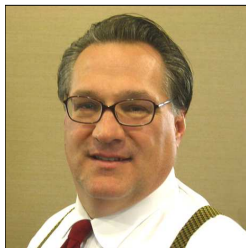




KEEPING AN EYE ON INFLATION

IMMEDIATE RISK OF INFLATION IS VERY LOW YET FUTURE RISK IS A GROWING CONCERN



Stephen Molyneaux

With the economy just beginning to claw its way out of a deep recession, it is difficult for most investors to be concerned about inflation. After all, with near double-digit nationwide unemployment, sluggish growth, and a terribly battered American consumer not spending money on much of anything, it is nearly impossible to see how prices are going to be pressured into increasing in the immediate future. But investors should keep in mind that all throughout the recession the federal government has been spending money at a historic rate while tax revenues have fallen off a cliff. The Feds have spent trillions of dollars they do not have on a myriad of programs attempting to turn the economy around. All those dollars are chasing about the same amount of goods and services and that tends to push the price of those goods and services higher. In other words the value, or purchasing power, of the currency is declining. Between bank recapitalizations, bailouts, stimulus plans, and an entire array of alphabet soup proposals it is difficult to envision how all this spending will not eventually lead to some increased level of inflation.

Inflation forecasts for the next year or two run the gamut from dire 1970s-style hyperinflation scenarios to very modest levels, but the simple truth is that no one can consistently be right in forecasting inflation rates. Inflation may destroy the value of some investments and erode the purchasing power of your money. Fixed income and stocks are particularly vulnerable to inflation. Investors need to be cognizant of these risks and hedge their portfolios accordingly.

Fixed income investments suffer in inflationary times due to the fact that an increase in inflation will always push interest rates higher. As interest rates rise, the value of your bond holdings will decline. For example, if last year you purchased a bond for \$1000 that pays you \$50 interest per year (5%) and currently new bonds now pay 7% then your bond must be worth less than new bonds. If you wanted to sell your 5% bond you must discount the price enough so that the \$50 interest payment would be equal to the "new" 7% yield.

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Laurence Burnette, CFP

Retirement Funding In Turbulent Times

Many Americans Finding It Tougher To Save For Retirement

Times are tough. Recent surveys reflect a growing number of Americans are having serious concerns about how they are going to be able to fund their retirement years. A January survey by the National Institute on Retirement Security noted that 83 percent of Americans are concerned about their ability to retire. As the economy has worsened, not only have many retirement accounts lost value, but many people have also been tempted to tap into their savings as a way to reduce their debt or otherwise shore up their finances. Other people may have also discovered that their employers have stopped making matching contributions to their retirement plans.

When planning for long term goals such as retirement funding do not let short term needs guide your decision making. Do not make the mistake of thinking you can stop saving for retirement now and that you will start again, *once the economy improves*. Trying to time when markets will rebound is a game for speculators – investors stay invested. No one can know with any certainty when

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Frank Johnson, CFP

IT'S NEVER TOO EARLY TO START A ROTH IRA

"The Most Powerful Force In The Universe Is Compound Interest"

- Albert Einstein

Perhaps, at no time since the Great Depression have college students been more worried about money than in today's economy. Tuitions continue to rise, financing sources continue to contract, and finding a part-time job or summer employment can be extremely difficult. So why should a student worry about finding money for, of all things, retirement?

Because even a few dollars of earned income a week put toward a Roth IRA can reap enormous benefits over the 40-50 years of a career lifetime that today's average college student will complete after graduation. Take the example of an 18-year-old who contributes \$5,000 each year of school until he graduates. Assume that \$20,000 grows at 7.5 percent a year until age 65 – that would mean more than a half million dollars from that initial four-year investment without adding another dime.

Before a student begins to accumulate funds for an IRA, there are a few considerations that should be addressed. First, students should try to avoid or extinguish as much debt as possible – particularly high-rate credit card debt. Then, it's time to establish an emergency fund of 3-6 months of living expenses to ensure that a student can continue to afford the basics at school if an unexpected problem occurs.

The basics of Roth IRAs: A good starting point would be to understand the difference between a traditional IRA and a Roth IRA. Traditional IRAs allow investors to save money tax-deferred with deductible contributions until they're ready to begin withdrawals anytime between age 59 ½ and 70 ½. Following age 70½ annual required minimum distributions are necessary. In contrast, Roth IRAs do not allow tax-deductible contributions, but they are tax-deferred and allow tax-free withdrawal of funds with no mandatory distribution age and allow these assets to pass to heirs tax-free as well. If someone leaves their savings in the Roth for at least five years and waits until they are age 59 ½ to take withdrawals, they will never pay taxes on the gains. For someone in their late teens and early 20s, that offers the potential for significant earnings over decades with essentially no tax consequences later.

Getting started is easy: Some banks, brokerages and mutual fund companies will let an investor open a Roth IRA for as little as \$50 with an ongoing \$25 monthly contribution afterward. It is a good idea to check around for the lowest minimum amounts that can get a student in the game so they can plan to increase those contributions as their income increases over time. Also, some institutions offer cash bonuses for starting an account. Go with the best deal and start by putting any extra money right into the account.

It is wise to get advice first: Every student's financial situation is different. One of the best gifts a student can get is an early visit – accompanied by their parents – to a financial advisor such as a Certified Financial Planner™ professional. A planner trained in working with students can not only discuss IRA options, but also provide a broader viewpoint on a student's overall goals and challenges. While starting an early IRA is a great idea for everyone, students may also need to know how to find scholarships and grants and smart ideas for borrowing to stay in school. A good planner is a one-stop source of advice for all those issues unique to the student's situation.

Plan to invest a set percentage from the student's part-time or summer job paycheck: People who save in excess of 10 percent of their earnings are much better positioned for retirement than those who save less. Remarkably few people set that goal. One of the benefits of the IRA idea is it gets students committing early to the 10 percent figure every time they deposit a paycheck.

Get relatives to contribute: If a student regularly receives gifts of money from relatives, it might not be a bad idea to mention the IRA idea to those relatives. Adults like to help children who are smart with money, and if the student is seen as being committed to a savings plan, the relative might feel considerably better about the money they give away. At a minimum, the student should earmark a set amount of "found" money like birthday and holiday gift money toward a Roth IRA in excess of the 10 percent figure.

The bond for which you paid \$1000 would now have a market price of \$714. Of course if you held your bond to maturity you would get back your \$1000, but that amount would buy significantly fewer goods and services because inflation had pushed prices much higher. You could suffer a significant loss of purchasing power.

Equities are a mixed bag. In the short term inflation can depress stock prices in two ways. First, a higher interest rate attracts money away from stocks as money market and CD's become a more attractive alternative. An investor might prefer stocks if money market pays only one percent, but he will move money from stocks and into money market if rates are five percent. The higher interest rates increase, the greater the number of investors that will be drawn away from stocks and into a money market account or CD. The second way stocks suffer is that rising costs shrink profits. A company may see its costs rise for materials and labor faster than it can raise prices for its finished product. This shrinks a company's profit margin and in turn lower profits make stocks less attractive. In the long term, companies pass higher costs on to consumers and actually act as a good hedge against inflation. Unfortunately, the short term damage can be severe. There are several asset classes that help mitigate the ravages of inflation and protect investors' portfolios and purchasing power.

Precious metals benefit during periods of inflation by virtue of their fixed value in relation to a declining currency. Given the relative scarcity of precious metals the price adjusts quickly to an increase in the general level of prices in an economy. Investors' portfolios should contain a rather modest percentage of precious metals to maintain a hedge against the possibility of rapidly rising prices.

Real estate has historically done well in inflationary periods. As a tangible asset, its intrinsic value naturally rises in the face of a declining currency. Rental properties usually perform well and rents typically keep pace in inflationary markets. Commercial real estate can actually benefit from periods of inflation. Real estate investment trusts (REITS) have historically recorded strong performance during periods of high inflation. During the double-digit inflation of the 1970s and exiting the recessions of 1981-1982, 1990-1991, and 2001-2002, REITS performed much better than many other investment vehicles. Of course, past performance is no guarantee of future performance.

Commodities (energy, agriculture, base metals) are sometimes referred to as nature's inflation hedge due to their prices rising right along with rising inflation. What makes commodities durable throughout inflationary markets is their value as "hard assets." The price of a commodity will naturally go higher as more dollars are chasing the fixed amount of the commodity on the world market.

Foreign Currencies If inflation is rapidly eroding the purchasing power of one currency but not another then the other currency can be an excellent hedge. If the U.S. dollar is ravaged by inflation then some foreign currencies will appreciate in relative value. If it now takes twice as many dollars as a year ago to buy a barrel of oil but the same amount of German Deutschmarks, then the relative value of the Deutschmark has appreciate 50% as compared to the U.S. dollar. Any investor that held money in Deutschmarks would, in dollar terms, have doubled their money.

TIPS (Treasury Inflation Protected Securities) are a U.S. government bond with all the same guarantees as other U.S. government bonds and the added feature of an increase in interest paid if inflation increases. TIPS are coupled to the CPI (consumer price index) whereby any increase in the CPI triggers an increase in the rate of return. TIPS offer investors more liquidity than both precious metals and commodities. The market price of TIPS can fluctuate violently but over time they will protect your purchasing power.

The best defense against inflation is portfolio diversification. Attempting to guess if and when inflation will occur is a fool's game because nobody is consistently correct. There is no need for investors to place their investments at increased risk trying to guess how global economics, currency fluctuations, and government spending will impact inflation rates. A well-diversified portfolio that balances risk and protects assets during various market conditions is the investor's best defensive strategy for fighting the effects of inflation.



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the investment markets will rebound. However, by staying invested, your retirement funds stand to gain once the markets do start to rebound. Before you make a move, seek some retirement advice from a professional.

It is a good idea to check in with an expert such as a Certified Financial Planner to see where your retirement funds stand in relationship to your retirement plans. In the meantime, here are some fundamental guidelines:

Keep funding your 401(k) under any circumstances: Earlier this year, a Chicago-based consulting firm reported that 34 percent of U.S. employers have reduced or eliminated matching contributions to their defined contribution retirement plans (including 401(k)s and 403(b)s) since January 2008. The Pension Rights Center reports that besides the Big Three automakers, dozens of major companies have cut back their match, including Motorola, Starbucks, and JPMorgan Chase & Co. Losing your employer's matching contribution can have a significant impact on your retirement planning. There is no doubt that if you lose part or all of your present retirement plan it will have a serious impact on your financial future, but you should still make every effort to keep up with contributing something to your retirement fund.

Stay invested: Practicing market timing (jumping all in or out of a market) successfully is nearly impossible. Asset allocation is critical in a volatile environment. Keep an eye on quick changing economic conditions. It is important to note that the market's best performing days are typically few in number and usually come at the start of a recovery, so leave a certain percentage of your money in the market. An investor should never be all in or out of equities - a well balanced, diverse portfolio that is constantly being adjusted is usually the safest way to ride out the highs and lows of a volatile market.

Keep in mind that withdrawing or borrowing your funds can be costly: If you have an emergency situation, be careful. Workplace 401(k) plans do allow for hardship withdrawals, but you might have an option to take a loan, which would save you the taxes and the 10 percent penalty that accompany hardship withdrawals for account holders under the age of 59.5. The majority of 401(k) plans allow you to borrow up to 50 percent of your vested account balance or \$50,000, whichever is less.

Keep saving and adjust your spending so you can save more: If you have an existing Roth, traditional IRA or other means of saving for retirement, try to continue to fund these accounts. If you had a matching 401(k) through your employer, and your employer has stopped contributing to the account, you should still contribute as much as you can to the account yourself. Hopefully, when the economy recovers, many employers will once again return to matching 401(k) accounts. Until the economy turns around, take an honest look at your budget and see where you may cut back a bit and put the additional savings into your retirement account.

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