



# YOUR FINANCIAL FUTURE

Your Guide to Life Planning

August 2011



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The dreaded "I" word -- inflation -- has been cropping up more frequently lately, largely due to escalating commodity prices, which are pushing up consumer prices, both in the United States and abroad.

## Standard &amp; Poor's Economic Report: Food Price Inflation May Ease

By Tom Graves, CFA, Standard & Poor's Equity Analyst

AUGUST 2011 -- The increase in consumer food prices may ease in 2012, based on a new forecast from the U.S. Department of Agriculture (USDA) released last month.

The USDA anticipates that the index for all food will be up 2.5% to 3.5% in 2012, a range that is modestly below the 3.0% to 4.0% projected for 2011. However, this would still exceed the relatively small increases for food prices in 2010 (0.8%) and 2009 (1.8%).

Food-at-home (i.e., grocery store) prices in June 2011 were up 4.7% from the year-ago level, according to the USDA. Sharper increases of at least 7.9% reported for such categories as meats, fish and seafood, eggs, and fats and oils were partly offset by advances of 3.0% or less for foods such as processed fruits and vegetables, fresh fruits, and poultry.

However, the USDA says that "retailers have been slow to pass on cost increases," and suggests that weather conditions in the Midwestern harvest belt during the next few months could be a significant variable for 2012 food prices.

For 2012, the USDA is forecasting a higher range (up 3.0% to 4.0%) for the rise in food-at-home prices than it is for away-from-home expenditures (i.e., restaurants), for which a 2.0% to 3.0% rise is projected. The food-at-home price increase forecast for 2012 is slightly below the 3.5% to 4.5% range estimated for 2011.

For food retailers, we think easing cost inflation and reduced pressure to raise prices would be good news. This should lower the risk that checkout volumes suffer, with consumers less likely to curtail or reduce purchases due to high prices.

S&P Equity Research supermarket analyst Joseph Agnese says that if increases in shelf prices approach mid-single digit levels, "we believe margins will be negatively impacted as consumers alter their shopping behavior by trading down to lower-priced goods, cherry picking (purchasing based on promotion), and foregoing purchases."

While moderating retail price inflation would be good news for consumers, we expect that would put some near-term strain on profit margins for food manufacturers. We are already seeing indications that price hikes from makers of packaged foods are lagging the cost increases they have experienced. Also, in the second half of 2011, we anticipate that some acceleration of price increases going into effect will be at least partly offset by some favorable cost hedges (locking in lower prices) running out.

However, to protect at least most of their profit margin, we do not think food manufacturers need to raise prices nearly as much as their ingredient costs have risen. Agricultural ingredients are a relatively small portion of the retail price for most food products. Also, we believe manufacturers will be looking to offset at least a portion of the higher commodity costs through cost reductions in other areas and productivity improvements. Furthermore, we think there would be significantly more consumer resistance if efforts were made to raise retail food prices at the 20%+ rates at which some crop prices have increased.

Meanwhile, the pace of retail food price hikes forecast by the USDA is far lower than the increases in farm prices we have seen recently. According to the USDA in preliminary data released on June 29, the index for all crop prices was up 49%, year to year, in June, including a 77% rise for food grains, an 81% increase for feed grains and hay, and a 43% rise for oilseeds.

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## Remodeling Your Home: Is It Worth the Cost?

The renovations that recoup the greatest percentage of their initial cost are those that residents are likely to use frequently or that enhance energy efficiency.

With home values nationwide still well below the historic average highs set five years ago, many homeowners are considering making improvements to their homes rather than trading up for a bigger, better model.

*Remodeling* magazine conducts an annual Cost vs. Value Report that presents the national midrange cost for a variety of renovation projects and the typical cost recouped at sale. Note that these numbers are national data, and expenses may vary regionally.

### Remodeling Cost vs. Value 2010-2011<sup>1</sup>

Project	Midrange Cost	Resale Value	Percent Recouped
Attic bedroom	\$51,428	\$37,142	72%
Basement remodel	\$64,519	\$45,186	70%
Bathroom remodel	\$16,634	\$10,668	64%
Deck addition (composite materials)	\$15,620	\$10,337	66%
Deck addition (wood)	\$10,973	\$9,986	73%
Family room addition	\$85,740	\$53,624	63%
Home-office remodel	\$28,888	\$13,235	46%
Kitchen remodel (major)	\$58,367	\$40,126	69%
Kitchen remodel (minor)	\$21,695	\$15,790	73%
Master suite addition	\$108,090	\$68,146	63%
Siding replacement (vinyl)	\$11,357	\$8,223	72%
Sunroom addition	\$75,224	\$36,540	49%
Window replacement (vinyl)	\$11,066	\$7,920	72%
Window replacement (wood)	\$12,027	\$8,707	72%

### Bigger Isn't Always Better

If you focus on an upscale project with high-end materials or a more budget-conscious approach, the initial cost of the job and the cost recouped at sale will vary accordingly. For example, the difference between a minor kitchen remodel and a major kitchen remodel lies primarily in the design and materials used to renovate a 200-square-foot kitchen. Variables include semi-custom cabinets vs. existing cabinet boxes with new doors and drawers and the presence of a 3-by-5-foot island in the major kitchen remodel.

Ironically, the data show that the minor kitchen remodel recoups a higher percentage of its cost than the major kitchen remodel. Spending your money wisely vs. spending the largest amount of money, may be more worthwhile financially.

The renovations that recoup the greatest percentage of their initial cost are those that residents are likely to use frequently or that enhance energy efficiency. Bathrooms and kitchens, which typically are used daily, tend to be important to potential home buyers. Vinyl siding and window replacement can potentially enhance energy use.

Before embarking on a renovation project, consider whether you are likely to recoup a good portion of the cost

over the long term. This approach may help to focus your thinking on long-term value.

<sup>1</sup>Source: Remodeling, "2010-2011 Cost vs. Value Report" ([www.remodeling.hw.net](http://www.remodeling.hw.net)).

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## A New World Order: Investing Internationally

**A U.S. investor's foreign-investment return depends on both the local currency's exchange value against the U.S. dollar and the stock price in the local currency.**

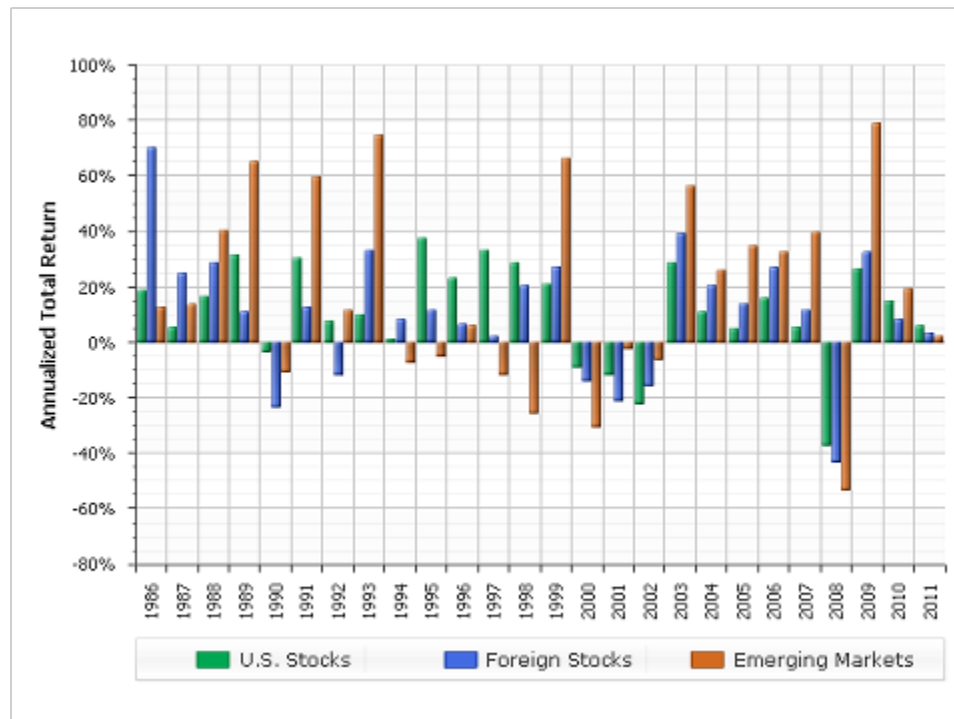
As the United States economy continues to sputter, investors in search of better returns and greater diversification are casting their nets elsewhere around the world.<sup>1</sup> Looking for growth abroad could be a smart move: Foreign markets currently represent nearly 60% of the world's investment opportunities -- and that number is only expected to grow.<sup>2</sup>

But investing internationally adds a different set of risks that typically do not affect investors in the domestic markets, such as higher taxation, less liquidity, political instability, and currency fluctuations. If you are thinking about expanding your horizons to include international investments, be sure to take the time to learn about various global markets and their unique characteristics.

### Separating Emerging Nations From Developed Nations

When categorizing the world markets outside of the United States, countries are typically grouped into one of two types: developed markets and emerging markets. Developed markets include nations with more traditionally stable economies, such as Germany, England, France, and Japan. Emerging markets are typically those nations that are moving toward becoming more established, but still demonstrate higher-than-average volatility, such as the "BRIC" nations: Brazil, Russia, India, and China.

### Calendar Year Returns for U.S., Foreign Developed, and Emerging Market Stocks



Source: ChartSource®, McGraw-Hill Financial Communications. Based on calendar-year returns from 1986 to 2011 (data is current through June 30, 2011). U.S. stocks are represented by the S&P 500 index. Foreign stocks are represented by the MSCI EAFE index. Emerging market stocks are represented by the MSCI Emerging Markets index. Past performance is not a guarantee of future results. It is not possible to invest directly in an index.

### Investing in Foreign Equities

One way you can include international exposure in your portfolio is to invest in stocks of U.S. companies that derive a large portion of their annual revenue from overseas markets. Examples of such companies are Coca-Cola, Microsoft, and McDonald's.

You can also buy stocks of foreign companies through American Depositary Receipts (ADRs) -- traded on the New York Stock Exchange -- and through mutual funds that invest in foreign companies. ADRs are negotiable certificates that represent the shares of a publicly traded foreign company. ADRs are issued in the United States, and their underlying shares are held in U.S. banks.

But familiarizing yourself with international markets (including the regulatory, political, and economic

environments) is time consuming, and access to company information can be difficult to obtain. One simpler way to invest internationally is to buy shares of broadly diversified international mutual funds or exchange-traded funds that may buy a mix of foreign and U.S. stocks. These types of funds offer instant diversification through an array of foreign market stocks.<sup>3</sup>

For more experienced and more aggressive investors wishing to target stocks in particular regions or countries, regional or country funds are also available. These funds are designed to take advantage of specific opportunities in the world's developed and emerging markets, but they do carry an increased risk of volatility.

### **Currency Value: A Special Risk of International Investing**

International investing does present unique risks and considerations. A U.S. investor's foreign-investment return depends on both the local currency's exchange value against the U.S. dollar and the stock price in the local currency. For example, falling currency values and plummeting stock prices in Asian nations in 1998 not only drove down stock prices for international investors in Asia, but also in the United States, because many American companies depend on Asia for customers. For U.S. investors, currency losses could also stem from a rise in the dollar's value against the currency of the foreign country they are investing in. Maintaining a long-term perspective and diversifying international investments can help minimize these risks.

<sup>1</sup>*Diversification does not ensure a profit or protect against a loss in a declining market.*

<sup>2</sup>*Source: Morgan Stanley Capital International.*

<sup>3</sup>*Investors should carefully consider the fund's investment objectives, risks, charges, and expenses before investing. To obtain a prospectus or, if available, a summary prospectus containing this and other information, contact the appropriate fund company or view the fund prospectus on the website of the appropriate fund company. Please carefully read the prospectus or summary prospectus before investing. Current performance may be higher or lower than in the past, which cannot guarantee future results.*

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Even the best plan probably won't provide 100% coverage for you or your family.

## Health Insurance Plans: Understanding the Options

Selecting the right health insurance plan for you (and your family) is a very important decision. Choose the wrong one, and you could have to pay thousands in either unnecessarily high premiums or in nonreimbursed costs for your care.

If you receive health insurance through your employer, your choices may be limited. Some employers offer plans from multiple health insurance providers, but most limit their offerings to one provider.

Most employers offer one or more of the following: an HMO, a PPO, or a traditional plan.

- An **HMO** (health maintenance organization) is usually the lowest cost alternative. As a result, enrollees are limited to doctors and treatment facilities within a limited "network." These plans usually have no deductibles. Enrollees are required to make copayments when seeing a physician.
- A **PPO** (preferred provider organization) allows enrollees greater flexibility. Enrollees can see doctors in or out of the PPO's established network of providers. Deductibles usually apply, and copayments are required. A visit to an out-of-network doctor will trigger an additional charge.
- A **traditional indemnity plan** is usually the most expensive, as it typically gives enrollees the greatest number of choices in choosing doctors and facilities. But the deductibles can be high, and the insurance company may cap the amount of money it will spend on the enrollee's behalf over his or her lifetime.

### Choices for the Self-Employed

If you are self-employed, you can comparison shop among the insurance providers licensed to do business in your state. It is a good idea to get as many estimates as you can because coverage and premiums vary significantly. Be sure you are comparing apples to apples: You want cost breakdowns for coverage with similar deductibles, copayments, prescription benefits, and physician access.

### Beyond Standard Insurance

Even the best plan probably won't provide 100% coverage for you or your family. If your employer allows, you can also fund a flexible spending account (FSA) or health savings account (HSA). An FSA, which is an employee benefit typically funded through payroll deduction, allows you to set aside pre-tax dollars to use toward copayments, out-of-network coverage, or other medical expenses. The drawbacks of an FSA: The maximum you can contribute is low, and any funds not used during a calendar year are forfeited. An HSA, available to those enrolled in a high-deductible plan, has a higher annual contribution limit and no "use-it-or-lose-it" rules.

If you feel you need more coverage and can afford it, you can also buy supplemental health insurance. The three most common types are disease specific, accidental death or dismemberment, and hospital indemnity. Be sure to comparison shop before purchasing as premiums and coverage limits can vary widely.

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## Should You Prep Your Portfolio for Inflation?

Although many economists project overall U.S. inflation to remain modest in the near future, most see an uptick down the road.

Economists and market watchers have been warning investors about the prospect of increased inflation since the housing bubble burst in 2007.

The dreaded "I" word has been cropping up more frequently lately, largely due to escalating commodity prices, which are pushing up consumer prices, both in the United States and abroad. At the beginning of 2011, the inflation rate stood at a paltry 1.6%. By May, it had more than doubled to 3.6%. And this could be just the start of a longer-term inflationary cycle.<sup>1</sup> With an improving economy and soaring federal deficits, many experts feel that prices in the United States will inevitably pick up their pace even further.

### Inflation Rates Around the World (as of May 31, 2011)<sup>2</sup>

Country	Rate
Brazil	6.6%
Canada	3.3%
China	5.5%
Egypt	11.8%
Germany	2.3%
India	9.4%
Japan	0.3%
Russia	9.6%
United Kingdom	4.5%
United States	3.6%
Venezuela	22.8%

### Staying Ahead

For investors, staying ahead of inflation means choosing investments that are most likely to provide returns that outpace it. Here's a look at how a climbing inflation rate could impact various investment types and asset classes.

- Domestic Stocks** -- Although past performance is no guarantee of future returns, historically, stocks have provided the best potential for long-term returns that exceed inflation. An analysis of holding periods between 1926 and December 31, 2010, found that the annualized return for a portfolio composed exclusively of stocks in Standard & Poor's Composite Index of 500 Stocks was 9.93% -- well above the average inflation rate of 3.01% for the same period. However, over shorter time periods the results are not as appealing. For the 10 years ended December 31, 2010, the S&P 500 returned an average of only 1.41%, compared to an average inflation rate of 2.33%.<sup>3</sup>
- International Stocks** -- Diversifying into foreign markets may help provide downside protection when the U.S. economy sputters.<sup>4</sup> During the same 10-year span that ended December 31, 2010, the Morgan Stanley Capital International (MSCI) EAFE, which is comprised of established economies such

as Germany and Japan, outpaced U.S. inflation with an average return of 3.94%. The MSCI Emerging Markets index, which tracks developing world economies such as Brazil and China, was even more stellar, returning an average of 16.23%.<sup>5</sup>

- **Bonds** -- Historically, investors have turned to shorter-term corporate and high-yield bonds for protection in rising-rate environments.<sup>6</sup> There are two types of bonds that receive a lot of investor interest when inflation starts to rise: Treasury Inflation-Protected Securities (TIPS) and I Savings Bonds. Both TIPS and I bonds are types of fixed-interest rate bonds whose value rises as inflation rates rise.
- **CDs and Other Cash Instruments** -- The Federal Reserve is still keeping a tight lid on interest rates, forcing investors who hope to keep pace with inflation by investing in cash instruments facing a harsh reality. The rates on a 1-year CD are averaging under 1%, while a 5-year CD is yielding just over 2%, according to Bankrate.com. Money market and other bank savings accounts are also averaging well under 1%.

Although many economists project overall U.S. inflation to remain modest in the near future, most see an uptick down the road. For investors, a well-rounded portfolio may be your best weapon. The key is to consider your time frame, your anticipated income needs, and how much volatility you are willing to accept, and then construct a portfolio with the mix investments with which you are comfortable. Consult your financial professional to discuss your specific needs and options.

<sup>1</sup>Source: U.S. Bureau of Labor Statistics, June 2011.

<sup>2</sup>Sources: TradingEconomics.com and U.S. Bureau of Labor Statistics, June 2011.

<sup>3</sup>Sources: Standard & Poor's, U.S. Bureau of Labor Statistics. The S&P 500 is an unmanaged index. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

<sup>4</sup>Diversification does not ensure a profit or protect against a loss in a declining market.

<sup>5</sup>Source: Morgan Stanley. The MSCI EAFE and MSCI EM are unmanaged indexes. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

<sup>6</sup>Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.