

# CFA Insights & Outlook

May 2011

Vol. No. 1

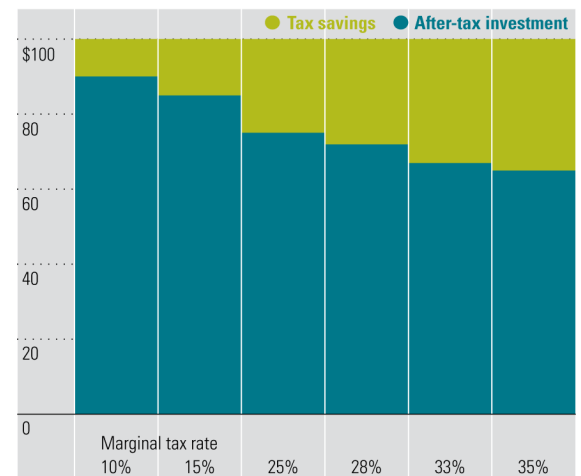
Investment Updates

## 401k Contributions and Tax Savings

A commonly-overlooked benefit of 401k investing is that contributions can be made pre-tax, so that even a small contribution can go a long way. In this situation, 401k contributions are not taxed until you retire. Therefore, the more you contribute to your retirement account, the smaller your taxable income becomes, and the more federal taxes you are able to defer.

The image presents the tax savings (reduction in tax liability) achieved by a 401k contribution of \$100 for six marginal tax rates. For example, if you are subject to a 35% marginal tax rate and you choose not to contribute, you will pay \$35 in taxes and only have \$65 available to invest in another account. If, however, you invest pre-tax in your 401k, you will have \$100 that is yours and can grow tax-deferred until you retire.

Tax Savings from Investing in a 401k Plan



This is for illustrative purposes only and should not be viewed as tax advice. Be sure to consult with a financial advisor or tax professional for the latest rules and regulations.



Calvert Financial Advisory, Inc  
301-812-1550

Experience The Difference

Excellence  
Quality  
Committment  
These are our core values, and it is our pledge to you. At CFA, Inc we commit to you & our community through quality, excellence & unparalleled service.

# The Labyrinth of Financial Statements: The Balance Sheet

Public companies in the United States are required by law to disclose relevant business figures and other information. They do this in the form of financial statements: documents whose purpose is to offer detailed information on the company's financial situation: what the company owns (assets), what it borrowed and therefore has to pay back (liabilities), its stock, profit, cash going in and out, and other figures. All financial statements must follow official accounting rules and must be publicly available. There are three major financial statements: the balance sheet, the income statement, and the cash-flow statement. This article will focus on the balance sheet.

The balance sheet basically lists, in detail, what a company has and what it owes. It is organized into three sections: assets, liabilities, and shareholders' equity. Think of it as an individual sitting down at the end of the year and making a list: 1) Items owned (assets): house, furniture, car, books, and so on.; 2) Items owed (liabilities): mortgage, college loan, etc.; 3) Shareholders' equity can be thought of as total value—an individual's net worth.

1. **Assets:** Assets refer to resources the company owns. They include cash and cash equivalents, accounts receivable (payments the company is waiting for after the sale of products or services), inventories (supply of materials used in operations), and PP&E (property, plant, and equipment). Assets can be current or non-current. Current assets are defined as cash and other items that will be converted to cash within one year. Cash, accounts receivable, and inventories are considered current assets. Property, plant and equipment are considered non-current assets. An important term you may see in this section is depreciation or accumulated depreciation. This represents the decrease in the value of physical resources caused by wear and tear over time. For example, a piece of factory equipment is originally purchased for \$50,000, but after being used for a year, its value decreases to \$40,000. The \$10,000 difference is depreciation.

2. **Liabilities:** Just like an individual, when a corporation does not possess the resources necessary for its operations, it has to borrow (from investors or other corporations). When the company borrows, it owes money and is therefore in debt. Debts owed are called liabilities on financial statements. Liabilities include short-term (current) and long-term debt (obligations lasting longer than one year), accounts payable (what the firm has to pay its suppliers, for example), taxes payable (what the firm has to pay in taxes) and interest payable (interest the company owes to its lenders). Who does the company borrow from? A company usually borrows by issuing bonds, which are bought by investors (either individuals or institutions). When you include a bond in your portfolio, you are, in reality, lending money to the company and receiving interest on that money.

3. **Shareholders' equity:** The third item on the balance sheet is called shareholders' equity (or owners' equity). This represents the total sum of money stockholders have invested in the firm. The shareholders' equity portion of the balance sheet will list the dollar value and the number of shares for the company's common and preferred stock. Total shareholders' equity is composed of paid-in capital and retained earnings. Paid-in capital is the amount the company has raised in the past by issuing stock. Retained earnings represent the sum of past earnings (profit) that have been retained in the business.

A very important point about the balance sheet is what is generally known as the balance-sheet equation:  $\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$ . Also, it is important to remember that the balance sheet shows the company's financial situation at a specific point in time; for example, Dell's balance sheet as of Dec. 31, 2010.

## Major Stock Market Indexes

There are a number of stock market indexes that are frequently mentioned on television and cited in financial newspapers and magazines. They measure various slices of the stock market and can be used as performance benchmarks for both investment vehicles (such as mutual funds) and one's own portfolio returns. Here are three of the most popular and referenced indexes.

**Dow Jones Industrial Average:** The Dow Jones Industrial Average was first unveiled by Charles H. Dow on May 26, 1896, and consisted of 12 stocks. In 1916, the industrial average expanded to 20 stocks and in 1928 was subsequently bumped to 30, where it currently stands. The index constituents are 30 of the world's largest, most influential and well-known companies. Whenever you hear someone referring to what "the market" did in any given day, they are most likely referring to the Dow.

Changes to the index are rare and usually take place, according to Dow Jones Indexes ([www.djaverages.com](http://www.djaverages.com)), "when a current component is going through a major change, such as a shift in its main line of business, acquisition by another company, or bankruptcy. There is no review schedule."

**Standard & Poor's 500 Stock Index:** When you hear that a portfolio has "beaten the market" it is most likely being compared with the S&P 500, which was first published in 1957. The index is composed of 500 leading companies in leading industries of the U.S. economy, focusing on the large-cap segment of the market but also serving as a proxy for the total market—covering approximately 75% of the U.S. equities market.

The S&P Index Committee follows a set of published guidelines for maintaining the index (complete details of these guidelines are available at [www.indices.standardandpoors.com](http://www.indices.standardandpoors.com)). Some of the criteria for addition include a market capitalization (share price multiplied by shares outstanding) in excess of \$3 billion, adequate liquidity (how easy it is to buy and sell shares) and

reasonable price and financial viability. Those that substantially violate the criteria are dropped.

**Nasdaq Composite Index:** Launched in 1971, the Nasdaq Composite Index measures all Nasdaq domestic- and international-based common type stocks listed on the Nasdaq Stock Market. The index includes nearly 3,000 securities. While it is best known for its large portion of technology stocks, it also contains stocks in other industries.

To be eligible for inclusion in this index, securities must be listed on the Nasdaq Stock Market and they need to be of a specific type. For more information, visit [www.nasdaq.com](http://www.nasdaq.com).

Please keep in mind that a company can be a member of more than one of the three indexes described above. Microsoft is an example of a company that has a place in all three.

### Stock Market Index Comparison

Stock Index	Dow	S&P 500	Nasdaq
<b>Year Introduced</b>	1896	1957	1971
<b>Constituents</b>	30	500	2,900*
<b>Types of Companies</b>	Large, well-known, influential.	Leading companies in leading industries. Focuses on large-cap segment.	Large number of technology stocks. Also stocks in other industries.
<b>Index Modifications/Eligibility</b>	Companies undergoing a major change can lead to a modification.	Market cap in excess of \$3 billion, adequate liquidity/ reasonable price/ financial viability.	Listed on Nasdaq Stock Market and needs to be specific security type.
<b>Examples of Current Constituents*</b>	Walt Disney, Johnson & Johnson, Coca-Cola, McDonald's, Walmart	AT&T, Boeing, General Mills, Procter & Gamble, Google	Apple, eBay, Cisco, Dell, Yahoo!

\*As of 12/02/2010

Stocks are not guaranteed and are more volatile than other asset classes. The information above is provided for illustrative and information purposes only. The indexes noted are unmanaged and can not be directly invested in. References to specific securities should not be viewed as a recommendation to buy or sell the mentioned security.

## The End of the Recession

In September 2010, the National Bureau of Economic Research announced the long-awaited news: an end date for the recession that had begun in December 2007. The NBER determined the official end date as June 2009, quieting down (if not completely silencing) double-dip fears. NBER defines a recession as a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. Looking back at the performance of the main asset classes during the recession and in the months following the official end date, gold was the best overall performer, and long-term government bonds offered consistent positive returns. Out of the investments with the worst performances during the recession, REITs posted the most-impressive return in the 18 post-recession months.

### Returns During and After the Most Recent Recession

	<b>Recession</b> Dec 2007 to Jun 2009*	<b>Aftermath</b> Jul 2009 to Dec 2010*
Gold	19.3%	50.4%
Long-term government bonds	8.4%	8.5%
Treasury bills	1.9%	0.2%
Small stocks	-33.8%	60.7%
Large stocks	-35.5%	41.1%
International stocks	-39.7%	32.2%
REITs	-48.1%	86.6%

\*Returns in table represent cumulative returns during time periods indicated, not geometric returns.

**Past performance is no guarantee of future results.** This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Holding a portfolio of securities for the long term does not ensure a profitable outcome, and investing in securities always involves risk of loss. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards. REITs are subject to certain risks, such as risks associated with general and local economic conditions, interest rate fluctuation, credit risks, liquidity risks and corporate structure. Small stocks are more volatile than large stocks, are subject to significant price fluctuations, business risks, and are thinly traded. Government bonds and Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks, REITs, and gold are not guaranteed.

Source: Gold—Wall Street Journal London P.M. closing price. Long-term government bonds—20-year U.S. government bond. Treasury bills—30-day U.S. Treasury bill. Small stocks—Dimensional Fund Advisors, Inc. (DFA) U.S. Micro Cap Portfolio. Large stocks—Standard & Poor's 500® Index, an unmanaged group of securities considered to be representative of the U.S. stock market. International stocks—Morgan Stanley Capital International Europe, Australasia, and Far East (EAFE®) Index. REITs—FTSE NAREIT Equity REIT Index®.

©2011 Morningstar, Inc. All Rights Reserved. The information contained herein (1) is intended solely for informational purposes; (2) is proprietary to Morningstar and/or the content providers; (3) is not warranted to be accurate, complete, or timely; and (4) does not constitute investment advice of any kind. Neither Morningstar nor the content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. "Morningstar" and the Morningstar logo are registered trademarks of Morningstar, Inc.



Calvert Financial Advisory, Inc

3175 West Ward Rd Ste 120  
Dunkirk, Maryland 20754

Tel:301-812-1550