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Financial Briefs

SEPTEMBER/OCTOBER 2016

Your Objectives Drive Stock Strategies

No matter the activity you're engaging in, your strategy has to be driven by your end goals — what you want to achieve. In investing, of course, there are myriad objectives — short-term objectives like a trip to Hawaii, medium-term objectives like sending your children to college, and long-term objectives like a comfortable retirement. Here, we'll take three objectives that are very different but also very common among investors. We'll show how, based on these different objectives, your investment strategy may need to change.

Objective: Retire Comfortably in 25+ Years

If you're young and your primary investment objective is retirement, then your first strategy should be to take full advantage of the power of compounding. Compounding means you are earning returns on both your principal investment *and* accumulated earnings. It's what allows your money to work for you — to really grow over time.

But taking full advantage of the power of compounding requires that you start investing early, you stay invested for the long term, and you maximize the returns your investments generate. In other words, it requires that you invest in the stock market.

Remember, while the stock market has experienced some dramatic swings in the last century, over time, returns have been quite robust. The key is over time. When Jeremy Siegel, a professor of finance at Wharton, analyzed stock market returns over the 200 years ending in 2001, he found that stocks were very volatile, but only in the short term. The longer the term, the greater the return and lower the risk stocks posed. Over every 30-year period, stocks always made money. Why? Because the longer term gives stocks sufficient time to recover from downturns.

Objective: Retire Comfortably in 5–10 Years

While stocks have always made money over any 30-year period, over shorter time periods, returns were more volatile. No one knows that better than investors who were close to retirement when the financial system imploded in 2008. According to research by the Employee

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What Happens When Interest Rates Rise?

When interest rates fell after the recession, many investors realized that low rates would not last forever. Recently, interest rates have been on the rise, and it's unclear to what extent this will continue in future years. Many people find themselves wondering just what type of impact rising interest rates can have on stocks, as investors have become used to trading in a low-rate market. The fact is, rising interest rates *will* have an impact on the stock market, though perhaps not in ways that you might expect.

Sector-by-Sector Variance

One of the first things to understand about how rising interest rates will affect the stock market is the prevalence of sector-by-sector variance. That is to say that not all sectors will be affected equally. Some will fare just fine, virtually unaffected by rising rates. Others, however, will see marked shifts in either positive or negative directions. Some sectors may see near-term volatility, but a rise in Fed rates is usually a sign that the economy is moving in the right direction. Thus, sectors that experience initial shifts in momentum will likely settle down in due time.

Bank Stocks Will Perform Well

As stated above, a rise in Fed rates is typically an indication that the near future of the economy is looking good. Unsurprisingly, banks are the first to benefit from this,

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Your Objectives

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Benefits Research Institute, "many 401(k) participants near retirement had exceptionally high exposure to equities: Nearly 1 in 4 between ages 56–65 had more than 90% of their account balances in equities at year-end 2007, and more than 2 in 5 had more than 70%." Those investors suffered outsized losses as the stock market declined.

So as you get closer to retirement, it's important to move into less-risky investments — in other words, fewer stocks, more bonds and cash equivalents. (Though just as a long-term portfolio should not include only stocks, a shorter-term portfolio should not be completely devoid of stocks.) Increasingly prevalent are life-cycle or target-date funds, which automatically adjust a portfolio's asset allocation depending on the investor's age or years until retirement (typically, automatically shifting from stocks to bonds and cash as the investor ages and/or approaches retirement).

Objective: Generate Income

Many investors plan to use investment returns (and perhaps even withdraw principal) as income during retirement. Once you've reached that phase, your strategy should change again, different than the strategy you employed when you were 5–10 years from retirement. At this point, you'll have to balance the dual goals of generating enough returns so that your investments are not eroded by inflation and, at the same time, making withdrawals last for your lifetime. Inflation varies, but plan for a rate of about 3% a year, meaning that your investments must generate at least 3% to maintain an even level of purchasing power.

If you're going to also be drawing down the principal of your investments (rather than just using the returns), how much can you withdraw? The answer, of course, depends on the size of your portfolio, your age, and how long you might live.

Understanding Stock Market Risk

Investing in stocks involves risk, but just because stocks come with risk doesn't mean they should be avoided.

It's the fact that stocks come with risk that makes them such a potentially lucrative investment. In exchange for being willing to accept the possibility of loss, you receive the potential of earning significant returns.

Nonetheless, the perception that stocks are inherently risky keeps many people from investing in them.

But once you understand what risk means when it comes to stocks as well as the different types of risk, you'll be more comfortable investing in stocks and have a better idea of how the market works.

Risk and Stocks

Risk and stock investing go hand in hand. When you are buying a stock, you are purchasing a small piece of a company. And the value of that stock is not fixed. Rather, it rises and falls based on what the market determines it is worth.

You can make money if the stock increases in value, and you may lose money if the stock decreases in value. Because you can't know for sure what will happen to the stock's price in the future, the investment comes with risk.

Types of Risk

Stocks rise and fall in value for a variety of reasons. Once you understand the various factors that might affect a stock's price, you'll be better able to understand the risk associated with a particular investment and get a sense of whether it is a good addition to your portfolio. Risks associated with stocks fall into two broad categories:

Systematic risk or market risk: This is the type of risk that affects the entire market. You can't really avoid systematic risk, and it is also unpredictable. The 2008 stock market crash is an example of systematic risk, since it was caused by macroeconomic factors that individual investors couldn't have predicted.

Unsystematic risk: This is the opposite of systematic risk. Unsystematic risks affect only certain companies or sectors of the market. For example, changes in energy prices might affect the price of energy stocks, while a political crisis in a certain country might affect stock prices in that region. Or, a company might suffer a leadership shakeup that causes the stock to drop. It's easier to identify unsystematic risks than to anticipate systematic risks.

Coping with Risk

If you want to invest in stocks, you'll need to come to terms with risk. The key is to remember that risk or volatility in the stock market is natural.

Rather than worrying too much about what the market is doing in the short term, you can insulate yourself by developing a clear investment strategy, perhaps in partnership with your financial advisor.

Select stock investments based on your long-term goals. Then, keep your hands off your investments. That's because one other major risk stock market investors face is themselves. Letting emotions drive your investing decisions will almost always lead to less-impressive returns.

You can also cope with stock market risk by diversifying your portfolio into asset classes other than stocks. By including bonds, cash, and other investments in your portfolio, you'll be better able to cope with the ups and downs of the market.

Curious about how stock market risk might affect your investments? Please call if you would like to discuss this in more detail.

What Happens?

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which means bank stocks are likely to perform well once rate hikes have been announced. This is especially true of smaller community banks, who are likely to see an uptick in deposits and will be bringing in more money than before. Investors may want to look toward stocks in this sector even if they're unfamiliar with it, as consistent rate hikes bode well for bank stocks.

Companies Affected by Cash Flow Will Take a Hit

Whenever interest rates go up, cash flow can become a concern for companies that typically borrow from banks for ongoing business operations. Depending upon the severity of the issue, this may or may not become public knowledge, which can affect the future of specific stocks. Those who find themselves struggling to stay afloat may end up taking a hit in terms of stock prices, which is why it's important for investors to keep a watchful eye on their portfolios whenever turmoil occurs with interest rates.

Most Effects Won't Happen Immediately

It's understandable to be nervous about what rate hikes mean for the immediate future of the stock market, but this is typically not when most people will see noticeable changes. While certain stocks may waver initially, this tumultuous period will likely right itself quickly unless a company ends up taking a drastic hit from the rate hike. Most effects will occur over a much longer period of time, shifting the market in a steadily new direction as economic changes continue to occur.

Clearly, rate hikes *will* have an effect on the market, but it may take longer than you think for the true effects to show themselves. As hikes continue, keep a close eye on the subtle shifts you notice to ensure control over your portfolio, and don't forget to call to discuss this in more detail.

Lessons Learned about Stock Investing

If you pay attention to the stock market, you can learn some valuable lessons:

- **The market tends to revert to the mean.** There is a tendency for the stock market, when it has an extended period of above- or below-average returns, to revert back to the average return. Thus, following an extended period of above-average returns in the 1990s, the stock market experienced a significant downturn, helping bring the averages back in line.
- **Don't chase performance.** Investors often move out of sectors that are not performing well and invest that money in current high performers. But the market is cyclical, and often those high performers are poised to underperform, while the sectors just sold are ready to outperform. A classic example is technology stocks in early 2000. Many investors rushed to purchase technology stocks just as they peaked and were headed for a long slide down. Rather than trying to guess which sector is going to outperform, make sure your portfolio is broadly diversified across a range of investment sectors.
- **Avoid strategies designed to get rich quick in the stock market.** The stock market is a place for investment, not speculation. When your expectations are too high, you have a tendency to chase after high-risk investments. Your goal should be to earn reasonable returns over the long term, investing in high-quality stocks.
- **Don't avoid selling a stock because you have a loss.** When selling a stock with a loss, an investor has to admit that he/she made a mistake, which is psychologically difficult to do. When evaluating your stock investments, objectively review the prospects of each one, making decisions to hold or sell on that basis rather than on whether the stock has a gain or loss.
- **Make sure an investment will add diversification benefits to your portfolio.** Diversification helps reduce the volatility in your portfolio, since various investments will respond differently to economic events and market factors. Yet it's common for investors to keep adding investments that are similar in nature. This does not add much in the way of diversification, while making the portfolio more difficult to monitor.
- **Periodically check your portfolio's performance.** While everyone likes to think their portfolio is beating the market averages, many investors simply don't know for sure. So thoroughly analyze your portfolio's performance periodically. Compare your actual return to the return you targeted when setting up your investment program. If you aren't achieving your targeted return, you risk not reaching your financial goals. Honestly assess how well your portfolio is performing. Are major adjustments needed to get it back in shape?
- **No one knows where the market is headed.** No one has shown a consistent ability to predict where the market is headed in the future. Don't pay attention to either gloomy or optimistic predictions. Instead, approach investing with a formal plan so you can make informed decisions with confidence.

Please call if you'd like to discuss strategies for your investment portfolio.

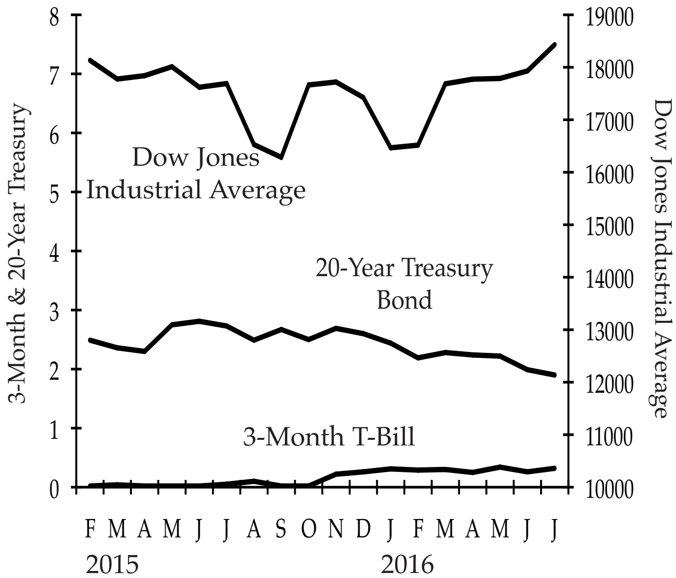
Business Data

Indicator	Month-end May-16	Jun-16	Jul-16	Dec-15	Jul-15
Prime rate	3.50	3.50	3.50	3.50	3.25
3-month T-bill yield	0.34	0.26	0.32	0.26	0.05
10-year T-note yield	1.82	1.61	1.58	2.24	2.32
20-year T-bond yield	2.22	1.99	1.90	2.60	2.73
Dow Jones Corp.	2.89	2.78	2.54	3.43	3.31
GDP (adj. annual rate)#	+1.40	+0.80	+1.20	+1.40	+3.90

Indicator	Month-end May-16	Jun-16	Jul-16	% Change YTD	12-Mon.
Dow Jones Industrials	17787.20	17929.99	18432.24	5.8%	4.2%
Standard & Poor's 500	2096.96	2098.86	2173.60	6.3%	3.3%
Nasdaq Composite	4948.05	4842.67	5162.13	3.1%	0.7%
Gold	1212.10	1320.75	1342.00	26.3%	22.2%
Unemployment rate@	5.00	4.70	4.90	-2.0%	-7.5%
Consumer price index@	239.30	240.20	241.00	1.6%	1.0%
Index of leading ind.@	123.90	123.30	123.70	-0.2%	0.1%

— 4th, 1st, 2nd quarter @ — Apr, May, Jun 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
February 2015 to July 2016



News and Announcements

How Much of Your Portfolio Should Be Invested in Stocks?

One of the most often asked questions is how much of a person's portfolio should be made up of stocks. It's a good question and one that doesn't always have a clear-cut answer. The amount of stocks you should have in your portfolio will vary depending upon a number of different factors, including your age, current net worth, and penchant for taking risks. Still, there are a few basic rules of thumb that are worth adhering to, which should make fleshing out your portfolio less stressful.

If you're saving for retirement, most financial advisors will recommend that the younger you are, the more of your portfolio should be allocated to stocks. As stocks are a relatively risky and volatile form of investment, this makes perfect sense. When we're young, taking risk tends to come along with less-catastrophic consequences than when we're nearing retirement age. If formulas work for you, the general idea is to subtract your age from the number 100 to wind up with a safe percentage of stocks versus other investments. Thirty-year-olds, for example, will often do well by allotting 70% of their portfolios to stocks, while 60-year-olds may want to reduce this percentage to 40%.

Of course, age is just one factor that influences portfolio allocations, and there are more aspects that need to be taken into consideration to make the right decisions. The best way to ensure your portfolio is properly divided is to work with a financial advisor who is fully aware of your situation and can make educated suggestions about how to move forward with your investments. After all, a formula can only get you so far, and personal recommendations will always be more valuable than guesswork.

Please call if you'd like to discuss stocks and portfolio allocation in more detail.

FR2016-0511-0001