JOHNSTON INVESTMENT COUNSEL

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**May, 2016**



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# Understanding Stock Market Indexes

No doubt you've seen headlines reporting that a particular stock index is up or down. But do you know what an index is, and how understanding the nuts and bolts of a specific index may be helpful to you?

An index is simply a way to measure and report the fluctuations of a pool of securities or a representative segment of a market. An index is developed by a company that sets specific criteria to determine which securities are included in the index based on factors such as a company's size or location, or the liquidity of its stock. For example, the S&P 500 is an index made up of mostly large-cap U.S.-based companies that Standard & Poor's considers to be leading representatives of a cross-section of industries.

The company that develops the index tracks the performance of its components and aggregates the data to produce a single figure that represents the index as a whole. Virtually every asset class is tracked by at least one index, but because of the size and variety of the stock market, there are more stock indexes than any other type. It's important to note that the performance of an unmanaged index is not indicative of the performance of any specific security. Individuals cannot invest directly in an index.

## Comparing apples to oranges

Since indexes encompass a wide range of securities, it's important to know what segment of the market a particular index covers. For instance, a composite index follows a specific stock exchange. The Nasdaq Composite Index includes all the stocks listed on the Nasdaq market. Conversely, sector indexes track securities in a specific industry.

Even indexes that include the same securities may not operate in precisely the same way. Generally, indexes tend to be either price-weighted or market capitalization-weighted. If an index is price-weighted, such as the Dow Jones Industrial Average, the impact of each stock on the overall average is proportional to its price compared to other stocks in the index. With a price-weighted index, the highest-priced stocks would have the most impact on the average. For example, a 1 percentage point drop in the price of a stock selling for $80 per share would have more impact on the overall index's performance than a 1 percentage point drop in the price of a stock that had been selling for $40 a share.

If an index is market capitalization-weighted or market value-weighted, such as the Nasdaq Composite Index or the S&P 500 Composite Index, the average of the index is adjusted to take into account the relative size of each company (its market cap) to reflect its importance to the index. Stocks with a larger market capitalization have a greater influence on how the index performs than stocks with a smaller market capitalization. For example, if the stock of a $10 billion market-cap company drops by 1 percentage point, it will drag down the index's performance more than a 1 percentage point drop in the share price of a $1 billion market-cap company.

Though an index adheres to a set of guidelines for selection of the securities it includes, the company that oversees the index generally reviews the security selection periodically and may make occasional changes. For example, some indexes may rebalance if an individual security grows so large that it dominates the index. Others have a limit on how much of the index can be devoted to a particular sector or industry, and may rebalance if the proportion gets skewed.

## Indexes are worth watching

Stock indexes can provide valuable information for the individual investor. If checked regularly, an index can provide information that may help you stay abreast of how the stock market in general, or a particular segment of it, is faring. However, understanding the differences between indexes and how each one works will help you make better use of the information they provide. All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.


See disclaimer on final page

# Four Lessons Grandparents and Grandchildren Can Learn Together

If you're a grandparent, maintaining a strong connection with your grandchildren is important, but that may become harder over the years as they leave for college or become busier building their careers and families. While they're just starting out financially, you have a lifetime of experience. Although you're at opposite ends of the spectrum, you have more in common than you think. Focusing on what you can learn together and what you can teach each other about financial matters may help you see that you're not that different after all.

## 1. Saving toward a financial goal

When your grandchildren were young, you may have encouraged them to save by giving them spare change for their piggy banks or slipping a check into their birthday cards. Now that they're older, they may have trouble saving for the future when they're focused on paying bills. They may want and need advice, but may not be comfortable asking for it. You're in a good position to share what experience has taught you about balancing priorities, which may include saving for short-term goals such as a home down payment and long-term goals such as retirement. You'll also learn something about what's important to them in the process.

You may even be willing and able to give money to your grandchildren to help them target their goals. While you can generally give up to $14,000 per person per year without being subject to gift tax rules, you may want to explore the idea of offering matching funds instead of making an outright gift. For example, for every dollar your grandchild is able to save toward a specific goal, you match it, up to whatever limit you decide to set. But avoid giving too much. No matter how generous you want to be, you should prioritize your own retirement.

## 2. Weathering market ups and downs

Your grandchildren are just starting out as investors, while you have likely been in the market for many years and lived through more than one challenging economic climate. When you're constantly barraged by market news, it's easy to become too focused on short-term results; however, the longer-term picture is also important. As the market goes up, novice investors may become overly enthusiastic, but when the market goes down they may become overly discouraged, which can lead to poor decisions about buying and selling. Sharing your perspective on the historical performance of the market and your own portfolio may help them learn to avoid making decisions based on emotion. Focusing on fundamentals such as asset allocation, diversification, and tolerance for risk can remind you both of the wisdom of having a plan in place to help you weather stormy market conditions.

***Note:*** *Asset allocation and diversification do not guarantee a profit or protect against investment loss. Past performance is no guarantee of future results.*

## 3. Using technology wisely

Some people avoid the newest technology because they think the learning curve will be steep. That's where your grandchildren can help. With their intuitive understanding of technology, they can introduce you to the latest and greatest financial apps and opportunities, including those that may help you manage your financial accounts online, pay your bills, track investments, and stay in touch with professionals.

Unfortunately, as the use of technology has grown, so have scams that target individuals young and old. Your grandchildren might know a lot about using technology, but you have the experience to know that even financially savvy individuals are vulnerable. Consider making a pact with your grandchildren that if you are asked for financial information over the phone, via email, or online (including account or Social Security numbers); asked to invest in something that promises fast profits; or contacted by a person or business asking for money, you will discuss it with each other and with a trusted professional before taking action.

## 4. Giving back

Another thing you and your grandchildren might have in common is that you want to make the world a better place.

Perhaps you are even passionate about the same special causes. If you live in the same area, you might be able to volunteer together in your community, using your time and talents to improve the lives of others. But if not, there are plenty of ways you can give back together. For example, you might donate to a favorite charity, or even find the time to take a "volunteer vacation." Traveling together can be an enjoyable way for you and your grandchildren to bond while you meet other people across the country or globe who share your enthusiasm. Many vacations don't require experience, just a willingness to help--and learn--something you and your grandchildren can do together.

***According to a Pew Research study, there are some significant differences between members of the Millennial generation (born 1981-96) and the Silent generation (born 1928-45).***

- ***68% of men and 63% of women in the Millennial generation are employed, compared with 78% of men and 38% of women in the Silent generation when they were young.***
- ***68% of Millennial generation members have never been married, compared with 32% of Silent generation members when they were the same age.***
- ***21% of men and 27% of women in the Millennial generation have at least a bachelor's degree, compared with only 12% of men and 7% of women in the Silent generation when they were young.***

***Source: "How Millennials today compare with their grandparents 50 years ago," Pew Research Center, Washington, D.C. (March 19, 2015), pewresearch.org.***

# Nearing Retirement? Time to Get Focused

***A financial professional can help you estimate how much your retirement accounts may provide on a monthly basis. Your employer may also offer tools to help. Keep in mind, however, that neither working with a financial professional nor using employer-sponsored tools can guarantee financial success.***

If you're within 10 years of retirement, you've probably spent some time thinking about this major life change. The transition to retirement can seem a bit daunting, even overwhelming. If you find yourself wondering where to begin, the following points may help you focus.

## Reassess your living expenses

A step you will probably take several times between now and retirement--and maybe several more times thereafter--is thinking about how your living expenses could or should change. For example, while commuting and dry cleaning costs may decrease, other budget items such as travel and health care may rise. Try to estimate what your monthly expense budget will look like in the first few years after you stop working. And then continue to reassess this budget as your vision of retirement becomes reality.

## Consider all your income sources

Next, review all your possible sources of income. Chances are you have an employer-sponsored retirement plan and maybe an IRA or two. Try to estimate how much they could provide on a monthly basis. If you are married, be sure to include your spouse's retirement accounts as well. If your employer provides a traditional pension plan, contact the plan administrator for an estimate of your monthly benefit amount.

Do you have rental income? Be sure to include that in your calculations. Is there a chance you may continue working in some capacity? Often retirees find that they are able to consult, turn a hobby into an income source, or work part-time. Such income can provide a valuable cushion that helps retirees postpone tapping their investment accounts, giving them more time to potentially grow.

Finally, don't forget Social Security. You can get an estimate of your retirement benefit at the Social Security Administration's website, ssa.gov. You can also sign up for a *my* Social Security account to view your online Social Security Statement, which contains a detailed record of your earnings and estimates of retirement, survivor, and disability benefits.

## Manage taxes

As you think about your income strategy, also consider ways to help minimize taxes in retirement. Would it be better to tap taxable or tax-deferred accounts first? Would part-time work result in taxable Social Security benefits? What about state and local taxes? A qualified tax professional can help you develop an appropriate strategy.

## Pay off debt, power up your savings

Once you have an idea of what your possible expenses and income look like, it's time to bring your attention back to the here and now. Draw up a plan to pay off debt and power up your retirement savings before you retire.

- **Why pay off debt?** Entering retirement debt-free--including paying off your mortgage--will put you in a position to modify your monthly expenses in retirement if the need arises. On the other hand, entering retirement with mortgage, loan, and credit card balances will put you at the mercy of those monthly payments. You'll have less of an opportunity to scale back your spending if necessary.
- **Why power up your savings?** In these final few years before retirement, you're likely to be earning the highest salary of your career. Why not save and invest as much as you can in your employer-sponsored retirement savings plan and/or your IRAs? Aim for the maximum allowable contributions. And remember, if you're 50 or older, you can take advantage of catch-up contributions, which allow you to contribute an additional $6,000 to your employer-sponsored plan and an extra $1,000 to your IRA in 2016.

## Account for health care

Finally, health care should get special attention as you plan the transition to retirement. As you age, the portion of your budget consumed by health-related costs will likely increase. Although Medicare will cover a portion of your medical costs, you'll still have deductibles, copayments, and coinsurance. Unless you're prepared to pay for these costs out of pocket, you may want to purchase a supplemental insurance policy.

In 2015, the Employee Benefit Research Institute reported that the average 65-year-old married couple would need $213,000 in savings to have at least a 75% chance of meeting their insurance premiums and out-of-pocket health care costs in retirement. And that doesn't include the cost of long-term care, which Medicare does not cover and can vary substantially depending on where you live. For this reason, you might consider a long-term care insurance policy.

These are just some of the factors to consider as your prepare to transition into retirement. Breaking the bigger picture into smaller categories may help the process seem a little less daunting.

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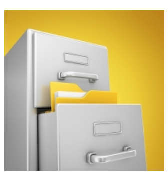
## How long should I keep financial records?

There's a fine line between keeping financial records for a reasonable period of time and becoming a pack rat. A general rule of thumb is to keep financial records only as long as necessary. For example, you may want to keep ATM receipts only temporarily, until you've reconciled them with your bank statement. But if a document provides legal support and/or is hard to replace, you'll want to keep it for a longer period or even indefinitely. It's ultimately up to you to determine which records you should keep on hand and for how long, but here's a suggested timetable for some common documents.

| One year or less | More than one year | Indefinitely |
|---|---|---|
| Bank or credit union statements | Tax returns and documentation* | Birth, death, and marriage certificates |
| Credit card statements | Mortgage contracts and documentation | Adoption papers |
| Utility bills | Property appraisals | Citizenship papers |
| Annual insurance policies | Annual retirement and investment statements | Military discharge papers |
| Paycheck stubs | Receipts for major purchases and home improvements | Social Security card |

*The IRS requires taxpayers to keep records that support income, deductions, and credits shown on their income tax returns until the period of limitations for that return runs out--generally three to seven years, depending on the circumstances. Visit irs.gov or consult your tax professional for information related to your specific situation.



## What are some tips for organizing financial records?

Organizing your financial records is a cyclical process rather than a one-time event. You'll need to set up a system that helps you organize incoming documents and maintain existing files so that you can easily find what you need. Here are a few tips.

**Create your system:** Where you should keep your records and documents depends on how quickly you want to be able to access them, how long you plan to keep them, and the number and type of records you have. A simple set of labeled folders in a file cabinet may be fine, but electronic storage is another option for certain records if space is tight or if you generally choose to receive and view records online. No matter which storage option(s) you choose, try to keep your records in a central location.

**File away:** If you receive financial statements through the mail, set up a collection point such as a folder or a basket. Open and read what you receive, and decide whether you can file it or discard it. If you receive statements electronically, pay attention to any notifications you receive. Once you get in a routine, you may find that keeping your records organized takes only a few minutes each week.

**Purge routinely:** Keeping your financial records in order can be even more challenging than organizing them in the first place. Let the phrase "out with the old, in with the new" be your guide. For example, when you get this year's auto policy, discard last year's. When you receive an annual investment statement, discard the monthly or quarterly statements you've been keeping. It's a good idea to do a sweep of your files at least once a year to keep your filing system on track (doing this at the same time each year may be helpful).

**Think safety:** Don't just throw hard copies of financial paperwork in the trash. To protect sensitive information, invest in a good quality shredder and destroy any document that contains account numbers, Social Security numbers, or other personal information. If you're storing your records online, make sure your data is encrypted. Use strong passwords, and back up any records that you store on your computer.

**Beware the Bogus IRS**

Most people have seen bogus emails purported to be from the executors of the estate of Nigerian princes or other obscure foreign notables who want to give them millions of dollars, and sometimes they get bogus calls telling them they can win a lottery sweepstakes or receive debt relief.

But apparently one of the most effective and dangerous telephone scams these days involves what appears to be a call from the Internal Revenue Service. The phone rings, and a very aggressive person on the other end of the line tells you that you owe money to the IRS. This debt, you are told, must be paid promptly through a pre-loaded debit card or wire transfer. If you refuse to cooperate (as, of course, you should), you're threatened with arrest, suspension of a driver's license or revocation of a business license. In the case of recent immigrants, the caller may also threaten deportation.

In the most sophisticated calls, the scammer may know (and recite) the last four digits of your Social Security number, and may even use electronic spoofing to make it appear on your phone's caller ID that the calling number comes from IRS headquarters. A bogus follow-up email may be sent to support the bogus call, or sometimes a follow-up call from an individual who is pretending to be from the local police or the Department of Motor Vehicles.

The goal, of course, is to scare you out of your wits—enough so that you'll make a payment so the federal authorities will go away and leave you alone. In all, the IRS says that 5,000 victims have collectively paid over $26.5 million to bogus IRS scammers.

A more recent version of the scam involves a less aggressive phone call from somebody pretending to be an IRS agent, who says he or she wants to verify your tax information so your forms can be processed. The scam artists say they're looking at your tax return, and need a few additional. The goal is to get you to give up personal information such as your Social Security number, bank numbers or credit card information that can then be used for identity theft scams.

The IRS has assured the public that it never, ever asks for credit card information over the phone, and it never requests prepaid debit card or wire transfer payments. It never asks for you to divulge personal information by phone or email, or demands payments without giving you an opportunity to appeal the amount they say you owe.

If you receive a call that threatens police action and demands immediate payment, that is a certain indication that the caller does not represent the IRS. Generally taxpayers who have a legitimate tax issue are contacted by mail.

If you receive one of these bogus calls, you can report the incident to the Treasury Inspector General at 800-366-4484. And if you get an email that purports to be from the IRS, make sure you don't click on any attachments. Instead, forward the email, in its entirety, to phishing@IRS.gov.

Sources:

http://www.ktvn.com/story/31465469/irs-says-scammers-changing-tactics-again

https://www.irs.gov/uac/Newsroom/IRS-Repeats-Warning-about-Phone-Scams

https://www.irs.gov/uac/Newsroom/IRS-Warns-of-Pervasive-Telephone-Scam

## The Best Ways to Buy Happiness

We all know that money can't buy you happiness, right? As it turns out, this is not exactly true.

A recent study by University of Michigan economists Betsey Stevenson and Justin Wolfers, examining data from more than 150 countries using World Bank data, has shed new light on the interaction between happiness and the size of your bank account. Their first conclusion: the more money you have, the happier you tend to be, regardless of where you are on the income spectrum. They concluded that multi-millionaires don't think of themselves as "rich."

However, there do seem to be income levels where a person's happiness can be increased faster than others. Princeton University economist Angus Deaton has found that peoples' day-to-day happiness level rises until they reach about $75,000 in income—a point where a person can comfortably afford the basic necessities of life without worrying where his or her next meal is going to come from. After that, this type of happiness levels off.

In fact, a report in Psychological Science magazine found that the wealthier people were, the less likely they were to savor positive experiences in their lives. Another study found that lottery winners tended to be less impressed by life's simple pleasures than people who experienced no windfall. Once you've had a chance to drink the finest French wines, fly in a private jet and watch the Super Bowl from a box seat, then a sunny day after a week of rain doesn't produce quite the same jolt of happiness it used to. The additional money tended to have a cancelling effect on day-to-day happiness.

It's another kind of happiness, which focuses on something the researchers call "life assessment," that continues to rise at all levels of wealth. The more money people have, the more they feel like they have a better life, possibly (Deaton hypothesizes) because they feel like they're outcompeting their peers.

Is there any way to more efficiently buy happiness with money? A study by the Chicago Booth School of Business found that people experienced more happiness if they spent money on others than when the money was spent on themselves. Treating someone else—or, more broadly, charitable activities—are among the most powerful financial enhancements to personal happiness.

Other research has shown that you get more happiness for your buck if you buy experiences rather than things. An epic trip to Paris, or a weekend at a bed and breakfast near the cost, can be more enduringly pleasure-inducing than buying a new watch or necklace. The watch of necklace quickly become a routine part of your environment, contributing nothing to happiness. But your travel experience can be shared with others and reminisced about.

Finally, you can buy time with money—decreasing your daily commute by moving closer to work, hiring somebody to help around the house, hiring an assistant to clear your desk—all giving you more leisure time to pursue your interests. With the free time, take music lessons or learn to dance—and you'll be happier than somebody with millions more than you have.

Sources:

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## The Anxious Bull

We're in one of the longest-running, biggest wealth-producing bull markets in history, but you wouldn't know it from the headlines or the gloomy mood of investors. On March 9, the bull market in U.S. stocks, represented by the S&P 500, celebrated its seventh year. The index has risen 194% since closing at 676.53 on March 9, 2009. The Russell 2000 is up 213% over the same seven years. The Nasdaq 100 has gained 311%. Corporate earnings are up 148% from the first quarter of 2009.

So why hasn't this bull market gotten more respect? For one thing, the S&P 500 is down 7% from its record highs in May 2015. There have been two separate drops of more than 10% between then and now. And the profit levels of American corporations are down 32% from a record high set in the third quarter of 2014.

Perhaps more importantly, the rise has been gradual, and the recovery from the Great Recession has been incremental and below the recovery rate from previous recessions. Wages have barely kept pace with inflation, which means that many people don't feel any wealthier today than they did seven years ago. And investors who didn't trust stocks, who bailed every time the markets dipped or who sat on the sidelines waiting for a clearer sign of recovery, are NOT wealthier than they were back then.

The truth is, only a few staunch investors have really benefited from one of the steadiest, longest bull markets in our history. Instead of celebrating, most of us are keeping a wary eye on the future horizon, doing what we humans do best: looking for the next thing to worry about.

Source:

- http://blogs.wsj.com/moneybeat/2016/03/09/the-bull-market-is-seven-years-old-why-arent-people-more-excited/

## Couples Decision Therapy

There have been studies showing that financial issues are one of the primary reasons why married couples fall apart. A recent article in Market Watch suggests that the biggest reason for these significant disagreements is a failure to create a unified view of the financial future that both parties have agreed to. In many cases, one dominant spouse will make decisions on behalf of the couple, which can lead to disagreements (and potential divorce) down the road, as one spouse feels left out of the picture.

How can you come to a basic mutual understanding of your financial priorities? Even if you already have a financial plan, there may be areas where you disagree with the current one. Sit down with your spouse and write down the answers to a few basic questions. How would you like to live when you retire? What does retirement look like, in terms of activities, travel and your daily routine? Is helping the kids (if you have them) a priority? If so, how much support do you have in mind? What will it cost to achieve these various goals?

Both parties will almost certainly give different answers—which, of course, is where the conflict comes from. The next step is to look for areas of compromise. Create "must have," "want" and "wish" lists, which helps prioritize where you might be willing to give up goals and where you want to stand firm.

After compromise comes evaluation. This may require amending your current financial plan, to see if you're still on track to achieve your mutual goals. But the result may be more harmony, better communication, and a better understanding of what's important to each other.

Source:

- http://www.marketwatch.com/story/how-couples-can-make-smart-retirement-decisions-together-2016-03-28