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Wealth by Numbers

America has long been known as the land of opportunity and the promise of a better life to people from all over the world. Recently, however, many Americans feel robbed of opportunities and better lives by the top 1% of their own. This growing income inequality has led to problems and civil unrest, as demonstrated by the "Occupy Wall Street" movement.

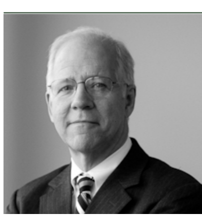
The table presents household income distribution data from the U.S. Census Bureau. Given that the poverty threshold for a two-member household is around $14,000, it appears that approximately 13.7% of Americans are poor. At the other end of the income spectrum, 3.9% are rich, with household incomes higher than $200,000.

Household Income Distribution in 2010

Under $5,000	3.5%
$5,000 to $9,999	4.3%
$10,000 to $14,999	5.9%
$15,000 to $19,999	6.1%
$20,000 to $29,999	11.5%
$30,000 to $39,999	10.2%
$40,000 to $49,999	8.9%
$50,000 to $74,999	17.7%
$75,000 to $99,999	11.4%
$100,000 to $149,999	12.1%
$150,000 to $199,999	4.5%
$200,000 and over	3.9%

Source: U.S. Census Bureau, Current Population Survey, 2011 Annual Social and Economic Supplement. Poverty threshold also from the U.S. Census Bureau.

Advisor Corner



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Ron was a major force in building the investment firm and now manages more than $100 million of retirement assets for his clients. He specializes in the unique rules, investment management, distribution, and estate planning considerations for IRAs and other assets for retirement income planning. A Certified Financial Planner, Ron has served on the boards of the International Association for Financial Planning and the Institute of Certified Financial Planners. He has been a Chartered Retirement Planning Counselor, and was named to Ed Slott's Elite IRA Advisor Group®, a national network of IRA specialists. He is a member of the Connecticut Chapter of the Financial Planning Association and the Estate and Business Planning Council of Hartford. Ron received a BA in psychology from the University of Connecticut and an M.Ed. from Boston College.

Dividends and Taxes: Dos and Don'ts

Dividend-paying stocks have enjoyed a renaissance during the past several years. Despite the high-profile blowups of many financial stocks, dividend payers generally outperformed non-dividend payers during the financial crisis. Further burnishing dividend payers' appeal is the currently benign tax treatment of dividends: Those in the 25% tax bracket and above pay taxes at a 15% rate on qualified dividends, while those in the 10% and 15% tax brackets pay no taxes at all on such dividends. That's a big attraction, but investors need to do their research before embracing dividend payers for their taxable accounts. Here are some dos and don'ts.

Do Understand the Difference between Qualified and Nonqualified Dividends: You often hear that the dividend tax rate is either 15% or 0%, depending on your tax bracket. But if it's not the right kind of dividend, you could actually owe ordinary income tax on your dividends (as much as 35%, depending on your tax bracket). That's because the Internal Revenue Service separates dividends into qualified and nonqualified categories. One big type of nonqualified dividends are those that REITs kick off; while their yields might be lush relative to the income you receive from other stocks, you'll owe ordinary income tax on that income. Owing to that tax treatment, investors in the typical real estate fund have paid a tax-cost ratio of 1.9% per year during the past decade, far higher than any other equity category. (Foreign-stock dividends may not necessarily qualify for the low tax treatment, either.)

Do Watch Out for Income-Focused Funds: If you buy and hold individual stocks, you can do your homework and downplay nonqualified dividend payers. But if you own stock mutual funds focused on dividend payers, such as those with "Equity Income" or "Dividend" in their names, you won't have the same opportunity to pick and choose. Unless a dividend-focused fund is explicitly tax managed, the manager's only goal is to maximize income and total return. That means it's highly possible that the fund will hold companies that kick off nonqualified dividends, and such a fund may even own some bonds, to boot. So before you park an equity-income fund in your taxable account, first spend some time looking under the hood.

Don't Assume It Will Stay This Way: We've gotten spoiled with the low tax rate on dividends. But the current policy has only been around since 2003, and it's set to revert to pre-2003 levels in 2013. That means that dividend income will again be taxed at investors' ordinary income tax rates. If that happens, you might decide you want to get those dividend payers into a tax-sheltered wrapper like an IRA or 401(k) post-haste. After all, it's better to let those dividends compound rather than letting the IRS take a big cut right off the top.

Don't Hold Very High Dividend Payers in Taxable Accounts: Even if a company's or fund's dividends are qualified all the way, companies and funds that kick off very high levels of income are still usually best left in your tax-sheltered accounts. That's because you're going to receive that high income stream whether you need the money or not, and in turn, you'll owe taxes on that dividend for the year in which you received it. By holding non-dividend payers in your taxable accounts, by contrast, you won't be on the hook for taxes unless you take action and sell shares. Of course, you might decide that dividend payers' fundamental attractions supersede the tax considerations, but all else equal, dividend payers are less tax-efficient than non-dividend payers, even in the current low-tax environment.

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Three-Step Checklist for Turbulent Markets

When the stock market experiences extreme volatility, an investor's best bet is to focus his/her energy on factors that can be controlled. Unfortunately, many investors panic-sell and lose their money. When the market rebounds, many investors are left wondering if it's the right time to get back in.

Your best bet during turbulent markets is an investment of time. You want to invest in time to see where you stand now, and, if you determine changes are in order, thoroughly research your options. Here is a three-step checklist to manage your investments during turbulent markets.

Step 1: Check adequacy of cash reserves.

The best way to manage your portfolio during volatile markets is to make sure you have adequate cash on hand to cover your near-term needs. This way, your long-term stock investments can ride out the market ups and downs, but you can take comfort in knowing that they won't affect your ability to fund short-term cash needs.

Step 2: Check your long-term positioning.

Once you've done the liquidity check, the next step is to check the asset allocation of your long-term assets. Market sell-offs can be alarming for retirees and people getting close to retirement simply because they typically have more money invested, compared with their younger counterparts. Checking your long-term positioning helps you put things into perspective so that you can make sound investment decisions for your future.

Step 3: Initiate defensive hedges with care.

During turbulent markets, investors may initiate defensive strategies like selling out of stocks and buying into the so-called "safe" investments like gold. Gold and treasuries can serve as a legitimate defensive role in a portfolio; however, these investments may have already enjoyed a sizable run-up. If you're moving into either, do so with caution, and only after you've checked your existing exposure to those asset classes.

Treasuries are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest. Debt securities are subject to credit/default risk and interest-rate risk (they have varying levels of sensitivity to changes in interest rates). In general, the price of a debt security tends to fall when interest rates rise and rise when interest rates fall. Securities with longer maturities and mortgage securities can be more sensitive to interest rate changes.

Gold/commodity investments will be subject to the risks of investing in physical commodities, including regulatory, economic and political developments, weather events, natural disasters, and market disruptions. Exposure to the commodities markets may subject the investment to greater volatility than investments in more traditional securities, such as stocks and bonds.

Monthly Market Commentary

April employment numbers were low, but auto sales were near record levels, housing data continued to improve, and retail sales are moving ahead at a slow but steady pace.

GDP: First-quarter real GDP growth slowed down to 2.2% from 3.0% in the fourth quarter last year. The number would have been much higher if government-defense and business-construction spending hadn't fallen significantly. In perspective, the drop in GDP growth is not such bad news given all the offsetting factors, and Morningstar economists estimate that we seem to be on track for 2.0%–2.5% growth in 2012 and 2013.

Employment: April's employment report was definitely bad news, with only 115,000 jobs added, a disappointingly low number when compared with the recovery high of 275,000 we saw back in January. If interpreted as a trend instead of as a number, this could mean more bad months ahead. However, weather, the auto industry, and seasonal factors can affect month-to-month employment data, making the bad news seem worse than it actually is. Examining the data year-over-year can strip out seasonality and eliminate month-to-month anomalies such as strikes or weather-related fluctuations. Year-over-year job growth has been steadily trending upward, from 0.8% in May 2011 to 1.6% in February 2012, then slightly down to 1.4% in April 2012.

Morningstar economists believe that, even though we shouldn't expect high numbers like in January anymore, employment growth will continue and will vary greatly by sector. So far, the manufacturing sector has been performing above average, while government has been experiencing a sharp decline. When comparing current job growth numbers with the ones observed during past recoveries, it becomes apparent that things are a little worse this time around (1.4% employment growth on an annualized basis versus a 1.9% average for the recoveries from the 1982, 1990, and 2001 recessions). Government is the sector with the worst shortfall.

Auto sales: In April, the auto industry experienced its second-best month of the recovery. Sales were not quite as strong as in February, but they were better than in any other month of the recovery since 2009. Strength in the auto sector was a main driver in the recovery, contributing 1.1% of the 2.2% increase in GDP during the first quarter of 2012.

Consumer spending: Inflation-adjusted consumer spending only increased by 0.1% in March, following 0.3% and 0.5% increases in January and February, respectively. However, warm weather and the reduced use of utilities may have played a role in keeping the March number low. On the other hand, year-over-year employment data suggests wage income is up only modestly (maybe 0.5% to 1.0% after inflation), while consumption is growing faster (about 2% after inflation).

Housing: Improvement in this sector has been steady and dramatic, as demonstrated by the Case Shiller 20 City Index, the Federal Housing Finance Administration Report, and pending home sales numbers. With mortgage rates back down, affordability back at record levels, and inventories in several markets near historic lows, the prognosis for further improvement is excellent.

When economies diverge: Can the U.S. economy keep improving if the rest of the world slows down? The Eurozone economy declined by 0.3% in the fourth quarter of 2011 and now appears poised to fall even faster in the first quarter. Inflation in Europe also seems to be on the rise, driven primarily by oil prices. As Europe is China's largest trade partner, a European slowdown may not bode well for China's economy. The U.S. derives less of its GDP from exports and a weakening in this area has so far been offset by a powerful auto industry, but the consensus is for the trade deficit to increase in the months ahead.

Reducing the IRS' Bite with Tax-Efficient Funds

Handing over a portion of your investment earnings to the IRS is never pleasant. Fortunately, a specific category of mutual funds, called tax-efficient funds, might help you keep the amount you send to Uncle Sam to a minimum. Here's how tax-efficient funds work. Mutual funds must pay you almost all of the money they make from interest, dividends, or capital gains (money made from selling stock) in a year. That's called a taxable distribution (since you must pay taxes on that money). Tax-efficient funds keep their taxable distributions as small as possible, thus lowering the amount you have to pay in taxes. Tax-efficient funds can use several strategies to keep distributions low. They avoid stocks that pay dividends. They don't sell their stocks very often. When they do sell stocks, they might also try to sell some that have lost money to offset those that have made money. They could also hold stocks for more than one year before selling, since the profits are taxed at a lower long-term capital gains rate than short-term transactions. These methods, as well as some others, keep your tax bill lower.

While tax-efficient funds seem extremely attractive, there are a few drawbacks to note. First, there are only a handful of these funds available from which to choose (relative to other categories). Second, of the funds that do exist, few have long-term investment records that you can analyze. Finally, most tax-efficient funds stick mainly with large-company stocks and tax-free (municipal) bonds. That means you might have to look at non-tax-efficient funds to get exposure to other types of investments in an effort to build a diversified portfolio.

Diversification does not eliminate the risk of experiencing investment losses. Past performance is no guarantee of future results.

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