



## ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments



December 23, 2011

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#### **Is Your Portfolio Ready for 2012?**

With just a few days left in the year, time is running out for those who are considering potential year-end tax saving moves. While it may be difficult to focus on these things during the hectic holiday season, the seven steps outlined below could pay dividends in 2012 and beyond.\*

- Is Your Portfolio Ready for 2012?

#### **1. Consider Rebalancing**

Rebalancing involves selling a portion of your portfolio that has experienced gains and reinvesting the proceeds in assets that are currently underweighted in your portfolio. For example, consider the hypothetical case of Frank, who invested in a portfolio comprised of three mutual funds on January 1, 2007. Frank invested one-third in a large-cap domestic fund, one-third in an international stock fund and one-third in a U.S. Treasury bond fund.

Due to variations in the performance of these funds over the past five years, Frank's asset allocation today would be drastically different, as Treasury bonds have outperformed stocks over this period, while U.S. stocks have outperformed international stocks. Therefore, this might be a good time for Frank to consider rebalancing his portfolio back to its original asset allocation.

While rebalancing is simple, psychologically and emotionally it is one of the most difficult tasks investors face, as it forces them to sell their "winners" and add to the "losers" in their portfolio. This is where investors can benefit from the discipline and guidance of an independent investment manager--one who can make these adjustments without the emotional attachment to the particular winners and losers in an account.

If you invest in a taxable account and plan to rebalance your portfolio's asset allocation this year, consider taking your losses in 2011 and waiting until 2012 to take gains. This may allow you to use the losses on your 2011 tax return and delay owing taxes on your gains until 2013. If

you are rebalancing within a tax-deferred account, such as an IRA, then taxes won't be an issue. Of course, before you make any decisions, consult with a trusted, professional tax adviser about your personal tax situation.

## **2. Know Your Funds' Distribution Dates to Avoid Taxable Income**

We mentioned this in our last two *Adviser Fund Updates*, but a review of year-end investing wouldn't be complete without it: If you are planning to make any additional purchases before year-end, it's important to know when your funds will be making their year-end distributions. That's because if you buy shares of a fund prior to its "ex-dividend" date (the date on which the fund's price is reduced by the amount of the expected dividend or capital gain), you will have to pay taxes on additional distributions on those shares, even though you didn't own the shares when that income was "earned." Buying shares just prior to the ex-dividend date is often referred to as "buying the dividend," and it's something we avoid whenever possible for our clients.

To help you skip this mistake when investing in Fidelity or Vanguard Funds, we published full distribution calendars for both firms in our last two *Adviser Fund Updates*. The Fidelity distribution calendar appeared in the [November 23](#) issue, while the Vanguard distribution calendar appeared in our [December 9](#) issue.

## **3. Should You Take a Loss?**

If you have a loss in a fund you own in a taxable account, it may make sense to sell your shares to avoid a distribution, rather than have the distribution add to your tax bill. However, you'll need to consider the size of the distribution, the size of your loss and any fees that may be incurred in the sale before doing so. If you own the fund in a tax-deferred account, distributions will not affect your taxes. This is another strategy where we'd recommend speaking with a tax professional about your plans before taking action.

## **4. Consider Opting Out of Automatic Reinvestment**

We recommend that our clients have their income and capital gains distributions deposited into a money market fund, rather than automatically reinvesting the proceeds in the fund that generated them. This provides the flexibility of reinvesting in the fund at a later date or, as part of a rebalancing strategy, using the cash to add to other funds that may have underperformed recently.

## **5. Maximize Opportunities for Tax-Deferred Growth**

It's a well-known fact that 401(k)s, IRAs and other retirement accounts are a great way to keep assets

growing tax-deferred. Therefore, consider contributing the maximum amounts allowable to each account every year. Depending on your employer's plan, you may be able to defer up to \$17,000 in earnings to a 401(k) or 403(b) plan in 2012. If you will turn 50 before December 31, 2012 and your plan allows it, you can contribute an additional \$5,500. For IRAs, the maximum contribution in 2011 and 2012 is \$5,000, plus a \$1,000 "catch-up contribution" for those who turn 50 before the end of 2012. You have until April 17, 2012 to make your 2011 contributions, but if you do it now, your money can enjoy the benefits of tax-deferral sooner rather than later.

## **6. Don't Forget Your Required Minimum Distributions (RMDs)**

If you have tax-deferred accounts, you will be required to withdraw a minimum percentage each year after reaching a certain age. The RMD rule exists to make sure that savings in retirement accounts are actually used for retirement and not just passed on to heirs.

You generally have until April 1 of the year following the calendar year in which you turn 70½ to take your first RMD. These rules apply to any retirement account in which you contributed tax-deferred assets or had tax-deferred earnings, such as Traditional IRAs, Rollover IRAs, SEP-IRAs, 401(k) and 403(b) plans (Roth IRAs are not subject to RMD rules).

The RMD is calculated (in most cases) by dividing the adjusted market value of your tax-deferred retirement account as of December 31 of the prior year by an applicable factor taken from the IRS life expectancy tables. If you fail to take your RMD from your retirement account, you will be assessed a penalty equal to 50% of the amount you should have withdrawn, in addition to normal income taxes. These are heavy penalties, so clearly it's in your best interests to take these RMDs, something we help our clients with each year.

## **7. Focus and Finish**

While taxes are one of the last things you may want to think about during the holiday season, taking the time to fine tune your portfolio now may help prevent bigger headaches and tax bills come April. That said, restructuring a portfolio and moving assets in an attempt to avoid distributions can be tricky, which is why we recommend you consult with a professional tax adviser before doing so.

\*Note: This piece includes a broad review of a number of year-end investing strategies, some of which are related to taxes. These tips should not be taken as personalized tax advice and are not appropriate for all investors. We strongly suggest speaking to a

trusted tax or investment professional before making any tax-related moves in your portfolio.

### **About Adviser Investments**

Adviser Investments and its subsidiaries operate as an independent, professional money management firm specializing in Fidelity and Vanguard mutual funds. With 2,400 clients and over \$2 billion under management, Adviser Investments is one of the nation's largest mutual fund research and money management firms. Our staff of 50 investment professionals focuses on helping individual investors, trusts, foundations, and institutions meet their investment goals. Our minimum account size is \$350,000.

For more information, please visit [www.adviserinvestments.com](http://www.adviserinvestments.com) or call 800-492-6868.

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