ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

June 6, 2014

The Investment Tipping Point

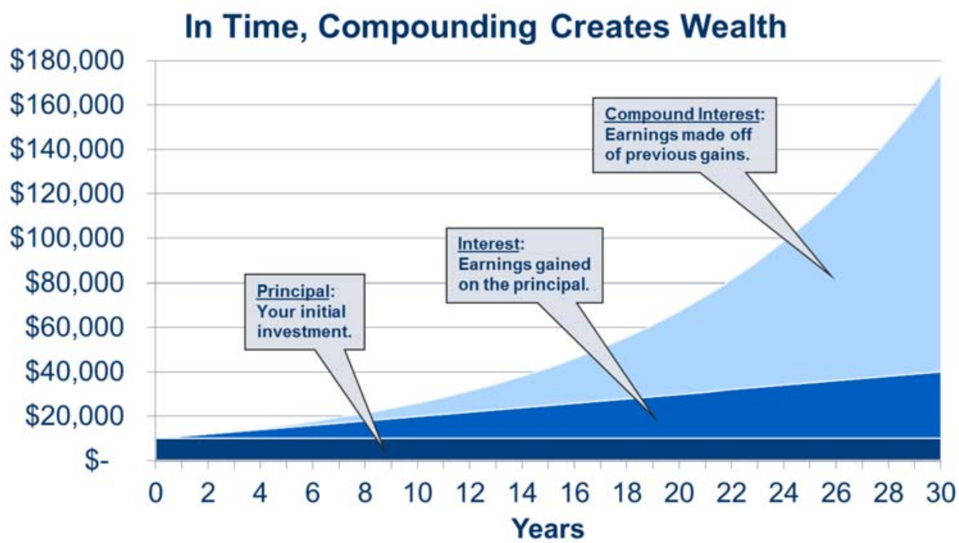
One of our favorite sayings at Adviser Investments is that time *in* the market—not market timing—is critical to investment success. We believe the best way for investors to reach their goals is to start putting money to work as early as possible to capitalize on the power of compound interest.

It takes patience and discipline to get an investment portfolio started. Discipline requires sticking with a regular contribution schedule *and* leaving those contributions invested in the market to build on themselves over time. Patience is necessary because, early on, the amount you invest far outweighs the amount earned on your initial contributions. But as you'll see in our examples below, money invested over long time periods can add up to very significant sums as it builds upon itself. Our aim is to show you how you get there and why perseverance is so important for long-term investors.

Let's start with a definition: Compounding is the phenomenon of earning a return on an initial investment while also increasingly making gains on those gains over time. You don't have to make a conscious decision to put the power of compounding to work, but it is the mechanism by which investments grow on themselves. The longer the investment period, the more spectacular the returns that may be achieved.

Take a look at the chart below, which shows the growth of a single $10,000 investment assuming an annual return of 10% over 30 years. We've broken this investment into its three components: Principal, interest and compound interest.

In This Issue



Source: Adviser Investments

In this hypothetical example, you can see how early on, most of the overall value of the portfolio still lies in the original $10,000 investment, or principal (the dark blue area along the bottom). This never changes since, in this example, we aren't adding any money over time. Gradually, the 10% return earned on the principal (a steady $1,000 each year) grows to match, and then exceed it (the lighter blue region in the middle).

But it's what happens in the "compound interest" area of the chart that is most intriguing (the lightest blue shading on top). Initially, it's the barest shadow of a line because there is little additional value to compound. Remember, we're only "adding" $1,000 per year to the portfolio from our 10% return on the $10,000 principal. In year two, we earn our first compound interest: 10% of the $1,000 gained in year one, or $100. The next year, compound interest accounts for $310 of gains. Each year thereafter, the gains generated by compounding keep growing, and this portion of returns becomes a visible, if relatively small piece of the overall portfolio's value. Starting in year 15, the amount of compound interest earned exceeds the interest on the principal each year. From that point onward those earnings on earnings really take off, driving a majority of the subsequent growth.

Regular Contributions Kick Compounding Up a Notch

While the numbers from that hypothetical single $10,000 investment left to grow over time are impressive, it's worth noting that the real power of compounding kicks into overdrive when combined with regular additional contributions into an investment—similar to what happens over the course of a career socking money away in a retirement account.

Meet our imaginary, 65-year-old friend, Joe, who retired a multimillionaire at the end of May 2014. A little over 40 years ago, on Monday, June 3, 1974, as a 25-year-old with a $30,000 salary, Joe started investing 10% of his paycheck every month in an S&P 500 index fund (we used Vanguard's 500 Index fund in this example; before its Sept. 1976 inception, we used the index's returns). Joe stuck with the same company for his entire 40-year career, and was rewarded for his loyalty with incremental, but appreciable 3% raises every year. Using the returns of the underlying S&P 500 index fund based on his contribution level and salary, we get this snapshot of where he finished:

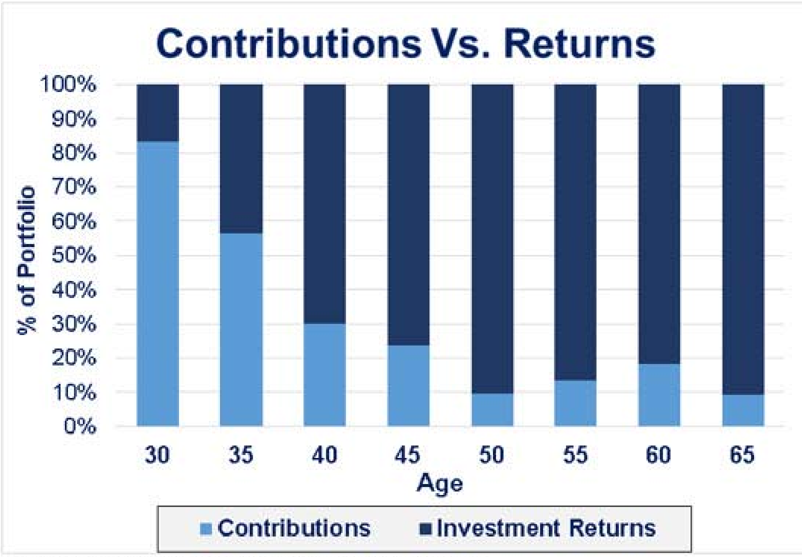
As you can see, Joe did pretty well for himself. His contributions increased each year in concert with his salary, and added up to a portfolio where the amount derived from compounding and earnings on contributions far outweighed the amount invested. All told, he retired with a sum that was more than 25 times his final annual salary of $95,011. (Note that Joe invested far more aggressively than most could stomach, with a poorly diversified, 100% stock portfolio from start to finish.)

Creation of a Millionaire

Starting Age	25
Retirement Age	65
% of Salary Invested	10%
Annual Raises	3%
Total Investment	$226,996
End Balance	$2,386,632
% from Contributions	9.5%
% from Investment Returns	90.5%

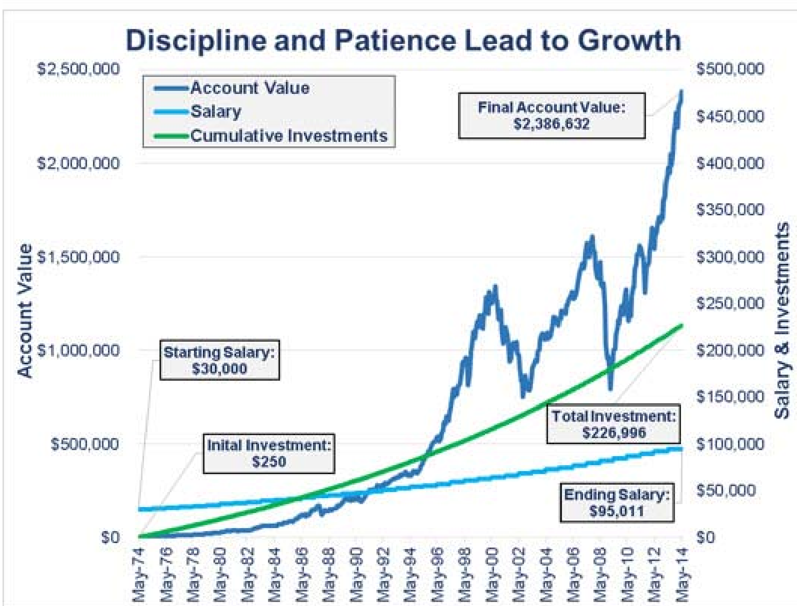
Sources: Morningstar (data), Adviser Investments (analysis).

If we take a peek at the percentage breakdown between contributions and investment returns in Joe's portfolio at various milestones (chart below), you can see that in the earlier part of his investing career, his monthly contributions accounted for a majority of assets, even after 10 years. By around the age of 40, after 15 years of monthly investments, Joe's portfolio had reached its tipping point, and from then on out, compound interest increasingly pushed the value upward and his contributions became proportionately smaller parts of the whole.



Sources: Morningstar (data), Adviser Investments (analysis).

Keep in mind that Joe's account weathered the steep market declines of the tech bubble in the early 2000s when he was in his early 50s and the financial crisis of 2008–2009 when he was in his late 50s (which you can see in the chart below). During those periods, his account lost 44% and 51%, respectively—this is where Joe's lack of diversification into buffering assets like bonds really hurt. But he remained disciplined in the face of those losses and continued to contribute that same 10% per paycheck. Because his account had already hit the turning point where compounding had taken over, he quickly regained and surpassed what was lost, helped by the strong stock market returns off of those bottoms.



Sources: Morningstar (data), Adviser Investments (analysis).

When it may feel like every market surge and correction is going to make or break your portfolio, think of these compounding tipping points, what it takes to get there and how impressive the results can be. It's something we've been helping our clients with since 1994. Unlike Joe, we invest with best-in-class fund managers, and put them to work in diversified, risk-aware portfolios built to weather all market cycles.

About Adviser Investments

Adviser Investments and its subsidiaries operate as an independent, professional money management firm with particular expertise in Fidelity and Vanguard mutual funds. With 2,500 clients and more than $3.0 billion under management, Adviser Investments is one of the nation's largest mutual fund research and money management firms. Our investment professionals focus on helping individual investors, trusts, foundations and institutions meet their investment goals. Our minimum account size is $350,000. Adviser Investments was recently named to *Barron's* list of the top 100 independent financial advisers nationwide and its list of the top advisory firms in Massachusetts.

For more information, please visit www.adviserinvestments.com or call 800-492-6868.