

DAVE'S COMMENTARY

Focusing On What Investors Can Control

Worrying about things that we have little or no control over provides little benefit to investors. To optimize investment success – and sleep better at night – it is far more beneficial to focus on the things we can control. Yet, there are many people who tempt and encourage us to do just the opposite, sometimes leading to decisions we may regret later.

For example, the financial media encourages us to worry about many things that are beyond our control: taxes, health care costs, government spending, terrorist attacks, income tax rates, interest rates, real estate prices, consumer prices, financial markets, the economy and stock market volatility. Cable news programs sensationalize the daily headlines and cater to our emotions of fear and greed to grab our attention.

Wall Street preys on these same emotions of fear and greed with investment strategies that may not be in our best interests. For example, there are thousands of stock brokers and investment managers who tout their unique ability to pick “winning stocks”. Unfortunately, they often fail to mention that most active investment managers who try to beat the market by picking stock winners fail to beat the relevant benchmarks on a consistent basis over the long term.

Other investment advisors tout their ability to “time the market”, promising to help us invest only when financial markets are rising and keep us safely “on the sidelines” in cash when markets are falling. If these folks really had this ability, surely they should be among the wealthiest among us. However, we’re not aware of any “market timers” on the Forbes 400 list of wealthiest Americans.

Since the financial news, price of securities and market direction are all beyond our control and cannot be accurately predicted in the short term, investors generally are better served by turning off the financial media and avoiding speculative Wall Street sales pitches for winning stocks and market timing strategies.

We believe that investors will be more successful over the long term if they instead focus on decisions and activities that they can control. Listed below are six key investment decisions that investors do control and have a major impact on investment results over time:

1. **Time horizon:** Investors can decide how long to invest particular assets. Investing for the long term offers opportunity to invest in securities with higher expected returns.
2. **Risk exposure:** Investors can decide how much investment risk to take. Markets tend to reward greater investment risk with higher returns over the long run in return for greater volatility in the nearer term.
3. **Diversification:** Investors can employ diversification to reduce investment risk by systematically diversifying assets broadly across non-correlated asset classes.
4. **Investment costs:** Investors can reduce investment costs by selecting mutual funds and exchange-traded funds with low expense ratios.

5. **Tax efficiency:** Investors can reduce investment-related tax costs by minimizing investment turnover – both in the selection and replacement of investment managers. Investors can also employ strategies to take advantage of lower capital gains tax rates and utilize tax loss harvesting when advantageous.

6. **Discipline:** Investors can use a disciplined investment approach to avoid knee-jerk, emotion-based decisions that are all too common with more seat-of-the-pants investment methods. Such disciplined approaches tend to be guided by a written investment policy that aligns with an investor’s investment time horizon, risk tolerance, goals, values, etc. From this an appropriate strategic asset allocation is defined and implemented. Results are monitored regularly, and the portfolio is periodically rebalanced to systematically buy assets that may be out of favor (buy low) and sell assets that have appreciated recently (sell high).

We encourage investors to ignore the financial hype, focus on what they can control and to stay disciplined over the long run in the face of short-term market adversities, since we believe this tends to lead to better results and sounder sleep. If you’d like to learn more about how to focus on the investment decisions that you control, we’d enjoy the opportunity to discuss this with you.

David Bromelkamp
President and CEO

Some things are in our control and others not. Things in our control are opinion, pursuit, desire, aversion, and, in a word, whatever are our own actions. Things not in our control are body, property, reputation, command, and, in one word, whatever are not our own actions.

The Enchiridion by Epictetus, 135 A.C.E

Headlines

- We were pleased to welcome three new clients to Allodium during the second quarter and appreciate their trust and business.
- Allodium Senior Investment Consultant Anne Ward recently earned membership in the National Association of Personal Financial Advisors (NAPFA) – the country’s leading professional association of fee-only financial advisors who are committed to working in their clients’ best interests. NAPFA has among the highest membership standards for professional competency, client-focused financial planning and fee-only compensation. You can learn more about NAPFA at www.napfa.org.
- In April Allodium CEO and President Dave Bromelkamp attended the annual fi360 Conference in Chicago. Fi360 is an independent organization that defines, promotes and provides training and resources to execute investment best practices for those who manage assets for others (i.e., investment fiduciaries). The theme for the conference was “Fostering a Higher Standard of Fiduciary Excellence”. You can learn more about fi360 at www.fi360.com.
- On Wednesday, June 13 Allodium hosted an educational workshop for foundation and endowment leaders on the topic of How to Identify and Manage Investment Conflicts Of Interest. Details about our next workshop for foundation and endowment leaders in December will be included in our September newsletter.
- FYI - our office will be closed on these upcoming New York Stock Exchange holidays:
 - Wednesday, July 4 – Independence Day
 - Monday, September 3 – Labor Day

FINANCIAL PLANNING TIPS

Positioning for Higher Taxes in 2013

After the first quarter’s remarkable performance, many investors are contemplating whether to trim positions to lock in recent gains or defer the tax consequences to a later date. While most people typically attempt to minimize income and gains in a given year, some potential tax law changes may make taking capital gains and income this year advantageous for some investors. A host of temporary provisions are set to expire at year-end, possibly driving tax rates higher if our elected leaders do not act to postpone the increases shown at right.

The new Medicare surtax is set to go into effect in 2013, affecting high-income earners when income exceeds certain thresholds. For these taxpayers, there may be a strong advantage to capturing investment gains in 2012 rather than waiting until next year. Not

only might a lower capital gains tax rate apply this year, but high-income earners may also avoid the Medicare surtax on such gains. If hesitant to sell due to a belief that security values may rise further, an investor can sell and immediately repurchase the same securities, since there are no wash-sale rules on gains.

Tax planning is never simple, but this year may be even more difficult. As the clock ticks toward the year-end expiration of the temporary tax reductions mentioned above, a number of tax proposals are being evaluated in Washington. However, with this being an election year, consensus may be difficult to reach, so there’s a lot of uncertainty. While it’s possible that tax hikes may be delayed, tax proposals on the table suggest that higher rates for high-income earners may be inevitable.

As always, we encourage you to visit with your tax professional to assess your unique situation.

Income Source	2012 Income Tax Rate	2013 Income Tax Rate
Ordinary income and short-term capital gains	10%	N/A
	15%	15%
	25%	28%
	28%	31%
	33%	36%
	35%	39.6%
Qualified dividends	15%	Ordinary rates up to 39.6%
Long-term capital gains	15%	20%
2013 Medicare Surtax		
Wages		0.9%
Investment income		3.8%

Upcoming Events

- **August 23:** Allodium will host an informal social event for our clients and their guests at the Minneapolis Institute of Arts. Invitations with more details will be mailed in July.
- **October 3:** Allodium will host a client educational workshop on the topic of Investing in a Rising Tax Environment. Invitations with more details will be mailed in September.

Please contact Rachel Halverson at 612-230-3706 or rhalverson@aicria.com to be added to our invitation list for future events and workshops.

Steward is published quarterly by Allodium Investment Consultants. Please contact Rachel Halverson at 612-230-3706 or rhalverson@aicria.com if you have any comments about this publication or would like to be added to or removed from our mailing list.



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