MITCHELL MCLEOD PUGH & WILLIAMS
INVESTMENT ADVISER

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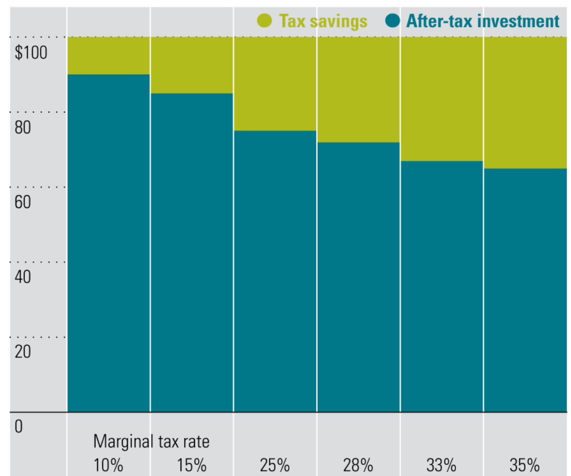
401k Contributions and Tax Savings

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.

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Mitchell McLeod Pugh & Williams, Inc. - Adviser Corner

Our firm exists only because of our clients' commitment and trust. It is this commitment that inspires us to search for ways to enhance the operation of our business. As part of this process, we recently have completed an upgrade of our computer systems and portfolio management software. This has ensured that we have some of the most efficient and up-to-date systems available today. Under the direction of Carmen Williams, the conversion went smoothly, and we are now set to accommodate the next five years of growth. Our clients are receiving this newsletter with their quarterly report packages. Also enclosed this quarter is a newly printed firm brochure briefly describing who we are and what we believe distinguishes us as investment advisers. Please consider passing this brochure along to anyone you feel may be interested in our services. We appreciate it every time someone chooses to offer our name to a friend, family member or business associate.

Monthly Market Commentary

June saw markets reacting strongly to a mix of positive and negative economic news, including a speech by Fed chairman Bernanke that didn't mention additional quantitative easing, and Greece narrowly avoiding a bond crisis for at least the next few months. After six weeks of declining markets, investors were finally rewarded when, based on a surprisingly strong purchasing managers' report and reported increases in housing prices and pending home sales, the market gained more than 6% in the last week of June.

GDP: The third and final read on real GDP for the first quarter of 2011 was revised upward to 1.9% from 1.8% because of lower imports (subtracted from GDP) and higher inventory adjustments. A significant portion of this GDP increase was due to autos, which is worrisome, because future GDP growth expectations may prove to be overstated.

Employment: Employment data was abysmal for June, growing a pitiful 18,000 compared with 25,000 in May and 217,000 in April. The April and May numbers were also revised downward from previous reports to a total of 44,000. Small gains in the private sector barely offset continued government job losses on primarily the local level but also at state and federal levels. The unemployment rate inched up slightly to 9.2% from 9.1%.

Housing: On a seasonally adjusted annual basis, May existing-home sales were lower than they were in April. May inventories, at 3.7 million units, were little changed from April, with the month of supplies number still sitting at 9.3 months. However, both the Federal Housing Finance Administration and the Case-Shiller Home Price Index reported a rise in home prices in April, representing the first increase in 11 and 8 months respectively. Pending home sales also increased by 8% from April to May, leading to early signs that housing may have finally hit a bottom.

Manufacturing: The ISM Manufacturing Index increased in June, along with a better-than-expected industrial production figure and a strong durable goods report. According to Morningstar economists, one of the causes for these numbers was increased production at Nissan and Toyota, with Nissan almost back to normal in the U.S. and Toyota up to 80% of normal. Another factor was better weather conditions; June did not experience the same negative impact from bad weather as in May.

Personal income and consumption: Real, inflation-adjusted incomes remained relatively flat through May as accelerated inflation eroded away most consumer gains. Inflation-adjusted consumption numbers fell in April and May, primarily because of declining auto sales caused by high prices and short supply. Gasoline and food demand were also quite soft in response to higher prices, although more recently gasoline and agricultural prices have declined—the U.S. Department of Agriculture reported increased planting and stored stocks for corn and soybeans.

Retail sales: The International Council of Shopping Centers report for June was particularly strong; it noted that falling gasoline prices and warmer weather were helpful factors that allowed consumers to spend more freely.

Quarter-end insights: The Japan disaster's effect on major supply chains and high gas prices resulting from unrest in the Middle East were two important factors that slowed down the economy during the first half of the year, but more fundamental indicators were also in play. Inflation and real wage growth are key concerns for consumers, who are ultimately driving the recovery (and holding up surprisingly well despite said concerns). However, with real wage growth moving into negative territory on a three-month moving average basis, consumers may not have any disposable income left with which to drive the recovery. The good news is that, in the long term, decent productivity growth, favorable demographics, and an eventual real estate recovery are positive drivers.

Dividends and Total Return

Income is important to consider when choosing an investment. Especially important for investors approaching retirement, income can add meaningfully to one's total return, which comprises income and price return (capital appreciation). Investors can pursue income returns in many ways including bonds, real estate investment trusts, and stocks.

Stock income is typically paid in the form of a monthly, quarterly, annual, or special cash dividend, which can be used to finance current consumption or to reinvest. Dividends are typically expressed in terms of yield. Like an interest rate, yield is represented as a percentage rate and is calculated by taking the annual cash dividend divided by a stock's current price. For example, a stock trading at $20 with a future annual cash dividend of $1 would have a dividend yield of 5%.

Keep in mind, though, that there is no guarantee a dividend will be paid, even if a certain company has a consistent dividend-paying track record. A company can increase, decrease, and even eliminate dividends altogether, depending on its financial situation. Furthermore, if a dividend is declared, the company has to pay dividends for preferred shares first, before any common share dividends can be paid.

Although stocks can be a source of income return, not all stocks are created equal in this regard. Some companies distribute significantly more of their profits in the form of dividends than others, and some don't distribute dividends at all. The following image demonstrates this point. Historically, dividend-earning stocks—represented by Morningstar's Dividend Composite Index—have had compound annual returns of 6.9%, while large stocks have had compound annual returns of 5.0%. Additionally, higher-yielding companies—represented by Morningstar's Dividend Leaders Index—have outperformed large stocks: Dividend Leaders Index components had a compound annual return of 9.0% compared with 5.0% for large stocks during the period studied. For investors looking both for income and total returns, dividend-paying stocks can be a reasonable place to invest.

Although higher-yielding stocks have demonstrated an ability to outperform large stocks, all that glitters is not gold. Dividends are paid at a company's discretion, and exceptionally high yields can indicate a potential dividend cut. For example, had investors been lured to many high-yielding bank stocks in late 2008, they would have been sorely disappointed when many banks subsequently cut their dividends as profitability declined during the credit crisis. When looking at dividend-paying stocks, investors should focus on reasonable dividend yields with companies that have the earnings power to increase their dividend distributions over time. Many large companies with recognizable brand names have demonstrated an ability to offer this slow and steady income distribution to shareholders.

Dividend-Paying Stocks
May Provide Better Returns

This is for illustrative purposes only and not indicative of any investment. Assumes reinvestment of all income and no transaction costs or taxes. An investment cannot be made directly in an index. Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed. Dividends are not guaranteed and are paid solely at a company's discretion.

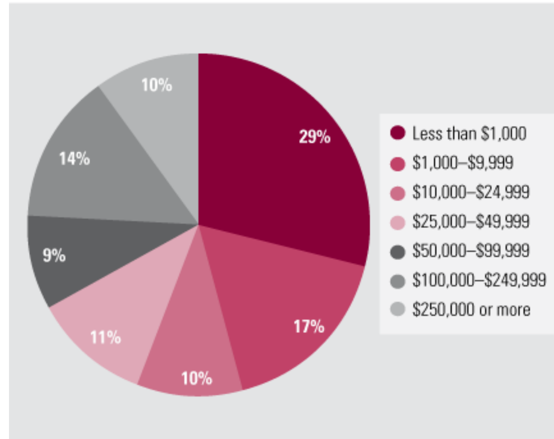
Source: Large Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general; Dividend-Paying Stocks—Morningstar Dividend Composite Index; High-Yield Dividend-Paying Stocks—Morningstar Dividend Leaders Index. Stocks in both indexes have a consistent record of dividend payment, have the ability to sustain their dividend payments and are weighted in proportion to the total pool of dividends available to investors. The Morningstar Dividend Composite Index captures the performance of all stocks in the U.S. Market Index. The Morningstar Dividend Leaders Index captures the performance of the 100 highest-yielding stocks.

Bleak Picture

The Employee Benefit Research Institute (EBRI) is an organization founded in 1978 with the mission of encouraging and contributing to the development of sound employee-benefit programs. Every year, the EBRI publishes a retirement confidence survey. The 2011 survey interviewed 1,004 workers and 254 retirees in order to find out their confidence in being able to meet retirement financial goals.

Unfortunately, the survey results look pretty bleak this year. For example, as the image illustrates, 29% of workers report having saved less than $1,000, and 17% report retirement savings in the $1,000–$9,999 range. Overall, more than half of workers have less than $25,000 saved, at a time when people start questioning if $1 million will be sufficient for a safe retirement. Take a minute and see if you recognize yourself in this picture.

Total Savings and Investments Reported by Workers



Source: EBRI 2011 Retirement Confidence Survey, No. 355, March 2011. Savings reported not including value of primary residence or defined-benefit plans. Percentages may not add up to 100% because of rounding.

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