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Not All Index Funds Are the Same

The choice to use index funds rather than actively managed funds is a significant one. Index funds tend to be rather straightforward, easy-to-own, and cost-effective investment vehicles. But, just like actively managed funds, index funds also have their differences that investors should be aware of.

Cost Still Counts. Different index funds can charge different fees. Funds that are otherwise virtually identical (meaning they track the same index) can nonetheless produce different returns based on their fees, because fund fees are deducted from returns. This cost difference can have a significant effect on fund performance when compounded over time.

The Challenges of Tracking an Index. Tracking error is the degree to which an index fund fails to mirror its benchmark's performance during a given time period. As the components and weightings of an index change over time, the fund must buy and sell holdings in an attempt to match it, and some funds may do this better than others.

Subtle Index Differences. Index funds within the same category may not track the same index. Consequently, two index funds that may sound very similar could actually have very different portfolios and performance numbers.

The investment return and principal value of mutual funds will fluctuate and shares, when sold, may be worth more or less than their original cost. Mutual funds are sold by prospectus, which can be obtained from your financial professional or the company and which contains complete information, including investment objectives, risks, charges and expenses. Investors should be read the prospectus and consider this information carefully before investing or sending money.

Our priority is the privacy, protection and performance of our clients' assets.

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Atlantic Capital Management has been providing their clients with strategic financial planning and investment management services for over 25 years.

Our active and sophisticated investment approach is designed to minimize risk and maximize returns.

Monthly Market Commentary

In recent economic data, employment matches expectations, manufacturing flattens after a period of decline, and auto sales growth continues to moderate.

Employment: The U.S. economy added 223,000 jobs in April, matching expectations. However, it wasn't all good news; the March estimate was reduced from 126,000 jobs added to just 85,000, providing a much easier set of goalposts to hit for the April report. Furthermore, hourly wage growth, at least on a month-to-month basis, was surprisingly weak with just 0.1% growth or 1.2% annualized. On the positive side, the unemployment rate continued to trend down, ending April at 5.4%, down from 5.5% a month ago and 6.2% a year ago. This is the lowest reading in seven years. For a change, the rate went down exclusively because new jobs were added even as 166,000 people entered the work force in April. The higher percentage of people looking for jobs is a sign of increased consumer confidence.

Looking at private sector job growth, which excludes the much slower-growing government sector, the three-month average, year-over-year growth rate remains relatively high at 2.6%, which is down just a touch from recent highs and still above the 2.4% average growth rate of the past 12 months. Those year-over-year growth rates are likely to continue deteriorating modestly in the months ahead.

GDP: The U.S. GDP report of just 0.2% GDP growth in the first quarter was disappointing to everyone, as falling oil drilling activity ruined a report that was already expected to be hit hard by bad weather and West Coast port-related activities. Drilling activity pushed GDP growth down by 0.8%, about the size of the negative surprise. Still, we wouldn't be too upset with a GDP report that shows four-quarter-over-four-quarter growth of over 3%. Seasonal factors and weather have really confounded economists and statisticians, who tend to favor the sequential quarter-over-quarter growth methodology.

The individual GDP component factors weren't too far off of consensus forecasts. Consumption growth was cut in half in a widely expected drop from 4.4% to just 1.9% growth between the fourth quarter and the first quarter. At almost 70% of GDP, that fall single-handedly took off 1.7% from the GDP growth rate (contribution from 3% to 1.3%). The rapid deterioration in consumption, however, was widely expected. Morningstar economists still predict that U.S. GDP will grow at a rate of 2.0%–2.5% in 2015.

Manufacturing: The overall ISM Purchasing Manager Index, a great leading indicator of manufacturing activity, was flat in April at 51.5, after falling for five consecutive months. At a reading of 51.5, the metric shows that more businesses are seeing an increase in activity versus a decline. Still, the number, at least on the surface, disappointed analysts who expected a weather- and port-related bounce to 52.2. That said, the April report was a bit stronger than it looked. New orders—the leading part of the index—increased from 51.8 to 53.5, and current production moved from 53.8 to 56. Exports and imports also showed nice increases, though these are not used in calculating the composite index.

Auto sales: While auto manufacturers were trumpeting good April numbers, the auto recovery is looking a little long in the tooth. The auto sales for April were about 16.5 million units, which marks a 3.1% annual increase. That's down from the 3.8% rate reported in March. It is now apparent that auto sales growth has peaked and further year-over-year increases will be modest, indicating that the auto industry will have limited impact on GDP and employment going forward.

Key Reasons Why Investing in a Taxable Account May Be Underrated,

Tax-sheltered savings vehicles offer tax-deferred compounding, meaning investors won't pay any taxes on a year-to-year basis as long as they don't withdraw any assets. And depending on the vehicle, they may also receive a tax break on contributions and/or withdrawals, too. Those tax breaks can help enhance take-home return.

With all the attention paid to accumulating money in those tax-sheltered accounts, many investors see saving in a taxable account as a last resort—something to be considered only after they've fully funded their tax-sheltered accounts.

But investing via a taxable account can be a sensible maneuver, and not just if you're running out of tax-sheltered receptacles for your money. In fact, investors may want to consider simultaneously funding their taxable and tax-sheltered accounts, and the current tax and interest-rate environment make saving in a taxable account particularly sensible. Here are six key reasons why.

Reason 1: Flexibility.

Investing via a taxable account carries two key advantages, both of which make the taxable account more flexible.

First, liquidity: If you have near-term income needs or are simply building an emergency fund, a taxable account will allow you access to your money without any strings attached (though you may owe taxes if your investments have appreciated). True, a Roth IRA allows you to tap your contributions (not your investment earnings) at any time and for any reason, which is one reason it's a suitable vehicle for younger investors who are conflicted between saving for near-term financial goals and retirement. But for higher-income folks who need to use their tax-advantaged options for retirement savings, putting money for liquidity needs into a taxable account may be the way to go.

The other reason investing in a taxable account is so flexible is that you can invest in literally anything. You'll have to choose from a preset menu if you're investing in a company retirement plan, for example. And while you may have more leeway when investing in an IRA, there are still a few investment types that are off limits. A taxable account is the one account type that gives you carte blanche. (Of course, it also gives you more opportunity to make mistakes!)

Reason 2: Compounding and potentially minimizing taxes if you plan carefully.

When investing inside of a taxable account, it may not be all that difficult to simulate the tax-deferred compounding you get with many tax-sheltered vehicles. The key is to choose investments that kick off limited taxable income and capital gains distributions. For example, income from municipal bonds is exempt from federal and in some cases state income taxes. Choosing tax-efficient securities can make it possible to buy and hold a basket of securities for years inside a taxable account while owing very little in taxes on that portfolio during your holding period.

It's also worth noting that income is low on an absolute basis right now, so the tax hit associated with owning securities that produce income that is taxed at your ordinary income tax rate is also going to be pretty low, at least in dollar terms. (That will change if yields go up, though.)

Reason 3: You can use tax losses to reduce your tax bill.

In addition to the ability to have your assets grow without owing a lot in taxes, investing in a taxable account also gives you the ability to harvest losses, something that is not easy to do with investments held inside tax-sheltered accounts. You can sell securities that are trading below your purchase price and use your loss (the difference between your purchase price and your sale price) to offset capital gains or, if you still have excess losses, up to $3,000 in ordinary income.

Retirement Distribution Pitfalls: Income-Producing Securities

Accumulation is a key facet of reaching your retirement goals. However, we tend to see far less about portfolio drawdown, or decumulation—the logistics of managing a portfolio from which you're simultaneously extracting living expenses during retirement. This can be even more complicated than accumulating assets.

Pitfall: One of the big mistakes of retirement distribution can be relying strictly on income-producing securities to meet income needs. Sticking exclusively with income distributions can leave retirees beholden to the current interest-rate environment. We've seen that problem in sharp relief during the past several years, as income-oriented investors have been forced into riskier areas, such as emerging-markets bonds, to scare up the income they need.

Workaround: The bucket approach to retirement income is essentially a total-return approach that relies on regular rebalancing to provide income for living expenses. Using such a structure, a retiree would own bonds and dividend-paying stocks but would also own other stock types, including those that don't pay dividends. Such a strategy could potentially provide a better-diversified portfolio than the income-only approach for some retirees, and may also allow a retiree to enjoy a fairly stable standard of living.

All investments involve risk, including the loss of principal. There can be no assurance that any financial strategy will be successful. Diversification is an investment method used to help manage risk. It does not ensure a profit or protect against a loss. This is for informational purposes only and should not be considered tax or financial planning advice. Please consult a tax and/or financial professional for advice specific to your individual circumstances.

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