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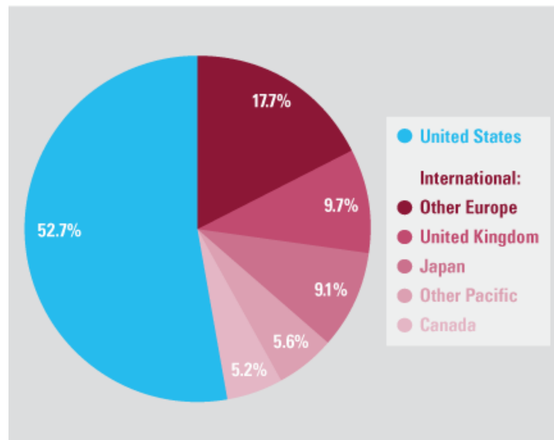
A World of Opportunity

As trade barriers continue to break down, the world economy has become a small neighborhood. Should investors seek to participate in this wave of globalization, or are they getting all they need here at home?

Historically, foreign investments have acted in a significantly different way from domestic investments. When the U.S. market slumped, various opportunities abroad have prospered. An American investor who put some money into foreign markets may have reduced risk while still attaining attractive returns. With the spread of globalization, this benefit decreases as companies across the globe are acting more like each other. However, as the image illustrates, an investor who doesn't take advantage of options outside of the United States is missing out on roughly half of the investable developed stock market opportunities in the world.

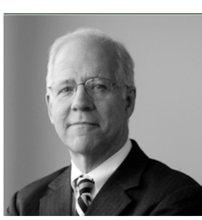
World Stock Market Capitalization
Year-End 2011



International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards.

Source: World Market Capitalization by Country is from the Morgan Stanley Capital International Blue Book℠. The data is expressed in U.S. dollars.

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.

How to Read a Prospectus

Mutual funds are required by law to provide significant (or “material”) information to investors in the form of a prospectus. A prospectus is a legal document describing the history, organization, management, operations, performance, and costs of a mutual fund.

Since legal jargon can make prospectuses difficult to understand, here is a list of important points an investor should keep in mind while reading a prospectus. It is strongly recommended that potential investors read and understand the prospectus before investing.

1. The document—how to obtain one: Mutual fund companies will mail you a prospectus for free. You can also contact the fund company by phone. Moreover, most companies now provide prospectuses on their websites—look for a section titled “Fund Documents” or “Literature.”

2. Investment objective/goals: This will probably be the first section you see right after the title. It describes, in one sentence, what the fund does and what it wants to achieve. For example, “The fund seeks long-term capital appreciation,” or “The fund’s goal is to provide attractive total returns on an after-tax basis.” Understand, however, there is absolutely no guarantee that the fund will meet its objective.

3. Investment strategy: The strategy section will tell you what the fund invests in and how it invests in order to achieve its objective. Statements like: “The fund invests at least 80% of assets in equities,” “The fund invests a minimum of 50% of assets in bonds” should give you an idea of where the fund places your money. Again, keep in mind that “a minimum of 50%” can mean 50% as well as 90%.

4. Risks: All mutual funds carry a certain amount of risk and you may lose money by investing. This section will describe in detail what kind of risks the fund will expose you to: market risk, large/mid/small company risk, interest-rate risk, credit risk, derivatives risk, liquidity risk, the list is endless. In summary, be prepared for all types of risk.

5. Historical performance: Here you will usually see a chart depicting the fund’s past returns. The representation of performance in these graphs can vary greatly (monthly, annually, since inception), and it is important to know how a fund has performed in the past, but use these numbers wisely. It is even more important to remember that past performance does not guarantee future results.

6. Fees and expenses: These are what the fund charges you to manage your money. Funds may or may not have front or deferred sales charges (commonly known as loads) and redemption fees. However, most funds have operating expenses, as well as management and administrative fees. Consider that no matter if your investment grows or declines, you will still have to pay these fees.

7. Share classes: A mutual fund might offer multiple share classes: different purchase options (into the same fund) with different investment minimums and fee structures. Common types of share classes can be designated by letters (A, B, C), or classified as R (Retail) or I (Institutional). The share class you choose to invest in will determine what fees you will pay.

In addition, the prospectus will tell you the name of the fund manager(s)—they are the ones who make all the important decisions about when and how to invest the fund’s assets. Some funds have a minimum investment requirement ($5,000, $10,000, and so on), which is something you also have to take into consideration. Other important details include how to open an account with the fund, how to buy and sell shares and how to contact someone for help, if needed.

The investment return and principal value of mutual funds will fluctuate and shares, when sold, may be worth more or less than their original cost. Investing in any mutual fund always involves risk of loss.

Monthly Market Commentary

In early September, the European Central Bank took steps to ease monetary policy and China introduced new infrastructure stimulus measures, as economic news in both regions continued to show signs of slowing. Both these actions have led many to expect the Federal Reserve to do the same with some form of quantitative easing, following poor manufacturing data and a softer-than-expected employment report in August. Morningstar economists believe that lowering rates further may do little to help the economy. Corporations are already awash with cash, while consumers are still finding it difficult to get loans at these low rates. Furthermore, commodities are on the rise again with gold setting a five-month high, and oil prices moving higher.

GDP: Second quarter real GDP was revised upward to 1.7% from 1.5%, which typically means that things were stronger in the last month of the quarter than originally anticipated. Overall, consumer spending was revised up, exports also improved (despite turmoil in Europe), and government spending shrank less than previously estimated. Although the quarter-to-quarter data over the last 2 years continued to be extremely volatile (ranging from 0.1% to 4.1%), the year-over-year data shows GDP growing at a slow but consistent pace (1.6% to 2.8%).

Employment: August saw a disappointing 96,000 jobs being added, down from 163,000 jobs in July. Morningstar economists have highlighted a few inconsistencies over this data: at a time when new and existing home sales were up, the report indicated construction employment did not grow at all. Also, the employment at building material and garden centers was reported to have fallen by almost 10,000 people, which Morningstar economists felt was unlikely, given the better construction market. An unusually large number of employees (380,000) left the workforce in August, which caused the unemployment rate to drop to 8.1% from 8.3%. Morningstar economists believe that this was mainly because of students returning to school from their summer jobs. While seasonal adjustment factors are typically supposed to capture this change, many schools and universities are shifting the start of their school year earlier in August. The high dropout rate could also have come from more employees quitting, or ceasing to look for jobs, to go back to school due to poor economic prospects.

Housing: The housing recovery has continued long enough that both leading indicators (pending home sales) and lagging indicators (Case-Shiller Home Price Index) were moving in the same positive direction. July pending home sales jumped 2.4% compared with June and 12.4% compared with July 2011. It is important to note that pending sales have been higher than closed sales all year, as the failure of homes to appraise at the agreed-upon price and tight lending conditions are holding back closings. In June, the Case -Shiller 20-city index increased 0.5% on a year-over-year basis, which marked the first year-over-year increase in two years. Although the index just broke into positive territory, the improving trend has been in place for six consecutive months. Month-to-month data showed a 2.3% increase, and all 20 cities in the index showed home price improvement.

Manufacturing: U.S. manufacturing in August continued to slow, as new orders fell and inventory levels increased. However, auto sales accelerated to 14.52 million units in August, the best performance since the cash-for-clunkers promotion in 2009. Year-over-year sales growth of over 20% was inflated by a strong recovery from Japanese brands that suffered supply shortages last August because of the tsunami. Pent-up demand and low cost has also resulted in the Detroit Big Three reporting year-over-year gains of more than 10%, mainly from pickup truck sales. Outside the U.S., manufacturing in Europe continued to weaken, including Germany, because of softer orders from China. China's manufacturing sector also underperformed, reporting its lowest level since 2009.

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.

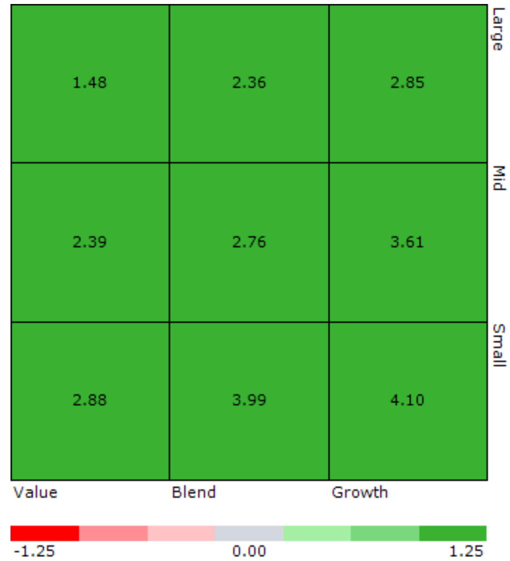
Do Understand the Difference between Qualified and Nonqualified Dividends: You often hear that the dividend tax rate is either 15% or 0%, depending on your tax bracket. But if it's not the right kind of dividend, you could actually owe ordinary income tax on your dividends (as much as 35%, depending 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.

Monthly Market Barometer



1 Month, ending August 31, 2012. The U.S. Market returned 2.47% (YTD 13.31%).

The Morningstar Market Barometer provides a visualization of the performance of various stock market indexes. The color scale (red for losses and green for gains) allows you to assess which areas of the market performed strongly and which areas showed weakness for the time period analyzed. The nine-square grid represents stocks classified by size (vertical axis) and style (horizontal axis). There are three investment styles for each size category: small, mid and large. Two of the three style categories are “value” and “growth” while the central column represents the core style (neither value nor growth characteristics dominate). Large-caps account for the top 70% of the capitalization; mid-caps represent the next 20%; and small-caps represent the balance.

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