McGladrey Wealth Management LLC
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Commodities are important raw materials as they represent some of the ingredients we need for the foods we eat or the materials we use for manufacturing goods. Commodities as an asset class are interesting because commodities are quite different from traditional stocks and bonds. Commodities are hard (or real) assets rather than financial assets. Examples of commodity sectors include energy, agriculture, industrial metals, precious metals and livestock. Read our piece titled Making the case for commodities exposure in investment portfolios (which can also be found on the Wealth Management home page of mcgladrey.com) to see how investors can receive commodity exposure, how different commodity indexes are constructed and why McGladrey Wealth Management still recommends investors have a dedicated commodity exposure in light of the asset class's recent performance.

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Correlation and Portfolio Performance

Different types of investments are subject to different types of risk. On days when you notice that stock prices have fallen, for example, it would not be unusual to see a rally in the bond market.

Asset allocation refers to how an investor's portfolio is divided among asset classes, which tend to perform differently under different market conditions. An appropriate mix of investments typically depends on the investor's age, risk tolerance, and financial goals.

The concept of correlation often plays a role in constructing a well-diversified portfolio that strikes a balance between risk and return.

Math that matters

In the financial world, correlation is a statistical measure of how two securities perform relative to each other. Securities that are positively correlated will have prices that tend to move in the same direction. Securities that are negatively correlated will have prices that move in the opposite direction.

A correlation coefficient, which is calculated using historical returns, measures the degree of correlation between two investments. A correlation of +1 represents a perfectly positive correlation, which means the investments always move together, in the same direction, and at a consistent scale. A correlation of -1 means they have a perfectly negative correlation and will always move opposite one another. A correlation of zero means that the two investments are not correlated; the relationship between them is random.

In reality, perfectly positive correlation is rare, because distinct investments can be affected differently by the same conditions, even if they are similar securities in the same sector.

Correlations can change

While some types of securities exhibit general trends of correlation over time, it's not uncommon for correlations to vary over shorter periods. In times of market volatility, for example, asset prices were more likely to be driven by common market shocks than by their respective underlying fundamentals.

During the flight to quality sparked by the financial crisis of 2008, riskier assets across a number of different classes exhibited unusually high correlation. As a result, correlations among some major asset classes have been more elevated than they were before the crisis. There has also been a rise in correlation between different financial markets in the global economy.[1] For example, the correlation coefficient for U.S. stocks (represented by the S&P Composite Total Return index) and foreign stocks (represented by the MSCI EAFE GTR index) increased from 0.75 over the last 25 years to 0.89 over the last 10 years.[2]

Over the long run, a combination of investments that are loosely correlated may provide greater diversification, help manage portfolio risk, and smooth out investment returns. Tighter relationships among asset classes over the last decade may be a good reason for some investors to reassess their portfolio allocations. However, it's important to keep in mind that correlations may continue to fluctuate over time because of changing economic and market environments.

The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. Past performance is no guarantee of future results. All investing involves risk, including the possible loss of principal. Asset allocation and diversification strategies do not guarantee a profit or protect against investment loss; they are methods used to help manage investment risk.

Investing internationally carries additional risks such as differences in financial reporting, currency exchange risk, as well as economic and political risk unique to the specific country. This may result in greater share price volatility. When sold, investments may be worth more or less than their original cost.

[1] International Monetary Fund, 2015

[2] Thomson Reuters, 2015, for the period 12/31/1989 to 12/31/2014

See disclaimer on final page

Six Life Insurance Beneficiary Mistakes to Avoid

Note: *As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications.*

Note: *While trusts offer numerous advantages, they incur up-front costs and often have ongoing administrative fees. The use of trusts involves a complex web of tax rules and regulations. You should consider the counsel of an experienced estate planning professional and your legal and tax advisors before implementing such strategies.*

Life insurance has long been recognized as a useful way to provide for your heirs and loved ones when you die. Naming your policy's beneficiaries should be a relatively simple task. However, there are a number of situations that can easily lead to unintended and adverse consequences. Here are six life insurance beneficiary traps you may want to avoid.

Not naming a beneficiary

The most obvious mistake you can make is failing to name a beneficiary of your life insurance policy. But simply naming your spouse or child as beneficiary may not suffice. It is conceivable that you and your spouse could die together, or that your named beneficiary may die before you. If the beneficiaries you designated are not living at your death, the insurance company may pay the death proceeds to your estate, which can lead to other potential problems.

Death benefit paid to your estate

If your life insurance is paid to your estate, several undesired issues may arise. First, the insurance proceeds likely become subject to probate, which may delay the payment to your heirs. Second, life insurance that is part of your probate estate is subject to claims of your probate creditors. Not only might your heirs have to wait to receive their share of the insurance, but your creditors may satisfy their claims out of those proceeds first.

Naming primary, secondary, and final beneficiaries may avoid having the proceeds ultimately paid to your estate. If the primary beneficiary dies before you do, then the secondary or alternate beneficiaries receive the proceeds. And if the secondary beneficiaries are unavailable to receive the death benefit, you can name a final beneficiary, such as a charity, to receive the insurance proceeds.

Naming a minor child as beneficiary

Unintended consequences may arise if your named beneficiary is a minor. Insurance companies will rarely pay life insurance proceeds directly to a minor. Typically, the court appoints a guardian--a potentially costly and time-consuming process--to handle the proceeds until the minor beneficiary reaches the age of majority according to state law.

If you want the life insurance proceeds to be paid for the benefit of a minor, you may consider creating a trust that names the minor as beneficiary. Then the trust manages and pays the proceeds from the insurance according to the terms and conditions you set out in the trust document. Consult with an estate attorney to decide on the course that works best for your situation.

Per stirpes or per capita

It's not uncommon to name multiple beneficiaries to share in the life insurance proceeds. But what happens if one of the beneficiaries dies before you do? Do you want the share of the deceased beneficiary to be added to the shares of the surviving beneficiaries, or do you want the share to pass to the deceased beneficiary's children? That's the difference between per stirpes and per capita.

You don't have to use the legal terms in directing what is to happen if a beneficiary dies before you do, but it's important to indicate on the insurance beneficiary designation form how you want the share to pass if a beneficiary predeceases you. Per stirpes *(by branch)* means the share of a deceased beneficiary passes to the next generation in line. Per capita *(by head)* provides that the share of the deceased beneficiary is added to the shares of the surviving beneficiaries so that each receives an equal share.

Disqualifying the beneficiary from government assistance

A beneficiary you name to receive your life insurance may be receiving or is eligible to receive government assistance due to a disability or other special circumstance. Eligibility for government benefits is often tied to the financial circumstances of the recipient. The payment of insurance proceeds may be a financial windfall that disqualifies your beneficiary from eligibility for government benefits, or the proceeds may have to be paid to the government entity as reimbursement for benefits paid. Again, an estate attorney can help you address this issue.

Taxes

Generally, life insurance death proceeds are not taxed when they're paid. However, there are exceptions to this rule, and the most common situation involves having three different people as policy owner, insured, and beneficiary. Typically, the policy owner and the insured are one in the same person. But sometimes the owner is not the insured or the beneficiary. For example, mom may be the policy owner on the life of dad for the benefit of their children. In this situation, mom is effectively creating a gift of the insurance proceeds to her children/beneficiaries. As the donor, mom may be subject to gift tax. Consult a financial or tax professional to figure out the best way to structure the policy.

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Frequently Asked Questions on Opening a 529 Plan Account

529 plan assets surpass $230 billion

Assets in 529 college savings plans reached $231.9 billion in the first quarter of 2015, a 10.1% increase over the first quarter of 2014. (Source: www.savingforcollege.com, June 11, 2015)

Note: *Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also consider whether your state offers a 529 plan that provides residents with favorable state tax benefits. As with other investments, there are generally fees and expenses associated with participation in a 529 savings plan. There is also the risk that the investments may lose money or not perform well enough to cover college costs as anticipated.*

529 plans are savings vehicles tailor-made for college. Anyone can open an account, lifetime contribution limits are typically over $300,000, and 529 plans offer federal and sometimes state tax benefits if certain conditions are met. Here are some common questions on opening an account.

Can I open an account in any state's 529 plan or am I limited to my own state's plan?

Answer: It depends on the type of 529 plan. There are two types of 529 plans: college savings plans and prepaid tuition plans. With a college savings plan, you open an individual investment account and direct your contributions to one or more of the plan's investment portfolios. With a prepaid tuition plan, you purchase education credits at today's prices and redeem them in the future for college tuition. Forty-nine states (all but Wyoming) offer one or more college savings plans, but only a few states offer prepaid tuition plans.

529 college savings plans are typically available to residents of any state, and funds can be used at any accredited college in the United States or abroad. But 529 prepaid tuition plans are typically limited to state residents and apply to in-state public colleges.

Why might you decide to open an account in another state's 529 college savings plan? The other plan might offer better investment options, lower management fees, a better investment track record, or better customer service. If you decide to go this route, keep in mind that some states may limit certain 529 plan tax benefits, such as a state income tax deduction for contributions, to residents who join the in-state plan.

Is there an age limit on who can be a beneficiary of a 529 account?

Answer: There is no beneficiary age limit specified in Section 529 of the Internal Revenue Code, but some states may impose one. You'll need to check the rules of each plan you're considering. Also, some states may require that the account be in place for a specified minimum length of time before funds can be withdrawn. This is important if you expect to make withdrawals quickly because the beneficiary is close to college age.

Can more than one 529 account be opened for the same child?

Answer: Yes. You (or anyone else) can open multiple 529 accounts for the same beneficiary, as long as you do so under different 529 plans (college savings plan or prepaid tuition plan). For example, you could open a college savings plan account with State A and State B for the same beneficiary, or you could open a college savings plan account and a prepaid tuition plan account with State A for the same beneficiary. But you can't open two college savings plan accounts in State A for the same beneficiary.

Also keep in mind that if you do open multiple 529 accounts for the same beneficiary, each plan has its own lifetime contribution limit, and contributions can't be made after the limit is reached. Some states consider the accounts in other states to determine whether the limit has been reached. For these states, the total balance of all plans (in all states) cannot exceed the maximum lifetime contribution limit.

Can I open a 529 account in anticipation of my future grandchild?

Answer: Technically, no, because the beneficiary must have a Social Security number. But you can do so in a roundabout way. First, you'll need to open an account and name as the beneficiary a family member who will be related to your future grandchild. Then when your grandchild is born, you (the account owner) can change the beneficiary to your grandchild. Check the details carefully of any plan you're considering because some plans may impose age restrictions on the beneficiary, such as being under age 21. This may pose a problem if you plan to name your adult son or daughter as the initial beneficiary.

What happens if I open a 529 plan in one state and then move to another state?

Answer: Essentially, nothing happens if you have a college savings plan. But most prepaid tuition plans require that either the account owner or the beneficiary be a resident of the state operating the plan. So if you move to another state, you may have to cash in the prepaid tuition plan.

If you have a college savings plan, you can simply leave the account open and keep contributing to it. Alternatively, you can switch 529 plans by rolling over the assets from that plan to a new 529 plan. You can keep the same beneficiary when you do the rollover (under IRS rules, you're allowed one 529 plan same-beneficiary rollover once every 12 months), but check the details of each plan for any potential restrictions. If you decide to stay with your original 529 plan, just remember that your new state might limit any potential 529 plan tax benefits to residents who participate in the in-state plan.

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How can I protect my Social Security number from identity theft?

Your Social Security number is one of your most important personal identifiers. If identity thieves obtain your Social Security number, they can access your bank account, file false tax returns, and wreak havoc on your credit report. Here are some steps you can take to help safeguard your number.

Never carry your card with you. You should never carry your Social Security card with you unless it's absolutely necessary. The same goes for other forms of identification that may display your Social Security number (e.g., Medicare card)

Do not give out your number over the phone or via email/Internet. Oftentimes, identity thieves will pose as legitimate government organizations or financial institutions and contact you to request personal information, including your Social Security number. Avoid giving out your Social Security number to anyone over the phone or via email/Internet unless you initiate the contact with an organization or institution that you trust.

Be careful about sharing your number. Just because someone asks for your Social Security number doesn't mean you have to share it. Always ask why it is needed, how it will be used, and what the consequences will be if you refuse to provide it.

If you think someone has misused your Social Security number, contact the Social Security Administration (SSA) immediately to report the problem. The SSA can review your earnings record with you to make sure their records are correct. You can also visit the SSA website at www.ssa.gov to check your earnings record online.

Unfortunately, the SSA cannot directly resolve any identity theft problems created by the misuse of your Social Security number. If you discover that someone is illegally using your number, be sure to contact the appropriate law-enforcement authorities. In addition, consider filing a complaint with the Federal Trade Commission and submitting IRS Form 14039, Identity Theft Affidavit, with the Internal Revenue Service. Visit www.ftc.gov and www.irs.gov for more information.

What return are you really earning on your money?

If you're like most people, you probably want to know what return you might expect before you invest. But to translate a given rate of return into actual income or growth potential, you'll need to understand the difference between *nominal return* and *real return,* and how that difference can affect your ability to target financial goals.

Let's say you have a certificate of deposit (CD) that's about to expire. The yield on the new three-year CD you're considering is 1.5%.

But that 1.5% is the CD's nominal rate of return; it doesn't account for inflation or taxes. If you're taxed at the 28% federal income tax rate, roughly 0.42% of that 1.5% will be gobbled up by federal taxes on the interest. Okay, you say, that still leaves an interest rate of 1.08%; at least you're earning something.

However, you also need to consider the purchasing power of the interest that the CD pays. Even though inflation is relatively low today, it can still affect your purchasing power, especially over time. Let's say that consumer prices have gone up by 1% over the past year and you adjust your 1.08% after-tax return for inflation. Suddenly, you're barely breaking even on your investment.

What's left after the impact of inflation and taxes is your real return, because that's what you're really earning in actual purchasing power. If the nominal return on an investment is low enough, the real return can actually be negative, depending on your tax bracket and the inflation rate over time. Though this hypothetical example doesn't represent the performance of any actual investment, it illustrates the importance of understanding what you're really earning.

Knowing the difference between nominal and real return may help you make better decisions when it comes to investing your money. You'll want to choose investments that match your financial goals and tolerance for risk. In some cases, the security an investment offers may be important enough that you're willing to accept a low real return; in other cases, you may choose an investment that has the potential for a higher real return but carries a higher degree of risk.

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