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Foreign Markets: Risk and Reward

Investors who are interested in gaining exposure to new markets while, at the same time, adding another layer of diversification to a portfolio focused on domestic securities sometimes consider including foreign securities in their investment mix. Because U.S. and international investment returns may move in different directions or experience different degrees of change, investing abroad may help cushion a portfolio when U.S. markets are in a slump.

However, international markets may introduce risks that aren't present in U.S. markets. Changes in currency exchange rates, political uncertainty, and foreign taxation may take a toll on the performance and returns of foreign investments. And because foreign companies often don't file the same types of reports and communications as publicly traded U.S. companies, it may be difficult to find complete and up-to-date information on a company's operations. Before you invest overseas, familiarize yourself with the risks, talk with your financial professional, and proceed with caution.

Your Comfort Level

The degree to which you can tolerate risk should be a major factor in your decision to devote a portion of your portfolio to foreign securities. If you're comfortable with volatility, investing in areas of the world with emerging economies may offer the potential for rapid growth. But you may still benefit from international exposure by investing in countries or regions with more established economies that are typically less volatile.

Assess Your Current Exposure

Your portfolio may already have significant international exposure through U.S. companies that operate overseas. Before you invest abroad, take the time to determine whether adding foreign investments would benefit your strategy and fit your risk profile. Be aware that the factors affecting foreign companies will most likely affect U.S. companies operating in the same region.

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Economic Update

John Largent,
Chief Investment Strategist

The recent mantra of Federal Reserve (Fed) Chair Yellen and other Fed officials appears to be that it's time to be less accommodative and move the federal funds rates up a notch. The Federal Open Market Committee meets approximately eight times a year. By the time you read this note, the committee will have raised the rate by a quarter of 1% to approximately .65%. For a bit of perspective, this is a very low historical rate. Inflation is still under control, but economic growth is starting to appear sustainable.

The question most have is how much more is the Fed going to raise rates. Looking at the calendar and the probabilities at this time, the next hike after December's will be in June or July 2017. *The point is that rates are moving up but at a slow pace.* Investors should have only minor concerns that inflation is getting out of control or asset prices are approaching bubble levels. Increasing rates should be much less painful this time.

Margin Accounts — Understand the Risks

The strategy of *buying on margin* allows you to purchase investments using less of your own money up front. When you set up a margin account, you borrow money from your broker to buy securities, using your investments' value as collateral for the loan.

You can open a margin account by depositing a portion of the purchase price of the securities you want to buy — the margin — with your brokerage firm. If the value of your investment increases, you sell the securities, repay your broker with interest, and pocket any profit.

However, if the value of the securities purchased on margin drops below a required minimum, your broker will issue a *margin call*. You'll then have to deposit more cash or sell some of the securities in your account to make up the difference. If you don't meet the margin call, your broker may sell securities in your account without consulting you. And if the price of the securities keeps dropping, you could sustain substantial losses.

Before you open a margin account, consider whether you feel comfortable with the degree of risk it presents.

Managing Risk in a Margin Account

Although it presents more risk than trading on a cash basis, margin trading offers the potential for increasing profits and may appeal to investors who prefer not to tie up their own cash. If you're considering buying investments through a margin account, the following suggestions may help you manage risk.

- **Become familiar with margin account risks and rules.**
- **Consider your risk tolerance before you purchase securities on margin.**
- **Be aware of the volatility of the securities you're using as collateral for the loan.**
- **Monitor your account closely to avoid being surprised by a margin call.**
- **Have enough cash available to cover a potential margin call without having to sell securities when values are down.**

Your Estate Plan

Revisiting your estate plan should be one component of an annual financial review. However, changes in your personal or financial situation can significantly affect estate planning. Make reviewing your plan a priority under the following circumstances:

- Changes occur in your family situation due to marriage, divorce, births, adoptions, or deaths.
- You receive an inheritance or other windfall.
- You wish to change a beneficiary, guardian, trustee, or personal representative/executor.
- Your charitable goals have changed.
- You want to include or update advance directives, such as a living will or durable power of attorney for health care (health care proxy), or designate a different individual to manage your financial affairs under a durable power of attorney.
- New federal or state tax legislation may affect your estate plan.
- You haven't reviewed your estate planning documents recently.

A periodic review can confirm that your estate plan is complete and up to date and can help ensure that your final wishes will be followed.

Valuing Your Donated Assets

Making a charitable donation of property can benefit your favorite nonprofit organization and net you an income tax deduction — but only if all IRS rules are followed. Determining the property's fair market value is the first step.

Fair market value (FMV) is the price that a willing buyer and seller would agree on when neither is required to act and both have reasonable knowledge of the relevant facts. Several factors may be considered in determining FMV.

An item's cost or selling price may be an accurate measure of FMV, assuming the transaction and donation dates are close and there has been no change that would affect the item's value.

Sales of comparable properties similar to the donated property can help in determining FMV as long as the sales occurred close to the valuation date.

The replacement cost of donated property on the date of valuation may sometimes serve as an indicator of FMV, provided that depreciation is subtracted from the cost.

Expert opinion may be given weight, depending on the expert's experience, education, and knowledge.

Qualified Appraisals

You will generally need a qualified appraisal by a qualified appraiser to claim a charitable income tax deduction of more than $5,000 for donated property (exceptions apply). A *qualified appraiser* is someone who:

- Has earned an appraisal designation from a recognized appraiser organization or has met certain education and experience requirements
- Regularly prepares appraisals for a fee
- Is not an "excluded individual," such as the property's donor, the donee, or a party to the transaction in which the donor acquired the property (other exclusions apply)

A *qualified appraisal* must be signed and dated and completed no earlier than 60 days before the valued property is donated.

A Role in Retirement?

Life insurance coverage may have seemed essential when your family was young. But should you consider cashing in your policy once you're retired? Life insurance can play a role in your financial plan even when you no longer need protection for your family.

"Life insurance can play a role in your financial plan even when you no longer need protection for your family."

Consider the following suggestions:

- Designate a charitable organization as beneficiary of a life insurance policy. Life insurance proceeds paid to a charity at your death can support the charity's mission and benefit a cause that's important to you.
- Equalize an inheritance with life insurance when you plan to leave a substantial asset to only one of your children. Designating your other children as beneficiaries of the appropriate amount of life insurance can provide all your children with a substantially equal inheritance.
- Secure your adult children's financial security by naming them as beneficiaries of your life insurance policy.

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Mutual Funds

You may be able to reduce some of the uncertainties of investing overseas by purchasing professionally managed mutual funds. You can choose from funds that hold only foreign securities as well as funds that include U.S. securities. Here's an overview of the available options.

Global funds invest mainly in foreign companies but may also hold securities from U.S. companies.

International funds typically invest in companies outside of the U.S.

Regional funds focus on companies located in a specific geographical region, such as Latin America or the Pacific Rim. Funds may invest in developed or developing markets or a balance.

Country funds invest in securities from a single country and may focus on emerging or on well-established markets.

International index funds track the performance of a particular foreign market index, such as the MSCI EAFE, which includes stocks from developed markets worldwide, excluding the U.S. and Canada.

Other Choices

Buying shares of an *exchange-traded fund* (ETF) that tracks an international index is another option for investing abroad. One advantage of ETFs is that they're listed on stock exchanges and trade throughout the trading day like stocks.

American depositary receipts (ADRs), issued by U.S. depositary banks, are negotiable certificates that represent one or more shares, or a fraction of a share, of a foreign stock. ADRs trade in U.S. markets and allow you to buy and sell foreign shares just as you would U.S. stock shares. ADRs are priced and pay dividends in U.S. dollars and are subject to fluctuating currency exchange rates between the U.S. and the underlying foreign country.

This publication involves sophisticated tax and financial planning concepts. Before applying anything you read to your situation, you should consult with your professional advisor.