

Investor Insights & Outlook

January 2012

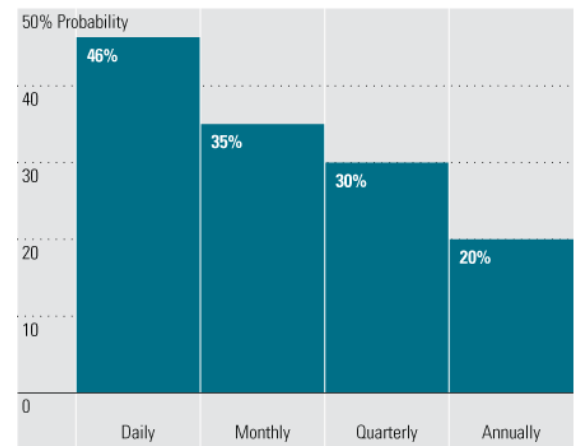
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Investment Updates

Short-Term Focus: Coping with Near-Term Fluctuations

Instant access to real-time quotes and media reports can make it difficult for investors with a long-term investment horizon to stay focused on their goals. In reality, these daily market movements may not be as extreme as they seem. As investors look longer term, their perception often changes. Short-term market fluctuations can be quite volatile, and the probability of realizing a loss within any given day is high. However, the likelihood of realizing a loss has historically decreased over longer holding periods. The image illustrates that while the probability of losing money on a daily basis over the past 20 years was 46%, the probability dropped dramatically when analyzing an annual time period—20%. Periodic review of an investment portfolio is necessary, but investors shouldn't let short-term swings affect their view of the future.

Probability of losing money in the market 1991–2010



Source: Stocks are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. An investment cannot be made directly in an index. Returns and principal invested in stocks are not guaranteed. Probability of loss is calculated as the number of negative periods divided by the number of total periods using the specified frequency of data.

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Advisor Corner

Happy New Year! As we move forward into 2012, a reflection of the past year allows us to become wiser into the future. What has 2011 taught us? Many of us lost someone close to us. This has taught us to live in the moment and appreciate life. Many of us lost jobs. This has taught us to realize what we really need to "live" on and allowed to see how important planning is and will be.

In tough times, we gain perspective and hopefully become wiser. As I reflect on 2011, it was another rough year in markets. With savings rate so low, we had to rely on the markets to provide some growth on our future savings. With 2008 fresh in our minds, the ups and downs of the market was not a fun ride. But, all of you stayed patient! Thank you for your years

of trust and business as I head into my 20th year providing objective financial planning and investment advice.

What Is Up with Gold?

With the runup on gold during the past few years, many investors have been enamored with its short-term performance and are aching to jump into it. Never mind that gold itself has almost no intrinsic value or that the price is largely determined by what other buyers are willing to pay. The past decade, with market crashes and uncertainty, has caused many investors to flee to the safety of gold, but looking longer term, gold might not be as attractive as it appears. An investment of \$100 in stocks beginning in 1980 would have grown to \$2,838 by November 2011. That \$100 invested in bonds over the same time period would now be \$2,186. And if one had invested that \$100 in gold in 1980, it would be a measly \$333 today.

History has shown that given the volatility of the price of gold, both stocks and bonds outperformed gold in the long run over the past 30 years by providing higher average returns. Stocks and bonds also outperformed gold over a 20-year time period. A starting point of 1980 was chosen because, not unlike today, the price of gold was then at all time highs. With gold fervor rampant, a speculative investment in gold, then, would have resulted in not-so-stellar results today, even with gold's recent performance.

Gold is not without its merits. It has traditionally been considered a good hedge against rising inflation rates, given its ability to preserve purchase power. Gold is also commonly considered a safe haven in times of political and currency crises. As fears of a double-dip recession mount, gold may be considered a tool for diversification, because it generally does not react identically to the same economic or market stimuli as stocks and bonds. A well diversified portfolio of stocks, bonds, and gold has the potential to produce a more appealing risk-and-return trade-off over various time periods.

Compound Annual Returns

	1 yr	3 yrs	5 yrs	10 yrs	20 yrs	30 yrs
Stocks	7.8	14.1	-0.2	2.9	8.3	10.8
Bonds	19.4	8.5	9.5	8.4	9.0	10.6
Gold	26.2	28.9	22.0	20.3	8.1	4.9
60/40 portfolio	12.9	13.2	5.3	6.2	9.4	11.4
50/40/10 portfolio	14.7	14.6	7.4	7.9	9.5	10.9
50/30/20 portfolio	15.3	16.5	8.5	9.0	9.4	10.4

Diversification does not eliminate the risk of experiencing investment losses. Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Gold, like any other coin or bullion, is subject to investment risks like perceived scarcity, its quality, current demand, market sentiment, and economic factors. There are material differences between investing in gold versus investing in stocks and bonds. Such differences may include investment objectives, costs and expenses, liquidity, safety, fluctuation of principal or return, insurance, tax features, and any other investment characteristics.

Source: Data as of November 30, 2011. Stocks in this example are represented by the S&P 500® index, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general. Bonds are represented by the 20-year U.S. government bond. Gold is represented by the Federal Reserve (2nd London fix) from 1980-1987 and the Wall Street Journal London P.M. closing price thereafter. Portfolios are rebalanced every 12 months.

The Price of Education

While it is often stated that a college education is priceless, the reality is that costs continue to rise each year. The good news is that many sources of financial aid are available to students and their families. For example, during the 2010–2011 academic year, \$227.2 billion in financial aid was distributed to undergraduate and graduate students in the form of grants from all different sources (see footnote). Moreover, there are plenty of savings vehicles that can be utilized.

The table illustrates the trends in college pricing for the 2011–2012 academic year, according to the College Board's Trends in College Pricing. When compared with the prior year, the various fees are up at least 4.4%, with a high of 8.3% (tuition and fees only). It appears that the rate of growth in tuition and fees has been more rapid at public four-year institutions than at private four-year institutions.

These costs might seem somewhat alarming to most people (especially to those parents who have put off saving and planning for their children's college). But about 44% of students who are enrolled at four-year colleges or universities attend institutions that charge tuition and fees of less than \$9,000 per year. When taking into account only public four-year colleges and universities, this number climbs to 61%. While private four-year institutions have a much wider range of tuition and fee charges, only about 11% of all students attended colleges (public and private) with tuition and fees totaling \$33,000 or higher per year.

In any case, it would be wise for parents to start saving for college as soon as possible and to assume children will attend a private four-year institution (assume "the worst"). If they receive grants and/or scholarships or decide to opt for a more affordable option, think of all the fun things you can do with the excess cash! There is an array of college-savings options available, and many offer tax-deferred growth and tax-free withdrawals (when used for qualified higher-education expenses). Some of the more popular plans include 529 plans and Coverdell Education

Savings Accounts (ESA). There are contribution limits to the various plans, and plenty from which to choose, so it would be wise to consult with your financial advisor to see what is right for you.

As with any goal, whether you are saving for retirement or a vacation home, the key is to start saving early (don't wait until your child is born), and save often. While it's easy to procrastinate when it comes to initiating a long-term college savings plan, the sooner you begin, the more likely it is that the plan will succeed. By starting early, you are taking advantage of the power of compounding and, in this case, time can be your best friend.

Trends in College Pricing: 2011–2012 Academic Year

Type of college/ university	Tuition & fees	% change vs. prior year	Including room & board	% change vs. prior year
Public 4-year (in-state student)	\$8,244	8.3%	\$17,131	6.0%
Public 4-year (out-of-state student)	\$20,770	5.7%	\$29,657	5.2%
Private 4-year (nonprofit)	\$28,500	4.5%	\$38,589	4.4%

Source: College Board's Trends in College Pricing, 2011.

¹College Board's Trends in Student Aid, 2011.

Tax-friendly States for Retirees

Federal taxes are the same wherever you choose to retire; however, state and local taxes add up depending on the state you pick to spend your retirement years. Taxes may apply to your retirement/pension income, purchases, real estate and social security benefits.

Taxes on individual and pension income differ from state to state. Seven states in the U.S. (Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming) currently do not tax individual income. On the other hand, California, District of Columbia, Hawaii, Iowa, Maine, New Jersey, New York, Oregon, and Vermont tax retirement income at a rate of 8% or higher. Pennsylvania and Mississippi exempt pension income completely, while states like Michigan and Maine exempt only a portion of pension income. If you estimate receiving considerable income in retirement, state income taxes could play a significant role in what you get to keep.

In addition to state taxes on retirement and pension income, retirees also need to look at sales tax charged on items they purchase. Sales tax varies from state to state with some states charging sales tax as high as 7%, while others adopt a “no sales tax” policy. Alaska, Delaware, Montana, New Hampshire, and Oregon have no state sales tax, while California has the highest sales tax rate of 8.25%. Retirees who rely only on a fixed source of income in retirement should also carefully consider property taxes and estate taxes when estimating their tax liabilities.

Source: 2011 CCH Whole Ball of Tax. The opinions herein are those of Morningstar, Inc. and should not be viewed as providing investment, tax, or legal advice. The information provided is as of October 2011. Please consult with your financial professional regarding such services.

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