that the 60/40 portfolio entails market risk.

…or Break It: Just as seemingly small percentage changes (either in contributions or return rates) can provide investors with an enormous helping hand, they can also work in reverse, and this is where many investors run into trouble. They blow off small percentage amounts like expense ratios and inflation rates when making investment decisions.

For example, let’s say an index fund has a fairly low expense ratio of just 0.63%. It's certainly cheaper than most actively managed funds, and it doesn't appear to be that much more expensive than most other S&P 500 index funds, some of which charge as little as 0.06%. If you opted for the expensive fund rather than a cheaper alternative and you held it for a long time, you'd be shortchanging yourself. Assuming a 10% annualized return and a $100,000 initial investment, you'd be leaving a lot of money on the table during a 25-year period by opting for the more expensive fund: nearly $170,000, to be exact. All because your fund charged 0.57% per year more than a comparable option.

Inflation is another factor that investors tend to underestimate, because the average historical inflation rate of roughly 3% looks pretty benign when viewed without any context. Should the fact that bananas that are $0.59 a pound today but might be $0.79 a pound 10 years from now cause a major rethinking of your financial plan? Yes, actually. When you extrapolate inflation across all of the items in your shopping cart and compound it over many years, it can have a hugely corrosive effect on the purchasing power of your savings, meaning you need to save a lot more than you thought you did.

Monthly Market Commentary

The markets went through a lot of turmoil in June, as stronger economic reports were offset by fears of the Fed tapering its bond-buying programs. Home prices, employment reports, and auto sales were all better than expected, unlike trade and GDP data. Together with falling business investment and government employment, that leaves the consumer and housing as the two main engines of economic growth.

Federal Reserve news: Fed statements and a news conference suggested that the economy was stronger than it previously thought, and, as a direct result, bond purchases could be cut back as early as this year and eliminated as early as the middle of 2014, if the economy tracks Fed forecasts and the unemployment rate is around 7%. This, combined with a solid employment report, caused a significant increase in mortgage rates the Friday after Independence Day. For example, 30-year fixed rates climbed into 4.75% territory, with some lenders at 4.875% (according to Mortgage News Daily).

GDP: The third and final revision of first-quarter GDP growth revealed a lower-than-expected 1.8%. The Fed's outlook for the economy has been remarkably bullish, with forecasted GDP growth for 2013 of 2.3%–2.5%—a little too high, in light of the weak first quarter.

Employment: The June employment report showed growth of 195,000 jobs, similar to the previous three months when all revisions are considered. This number was better than the 12-month average and the consensus estimate of about 160,000 jobs. Year-over-year three-month average data has remained virtually stagnant in the 1.9%–2.1% range for almost a year (2.0% for June). However, the mix of jobs added wasn't great. The leading categories were leisure/entertainment and retail; manufacturing and government were down. In other words, jobs considered to be higher-quality and better-paying were down, while lower-paying jobs showed most of the growth. Also, health care and education, normally strong sectors, showed about half of their normal growth. The unemployment rate remained unchanged at 7.6%.

Housing: Reported CoreLogic data for May showed that prices increased 12.2% compared with May a year ago, the biggest percentage increase since 2006. This also marks the 15th consecutive monthly increase in prices. These price increases (along with falling gasoline prices) may be behind the jumps in consumer confidence and consumer spending that exceeds income gains. Even higher mortgage rates are not likely to quell recent price movement by much. In fact, attempts to beat the mortgage-rate increases may be driving some of the real estate activity.

Consumer spending: The personal consumption report showed that spending was locked in its same tight range, with income growth improving but trailing way behind spending growth. Regrettably, income growth is likely to keep a lid on consumption growth, which in turn will keep GDP in check.

Trade: The U.S. trade deficit jumped from $40.1 billion in April to $45.0 billion in May. Exports shrunk by about 0.3%, as expected, but imports grew by 1.9%, indicating that the U.S. economy is stronger and improving compared with most of its trading partners. Global Purchasing Managers Index (PMI) data for the manufacturing sector was strongest for the U.S., with Europe second and China the weakest. This is probably not great news for those expecting China and other emerging markets to drive the world economy.

Quarter-end insights: Overall, it still looks like the economy is on the road to continued (if moderate) 2% growth, inflation is likely to remain below 2%, and long-term interest and mortgage rates are destined to go higher. When, not if, is the correct question to ask relative to interest rates. A tougher Fed and a tightening U.S. federal fiscal policy may keep a lid on short-term economic activity, but long-term fundamentals look strong.

Have a question?

Do you have a question or want more information about any of the issues discussed in Mentor's Monthly Missive? Are you concerned about whether the financial decisions you're making are right for you? Would you like a second opinion about an action you're thinking of taking or something recommended to you by a stockbroker or insurance agent?

We offer a no-obligation initial consultation that might help. Please phone to set an appointment with one of our advisors. It could be the most financially worthwhile 45 minutes you've ever spent!

Focus on small business
Aroma Home Cooked Meals

By John S. Davis

Part of an occasional series of articles profiling small businesses founded by clients of Mentor Capital.

Fond memories of the love and care her mother put into cooking for her Italian-American family set Lynne Kern on a path toward founding her own small business.

About 18 months ago Lynne (formerly Segreti), with three young children at home and an urge to get back to work, started Aroma Home Cooked Meals. She works as a personal chef for time-pressed families who appreciate the quality and nutrition of meals made from scratch, in the convenience of their own homes.

“I've talked with so many other moms who are stay-at-home, who want to be working but want the freedom and flexibility to be there for their kids. I thought: I'm always in the kitchen, I love to bake and I love to cook, I wish I could think of something to do with cooking. One of my friends said, 'You should be a personal chef!' It sounded fascinating to me.”

Lynne researched the field and found the Culinary Business Academy, which shows people how to transform their love of cooking into a business. She talked it over with her husband, Charlie, and signed up for a week-long course in Atlanta, Ga.

The curriculum focused less on developing culinary skills (it's assumed students already know how to cook) than on the business side. Topics included types of business entities, food safety, food handling, marketing and advertising. When she got home she was charged up and ready to get started.

“I plan a menu for the client,” Lynne said. “A menu consists of five entrees and two to four sides, four portions each, and is approved in advance. The day before, I buy everything I need. On cooking day I show up at their house, bring in the groceries and my own utensils, set up in the kitchen, create the five meals and sides, package, label, leave heating instructions, clean up and leave.”

Families who hire Lynne may have something special going on (guests coming in, a wedding to plan) or may be generally busy and need her services on a continuing basis. “I create custom menus for the family,” Lynne said. “They might say, 'My favorite thing is my grandma's spaghetti sauce, but I never have time to make it.' I say, “Well give me the recipe and I'll make it for you.”

When the three children, Charlie, Emma and Ethan, return to school in the fall, Lynne will have more time to devote to cooking. She's thinking about broadening Aroma's offerings to include a take-out service – still with the same home-cooked quality but for people who might not want to commit to five meals.

Lynne says her love of cooking came from her mom, Romilda (“Aroma” is a play on Romilda's nickname, “Ro”), a first-generation immigrant from Italy. “She was a phenomenal cook. She always said a love of cooking was born into her.

“I grew up in a family where food was an expression of love. I'm trying to express that in my family, and for my clients, too.”

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