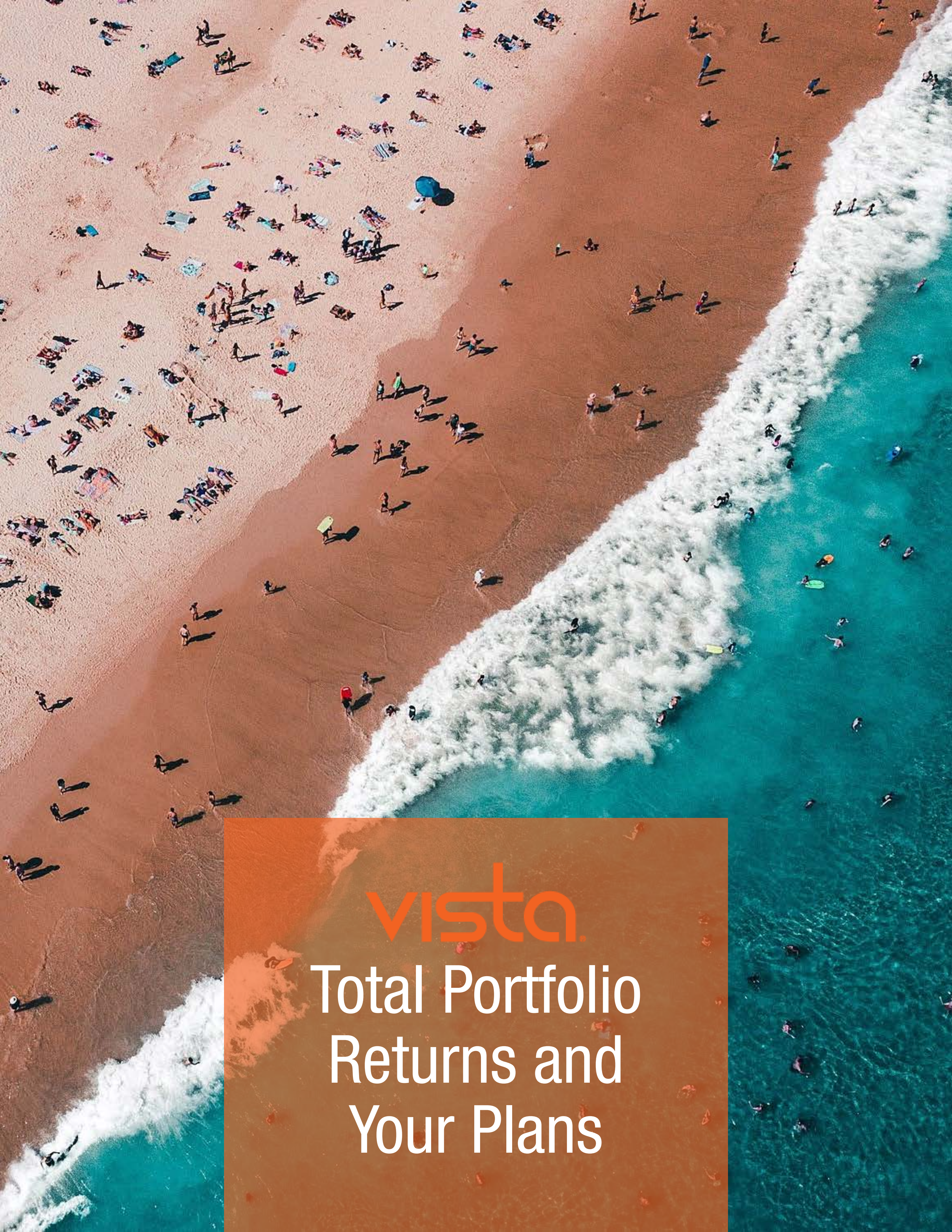


Total Portfolio Returns and Your Plans

Total Return and Your Lifestyle

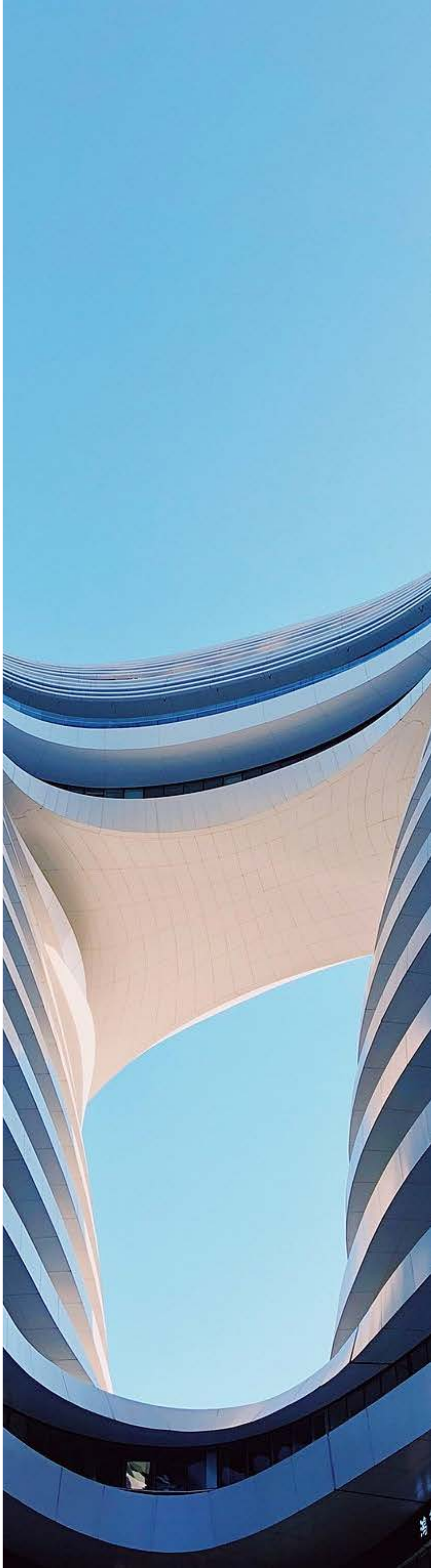
You may recall one of your grandparents admonishing you to “never spend your principal”, an idea firmly planted in them, perhaps during the Great Depression when few people invested in stocks. Today in a world of low interest rates and relatively high stock appreciation, never spending the principal can severely limit your lifestyle with the result of being overly generous to your heirs.

Your Returns Are Total

When we think about returns, we usually refer to the Total Return of a portfolio. The total return is derived by adding together the income return (or yield), usually dividends and interest, to the portfolio’s appreciation return.

The income return in today’s portfolios is usually much smaller than the appreciation. For example, the yield from dividends and interest of our current 60/40 portfolio (60% stocks and 40% bonds) averages approximately 3% per year. In addition to the yield, appreciation of the portfolio has averaged about 6% per year. The Total Return would therefore be 9%, which is simply the 3% yield plus 6% appreciation.

Total Returns are Between You and Your Heirs



Be Thrifty and Leave a Lot

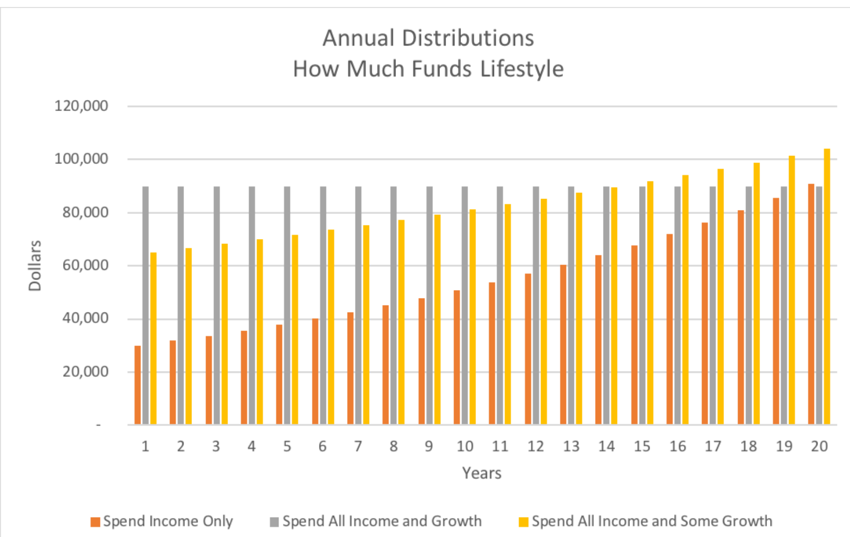
Thinking about those two components of Total Return, what happens if you're living off your portfolio and you just spend the income, or yield? Let's say you have an investment of $1 million in a diversified portfolio that is 60% stocks and 40% bonds. Applying the 3% yield that we mentioned, that portfolio would generate $30,000 per year to help support your lifestyle and that amount would increase as the portfolio grows.

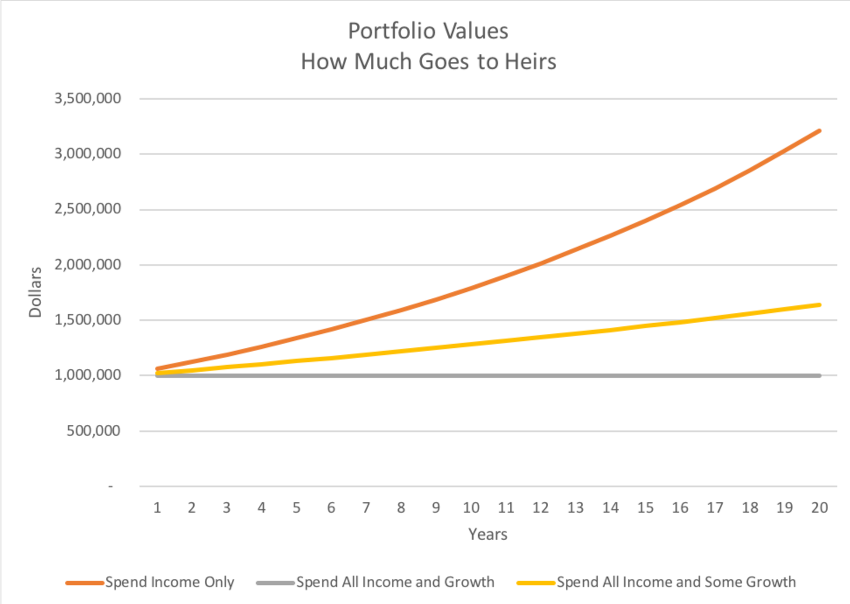
If we follow this through for 20 years, you would receive about $1.1 million in total income over the years from this portfolio. Meanwhile, the principal would grow to about $3.2 million, almost three times what you received. If you goal is to leave your heirs with a lot more money than you had, this would be a good plan for you. This scenario is illustrated on the following charts as "Spend Income Only".

Be Spendy and Leave Some

What if that wasn't your goal, though? What if your goal was to leave your heirs $1 million? How much could you spend then? Then you would take all of the Total Return, both the yield and appreciation, averaging $90,000 per year, or $1.8 million over the 20 year period. Compare that with the $1.1 million in the prior example. Also think about the difference between living off of the $30,000 of income versus the $90,000 of income and appreciation. That could make a huge difference in your lifestyle every year. This scenario is illustrated on the charts as “Spend All Income and Growth”.

Those two extremes are fairly simple. We could bring in more variables, or apply different distribution rates. We’ll give you one more example that is a little more realistic and focuses on the “Total Return” approach. Let’s say you wanted to leave $1 million to your heirs, after accounting for inflation. If we assume a 2.5% inflation rate, then in 20 years you would need to leave $1,639,000 to equal today’s purchasing power of $1 million. Your average distribution would be about $83,000 per year during the 20 year period (it, too, would increase each year and $83,000 is the average of what you would receive each year). This scenario is illustrated on the charts as “Spend All Income and Some Growth”.




Portfolio Values
How Much Goes to Heirs
3,500,000
3,000,000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
-
Dollars
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20
Years
Spend Income Only
Spend All Income and Growth
Spend All Income and Some Growth

Consistently Meeting Your Goals in an Inconsistent World

Of course, investment returns are not consistent, so the average total return we used of 9% would vary widely from year-to-year. Plus, the demands you make of the portfolio (your expenses) may also vary from year to year. How do we manage all of these variables? Through your financial planning.

At Vista, we start with historical total returns, adjust them to be more conservative (because we don’t want anyone running out of money), and then apply those adjusted returns to your long-term financial plan. We also test the outcomes by increasing your inflating expenses at two rates: 2% and 3%. Running these calculations gives us an idea of how you’ll do given your spending when compared to the total return of your investments. We can assist with making adjustments along way as the investment markets change, or as your goals change.

One of the situations we want to be sure to include is the “perfect storm” of low returns and high expenses that may occur at some time in your plan. Sometimes when the investment markets are dropping, it’s a good idea to minimize withdrawals from your investment portfolio. Doing this ensures that there is enough left in your portfolio to grow and fulfill your goals when the markets eventually come back.

All of this requires a dialogue with you. You may have often heard us ask “How much cash do you have?” or “Do you think that you have enough in your bank right now?” Many times, those are just the opening questions to help us determine how you’re doing compared to your plan and what we may need to do to update it.

Thanks

We hope this this sheds a little more light on our Total Return approach to investing and providing you with the growth and income you need.

Thank you for the trust you've placed in Vista, and we look forward to hearing from you.

Your Vista Wealth Management Team

Important Disclosure Information