Dwayne M. Dills, CPA, PC
Financial Advisor and Certified Public Accountant

18-D Regent Park Blvd. • Asheville, NC 28806
Phone: 828-398-0258 • Fax: 828-225-3900

Financial Briefs

JANUARY/FEBRUARY 2018

Focus on the Basics

How do you choose the right combination of investments to help you work toward a goal that may be decades away? The answer is to focus on the basics. Make sure you are getting these fundamentals right:

- **Don't wait — invest now.** To put the power of compounding to work for you, start investing now. It's easy to put off investing, thinking you'll have more money or time at some point in the future. Typically, however, you'll be better off saving less now than waiting and saving more later. Consider the savings habits of a 20-year-old couple. The wife starts contributing $2,000 per year to a tax-deferred investment such as a 401(k) plan when she is 20. After 10 years, she decides to stop investing and let her money grow until retirement. She has invested a total of $20,000. Her husband starts investing when she stops, investing $2,000 per year from the time he is 30 until he retires at age 65. Thus, he saves every year for 35 years, making a total contribution of $70,000 — $50,000 more than his wife. If they both earn 8% compounded annually, who will have the larger potential balance at age 65? Time and compounding favor the wife. Before paying any taxes, her balance would equal $462,649, while her husband's balance would be $372,204. (*This example is provided for illustrative purposes only and is not intended to project the performance of a specific investment.*)
- **Live below your means so you can invest more.** Most people have trouble coming to grips with the fact that the amount of money you have left over for investing is a direct result of your lifestyle. Don't have any money left over for investing? Ruthlessly cut your living expenses. Redirect all those reductions to investments. This should help significantly with your retirement. First, you'll be saving significant sums for that goal. Second, you'll be living on significantly less than you're earning, so you'll need less for retirement.
- **Maintain reasonable return expectations.** When developing your financial goals, you'll typically decide how much you need, when you'll need the money, and how much you'll earn on those savings. Those factors will determine how much you'll need to save on an annual basis to reach your goals. The higher

Continued on page 2

Assessing Your Risk Tolerance

While investors want the highest returns possible, returns compensate you for the risks you take — higher risks are generally rewarded with higher returns. Thus, you need to assess how much risk you are willing to take to obtain potentially higher returns. However, this can be a difficult task. It is one thing to theoretically answer questions about how you would react in different circumstances and quite another to actually watch your investments decrease significantly in value. What you are trying to assess is your emotional tolerance for risk or how much price volatility you are comfortable with. Some questions that can help you gauge your risk tolerance include:

- **What long-term annual rate of return do you expect to earn on your investments?** Your answer will help determine the types of investments you need to choose to meet that target. Review historical rates of return as well as

Continued on page 3

FR2017-0922-0001

Focus on the Basics

Continued from page 1

the expected return on your investments, the less you'll need to save every year. However, if your assumed rate of return is significantly higher than your actual rate of return, you won't reach your goals. Thus, it's important to come up with reasonable return expectations. While past returns aren't a guarantee of future returns, you'll want to start by reviewing historical rates of return for investments you're interested in. You can then adjust those returns based on your expectations for the future. Assessing your progress every year will allow you to make adjustments along the way.

- **Understand that risk can't be totally avoided.** All investments are subject to different types of risk, which can affect an investment's return. Cash is primarily affected by purchasing-power risk, or the risk that its purchasing power will decrease due to inflation. Bonds are subject to interest-rate risk, or the risk that interest rates will rise and cause the bond's value to decrease; and default risk, or the risk that the issuer will not repay the bond. Stocks are primarily subject to nonmarket risk, or the risk that events specific to a company or its industry will adversely affect a stock's price; and market risk, or the risk that a stock will be affected by overall stock market movements. These risks make some investments more suitable for longer investment periods and others for shorter investment periods.
- **Diversify your portfolio.** When stocks have above-average returns for an extended period, diversification acts as a drag on total return. By definition, allocating anything other than all of your portfolio to the best-performing asset lowers your return. But when stocks decline substantially, the disadvantage of investing in only one asset class becomes apparent. Typically, you do not know which asset class will perform best on a year-to-year basis. Diversification is a defensive strategy — it helps protect your portfolio during market downturns and helps reduce volatility. Diversify your investment portfolio among a variety of investment categories, such as stocks, bonds, cash, real estate, and other alternatives. Also diversify within investment categories.
- **Only invest in the stock market for the long term.** Stocks should only be considered by investors with an investment time frame of at least five years. Remaining in the market over the long term reduces the risk of receiving a lower return than expected.
- **Don't try to time the market.** Timing the market is a difficult strategy to accomplish successfully since so many factors affect the market. Remember that most people, including professionals, have difficulty timing the market with any degree of accuracy. Significant market gains can occur in a matter of days, making it risky to be out of the market for any length of time. Instead of timing the market, concentrate on setting an investment program that works in all market environments and you can stick with in good and bad times.
- **Pay attention to taxes.** Taxes are probably your portfolio's largest expense. Using strategies that defer income for as long as possible can make a substantial difference in the ultimate size of your portfolio. Some strategies to consider include utilizing tax-deferred investment vehicles (such as 401(k) plans and individual retirement accounts), minimizing portfolio turnover, selling investments with losses to offset gains, and placing assets generating ordinary income or that you want to trade frequently into your tax-deferred accounts.

Focusing on the fundamentals can help ensure you work toward your financial goals. If you need help with investing, please call.

Your Emotions and Investing

The current bull market began in March 2009 and continues through today. While it has been a good market for investors, it also makes them nervous wondering when the market will turn. All investors know the market goes through cycles, but that doesn't make people any less concerned about their financial future. The key, however, is to avoid letting your emotions deter you from a solid investment strategy.

During any portion of a market cycle, an investor's emotions can lead to irrational decisions, as they could be on a high from a great bull run or in a panic when the bear enters. Both have the potential of negatively impacting investment performance.

So how do you control those emotions? You will never be able to eliminate your emotional responses to your investments, but you can hold on tight to a solid investment plan that looks at performance over the long term.

Having a plan based on your objectives and risk tolerance with an asset allocation and diversification that is aligned to your financial situation is key. Additionally, you will want to stress test your plan to understand how poor market conditions can affect it. Performance modeling can bring you peace of mind knowing you will be able to ride out a market decline, or it can also lead you to make adjustments to your plan to better meet your needs.

Please call if you'd like to discuss this in more detail.

Risk Tolerance

Continued from page 1

variations in those returns over a long time period to see if your estimates are reasonable. Expecting a high rate of return may mean you'll have to invest in asset classes you aren't comfortable with or that you may be tempted to sell frequently. A better alternative may be to lower your expectations and invest in assets you are comfortable owning.

- **What length of time are you investing for?** Some investments such as stocks should only be purchased for long time horizons. Using them for short-term purposes may increase the risk in your portfolio, since you may be forced to sell during a market downturn.
- **How long are you willing to sustain a loss before selling?** The market volatility of the past several years will give you some indication of how comfortable you are holding investments with losses.
- **What types of investments do you own now and how comfortable are you with those investments?** Make sure you understand the basics of any investments you own, including the historical rate of return, the largest one-year loss, and the risks the investment is subject to. If you don't understand an investment or are not comfortable owning it, you may be tempted to sell at an inopportune time. Over time, your comfort level with risk should increase as your understanding of how risk impacts different investments increases.
- **Have you reassessed your financial goals recently?** Due to the significant market volatility of the past few years, your financial plan may need to be revamped. Otherwise, you may find you won't have sufficient resources in the future to meet your goals. Based on your current investment values, determine what needs to be done to meet your financial goals. You may need to save more, change or eliminate some goals, or delay your retirement date.
- **Do you understand ways to reduce the risk in your portfolio?** While all investments are subject to risk, there are some risk-reduction strategies you should consider for your portfolio. These strategies include diversifying your portfolio, staying in the market through different market cycles, and using dollar cost averaging. Please call if you'd like help assessing your risk tolerance.

The ABCs of Risk Premiums

Investing in the financial markets is inherently risky. There's never a guarantee you'll make a certain return on your investment or even that you'll get back what you put in. Of course, some investments are riskier than others, but they tend to offer potentially higher rates of return. That difference in expected return for riskier investments is called the risk premium. It's the investor's reward for taking greater risk.

To better understand risk premiums — what causes risk and why risk premiums are important — let's take a look at the anatomy of an investment's return, which has three components:

- **Inflation** — Inflation is the rate at which prices increase, typically hovering between 2% and 4%.
- **Risk-free rate of return** — A risk-free rate of return is the return on an extremely low-risk (so low it's termed risk free) investment. Typically, investors look at the short-term interest rate on a Treasury bill (T-bill) as a risk-free rate. Investors view the backing of the U.S. government and their short maturity as signs of the investment's stability and liquidity, in other words, low risk.
- **Risk premium** — The third component of an investment's return is the risk premium. On short-term T-bills, the risk premium is zero — those investments are considered risk free. But other investments, including stocks, have added elements of risk. A risk premium is the excess return of an investment that is greater than the risk-free rate of return.

What Causes Risk?

Broadly, there are three reasons that some investments are more risky than others:

- Returns on stock investments can fluctuate, unlike predictable bond coupon payments.
- Corporate bond holders have the first claim to corporate earnings before stock holders, who have a residual claim.
- Stock returns tend to be more volatile.

Historically, bonds and cash equivalents tend to be less risky than stock investments. But even among stocks, risk premiums vary. A company with historically stable stock returns, a long earnings history, and a conservative growth plan will likely have a lower risk premium than a new company that's growing quickly and aggressively.

Why Are Risk Premiums Important?

Understanding risk premiums is the first step in creating an asset allocation plan for your investments. To determine which assets to invest in, you'll have to determine the optimal risk-premium mix for you.

Some investors tolerate risk quite well, while others do not. You need to honestly assess your risk tolerance level, so you can determine the amount of risk that best suits your particular needs.

Please call to discuss the implications of risk premiums on your portfolio.

Business Data

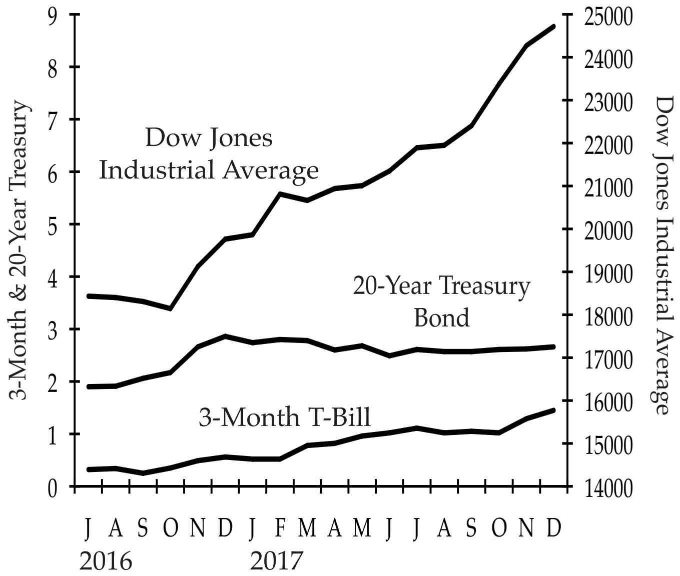
	Month-end				
Indicator	**Oct-17**	**Nov-17**	**Dec-17**	**Dec-16**	**Dec-15**
Prime rate	4.25	4.25	4.50	3.75	3.50
3-month T-bill yield	1.02	1.29	1.45	0.56	0.26
10-year T-note yield	2.33	2.37	2.46	2.55	2.24
20-year T-bond yield	2.61	2.62	2.66	2.86	2.60
Dow Jones Corp.	3.08	3.11	3.13	3.17	3.43
GDP (adj. annual rate)#	+1.20	+3.10	+3.20	+2.10	+1.40

	Month-end			% Change	
Indicator	**Oct-17**	**Nov-17**	**Dec-17**	**2017**	**2016**
Dow Jones Industrials	23377.24	24272.35	24719.22	25.1%	13.4%
Standard & Poor's 500	2575.26	2647.58	2673.61	19.4%	9.5%
Nasdaq Composite	6727.67	6873.97	6903.39	28.2%	7.5%
Gold	1270.15	1280.20	1296.50	11.9%	9.1%
Unemployment rate@	4.20	4.10	4.10	-10.9%	-8.0%
Consumer price index@	246.80	246.70	246.70	2.2%	1.7%
Index of leading ind.@	128.90	130.40	130.90	5.6%	0.1%

— 1st, 2nd, 3rd quarter @ — Sep, Oct, Nov Sources: *Barron's, Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

July 2016 to December 2017



News and Announcements

Avoid Five Common Investing Mistakes

Make sure to avoid these five investing mistakes:

1. **Putting all your investment eggs in one basket.** Diversification is a familiar term in investing. Investing in a variety of investment alternatives helps to decrease risk. If you have all your money invested in one company and that company does not perform well, your portfolio is going to suffer. However, by diversifying your portfolio, your overall return will not be as drastically impacted by the poor performance of one company.
2. **Spreading your investments too thin.** While there is value in diversification, overdiversification can be problematic. With too many investments in your portfolio, each investment has little impact on your total return.
3. **Expecting instant gratification.** Investing takes patience. When investors jump into an investment seeking to get rich quick, they often find themselves giving up on an investment too quickly and miss out on returns that might have materialized over time. If you select an investment after careful research, you don't need to monitor its every movement. Most investments will fluctuate, but good investments tend to appreciate over time.
4. **Neglecting risk level assessment.** Before investing money, you need to assess the investment's potential for both upside and downside gains and losses. When you understand the risk an investment faces, you are less likely to sell based on emotion.
5. **Skipping out on an investment education.** Many people invest without knowing anything about the markets or the field of investing. Whether the cause is time constraints or confusion, lack of education can be harmful to your portfolio. You need a solid understanding of invest basics. Once the education piece is in place, investing becomes much more interesting.

FR2017-0922-0001