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Monument QUARTERLY

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Investing Risk and Volatility Aren't the Same

David B. Armstrong, CFA, Managing Director, Co-Founder

Consider the elevator ride. I get in, press the button and wait to get to my floor. Some rides are slow if the car is full, some rides are smooth and sometimes I get on a down elevator when I want to go up. Eventually, though, I get where I am trying to go. Let's call it "elevator volatility."

One thing I don't consider on those rides is the the risk associated with riding elevators. The risk is there — cables snap, emergency brakes fail — but the various paths to my destination have nothing to do with the true measurement of the risk of equipment failure. There's a lesson here for investors.

Investors and financial services firms seem to assess risk and construct portfolios based on the volatility of the ride rather than its actual risks, even though an appropriate measurement of risk in investing, especially for long-term investors, is the failure to achieve a final outcome. Unfortunately, the industry is obsessed with the idea of volatility, especially short-term volatility.

Think about reacting to volatility for a minute. It's really an emotional barometer. Traders and investors buy and sell on reaction (and usually overreaction) to news and speculation without any consideration to long-term returns. Recall the sell-offs of 2011 and 2012 and look at where the markets are today. Volatility went through the roof, but did it really affect the long-term returns of an investor who assesses risk in terms of long-term failure to meet a final outcome? No. In fact, those who stayed invested while experiencing extreme volatility are probably better off for it.

Risk and volatility are not interchangeable, and trying to minimize volatility can actually hurt returns over time. The financial services industry is rife with advisers, compliance departments and research departments who embrace con-

Continue on page 2

Inside This Issue

Monument
WEALTH MANAGEMENT

Investing Risk and Volatility Aren't the Same... *Continued*

structing portfolios with a serious allocation to bonds because they will lower volatility. Not only is it well proven that stocks outperform bonds over the long term, but at today's interest rates, the interest payments on bonds are having a hard time even outpacing inflation. So in the interest of reducing short-term volatility, portfolios are being constructed with investments that increase the probability of actually impeding long-term growth.

But it's an emotional issue too. Investors like the idea of seeing their portfolios grow without the wild swings that accompany equity investing. Since most people look at their account balances on a very regular basis and they only like to see their accounts go up, not down.

It's a common refrain that investors say they'd be happy beating a broad stock index "with less risk on the downside" or some variation on that theme. The problem is any anyone telling you they can do that is either a charlatan or a fool.

But the financial services industry, including the sales side, the compliance side and the advisers who are not running their own money, have adopted volatility as a measure of risk anyway. They use it to justify portfolio creation, the manufacture of investment products and the rationalization of compliance oversight. It also feeds into the emotional needs of clients, which facilitates sales.

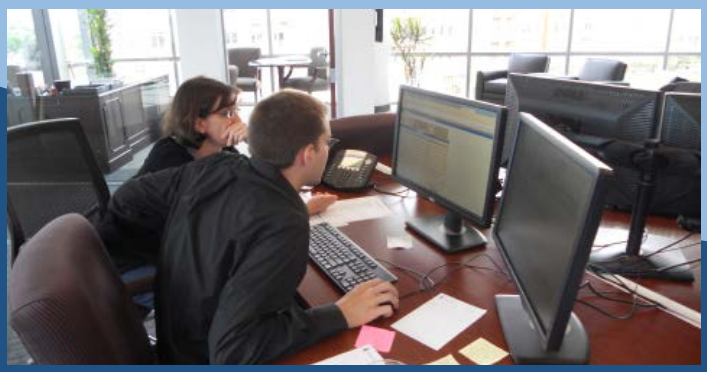
This is simply not in the best interest of clients. The industry has adopted the mindset that it's more important to concentrate on the ride rather than the destination. (This puts even the best advisers in a tough spot as well. They must choose whether or not to cater to the sentiments of a poorly conditioned client in order to not get fired.)

Here's a gauge – simply think about the last portfolio review you either received or conducted. Was it all about how well the portfolio did relative to an all-equity benchmark like the Standard & Poor's 500 index? This is a measurement of the near-term ride rather than the ultimate success or failure of the portfolio.

What both investors and advisers can do is to reevaluate their portfolio construction and determine whether it has been designed to manage short-term volatility or avoid the risk of failure over a longer time horizon.

Like the elevator ride, don't focus on the ride to your floor, just focus on the destination. The real risk is in failure, not how smooth or quick the ride is. As for what to consider trimming from investments designed only to smooth the ride, take a hard look at the bonds you own. If you own them for income and plan to hold them until they mature, that's one thing, but if you have them because they are supposed to reduce volatility, it may be time to reconsider.

This article and ohers written by David B. Armstrong can be found on www.monumentwealthmangement.com under our Resource tab. Please see additional disclosures on the back of this newsletter.



Meet our new summer interns! Chad (right) is our financial planning intern, Ben (left) is here for video production, and Lu is working on graphic design.

About Us

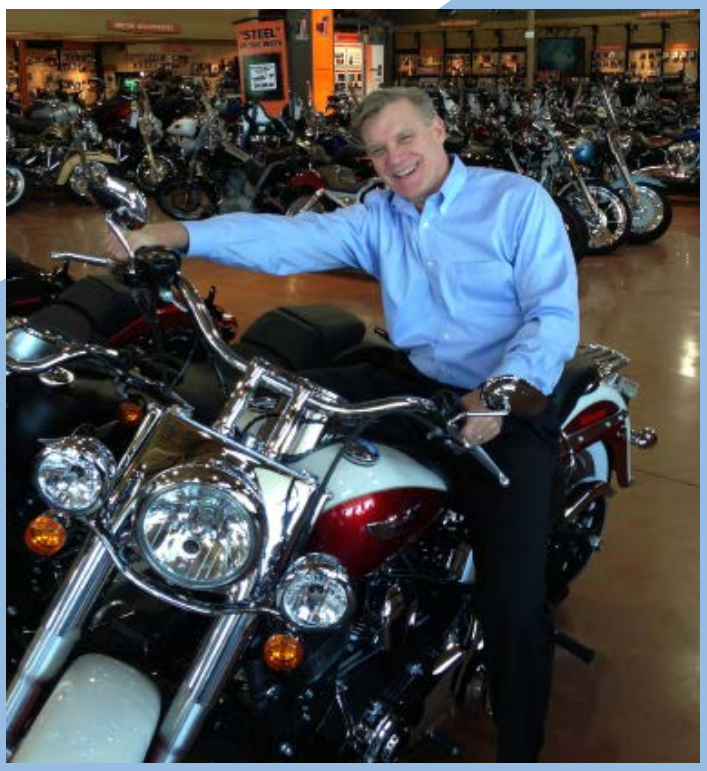
Monument Wealth Management is a financial advisory firm partnership that helps accomplished entrepreneurs transition to a life of longterm financial independence and wealth defined on their own terms.

Monument removes the anxiety and uncertainty that can accompany financial success through a rigorous focus on long-term cash-flow based private wealth planning for every possible scenario and goal.

Monument clients benefit from 'entrepreneurs advising entrepreneurs' and the seamless access to the firm's team of founders, superior investment management expertise, and a candid relationship with personal advocates who prize integrity and independence above all else.

Securities offered through LPL Financial, Member FINRA/SIPC. Investment advice offered through Monument Advisory Group, a registered investment advisor and separate entity from LPL Financial.

Fripp claimed his office on the first day!



"There are two kinds of people in this world; people who can ride motorcycles and people who wish they could ride motorcycles..."

Tax-Deferred Investing Matters More Than Ever

Dean J. Catino, CFP®, CRPC®, Managing Director, Co-Founder

There's an anonymous quote that is very fitting given the new realities of our current tax environment, "I'm putting all my money in taxes — it's the only sure thing to go up." Yes, taxes have gone up for many Americans, and it's my opinion that our politicians will continue with the eternal battle of taxes and spending for years to come.

As we consider taxes in the financial planning and investment world, we always look to minimizes taxes by trying to hold investments for long enough so they qualify for lower tax rates associated with long term capital gain treatment, or by trying to use capital losses to offset capital gains. In the end, there must be a balance in portfolio management – we always want to be aware of taxes, however, we don't want the "tax-tail" to wag the dog.

The further we look into investment returns, the more we realize that the most attractive account structure for long-term returns is to defer our taxes as long as possible and allow the investor to compound their gains over many years. Some of the most common choices for tax-deferred accounts are available through retirement-related vehicles offered through our employer. Oftentimes, the employer will match a portion of our deferred contribution, which only adds to the benefit – think of 401(k)s, 403(b)s, and 457(b)s. Even without the employer match there are similar arrangements offered to individuals, including IRAs, Roth IRAs, SEP plans and more. The big take-away is that contributing and investing within a tax-deferred account structure is undoubtedly the first logical step that all savvy tax-aware investors should participate in.

> With taxes rising, your tax-deferred account is still your best route to retirement saving.

We pay "taxes," but our government refers to them as "revenue." As such, the government limits our contributions in tax-deferred retirement accounts. Take the 401(k) as an example. The annual elective deferral contribution is $17,500 for 2013. (You can contribute an additional "catch-up" deferral of $5,500 if you are 50 or older). Even with the contribution limits, every investor should maximize their contributions into tax deferred accounts. To illustrate the power of the tax deferral and compounding of investment growth, consider the following scenario.

Let's look at a 50 year old who contributes $39,500 per year into their tax deferred accounts ($23,000 in their 401(k) and $6,500 in their IRA) each year for 20 years and gets a 7 percent annual return. At the end of 20 years, the tax-deferred value is 40 percent higher than the taxable value ($1.89 million tax deferred verses $1.35 million taxable). The tax deferred investment account allowed for significant compounding and growth over a long period of time and produced more than $539,000 in additional value!

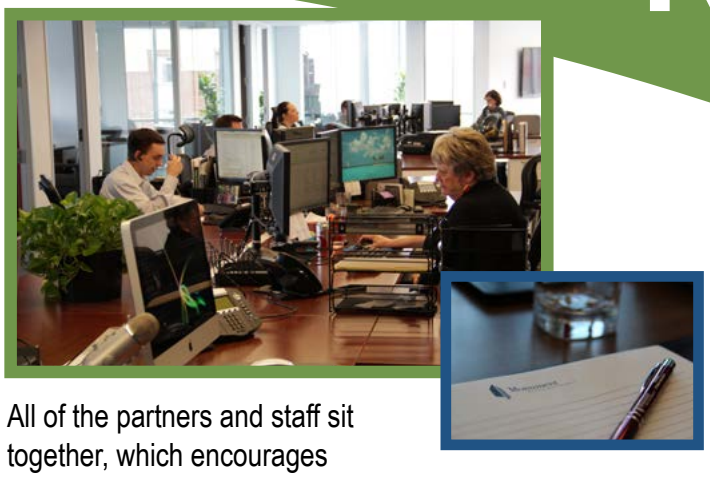
Clearly, there are significant advantages to tax-deferred investments and they should be strongly considered when planning and building an investment portfolio for the long term. Understanding the features, benefits and risks with each investment vehicle is essential to success. With the escalation of tax rates, taking full advantage of the tax deferral is a benefit every investor should exploit.

This article and others written by Dean J. Catino can be found on www.monumentwealthmangement.com under our Resource tab. Please see additional disclosures on the back of this newsletter.

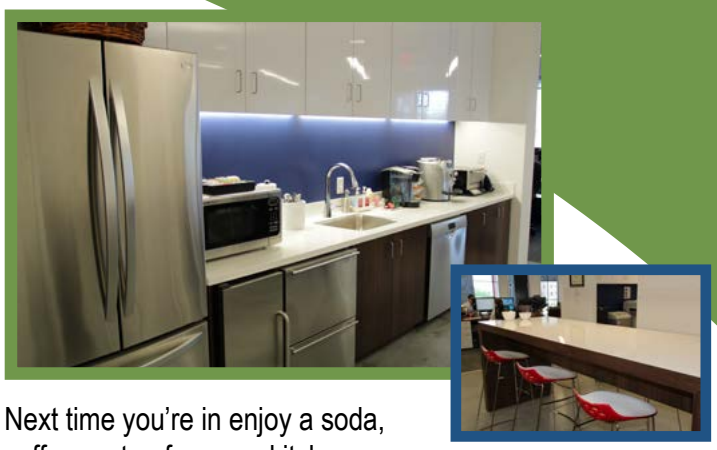
Find us online!

New Office!

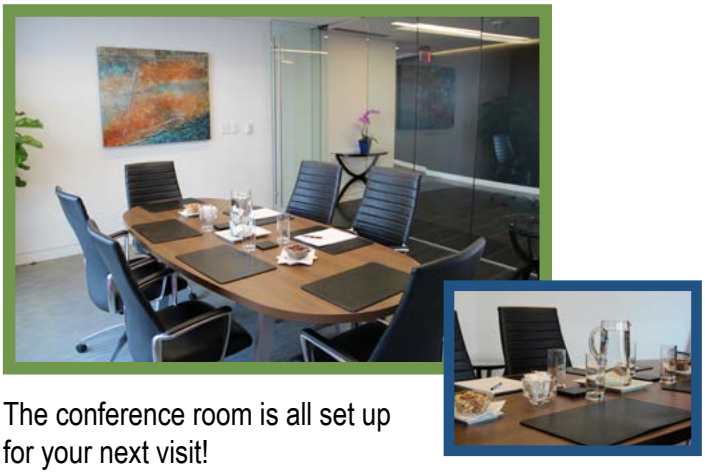
Same address, same phone number, but a whole new look! Can't wait to give you a tour on your next visit!



All of the partners and staff sit together, which encourages communication, collaboration, and transparency across the practice.



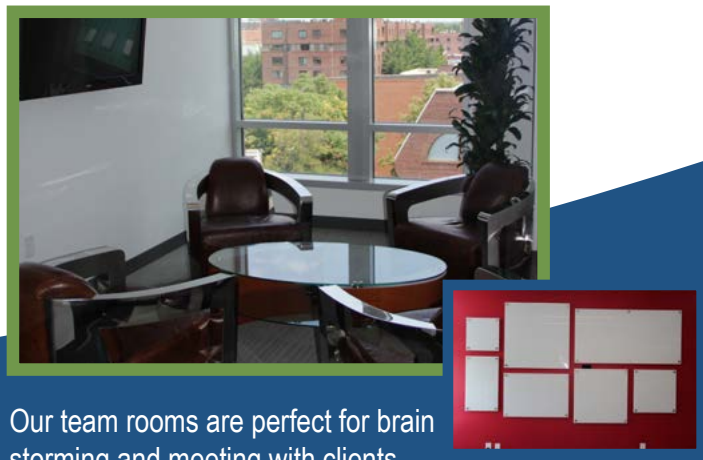
Next time you're in enjoy a soda, coffee, or tea from our kitchen.



The conference room is all set up for your next visit!

Full length windows fill the office with natural light!

Our new team building areas have magazines, TVs, and a putting area for when we need a quick break!



Our team rooms are perfect for brain storming and meeting with clients.

Monument
WEALTH MANAGEMENT

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