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Financial Briefs

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A Three-Step Asset Allocation Plan

Perhaps the most important move you can make for your investments is to properly diversify your portfolio. By investing in a mix of stocks, bonds, and cash, you'll reduce the risk of a significant loss.

How you combine your diverse mix of investments is called your asset allocation. Asset allocation is a highly individual determination that's based on your risk tolerance, financial goals, and age. Asset allocation will spread out your investments among different asset classes including a mix of three types:

- **Stocks** — Stocks tend to be a relatively risky investment. However, while they have a high potential for loss, they also offer a good potential for gain.
- **Bonds** — Bonds tend to be less risky than stocks but more risky than cash alternatives.
- **Cash** — Cash alternatives, such as savings accounts, certificates of deposit, and money market accounts, typically offer the lowest risk and the lowest potential returns.

The benefits of allocating your assets across the three types of asset classes include:

- Proper asset allocation diversifies your portfolio among the three types of investments, reducing your risk.
- Allocating your assets between the three types allows you to tailor your portfolio to your specific goals.
- You can help manage the level of risk and volatility of your returns.

Considerations

To properly allocate your investments across stocks, bonds, and cash, consider this three-step approach to asset allocation:

Step 1: Be honest about your level of risk tolerance. Some people think that investing in a relatively unknown start-up company with a great idea is a sound investment, while others prefer to stick with stable companies with household names. In other words, people's risk tolerances vary.

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Rebalance Your Portfolio

There is a relatively underused and simple technique to raise your long-term portfolio performance and reduce your risk at the same time. It's called "rebalancing," and it's something every investor can and should do.

Let's start with the basics. First, to rebalance, you need to have more than one investment in your portfolio (so you can hold investments in different asset classes, like stocks, bonds, and cash). Second, you need to determine the right mix of those investments for your objectives.

For example, an aggressive investor with a long time horizon might invest 80% of her portfolio in stocks, 15% in bonds, and 5% in cash. On the other hand, a conservative investor might hold 30% in stocks, 60% in bonds, and 10% in cash.

The opportunity for rebalancing arises when the market performance of your investments changes their value and, as a result, their weighting in your portfolio.

How Rebalancing Is Done

The purpose of rebalancing is to restore an investor's portfolio to the structure that fits his/her objectives. Here's how you do it: you sell off a portion of any asset class that has increased beyond its target percentage and reinvest the sale proceeds in more of asset classes that have shrunk below their target percentage.

The calculation is simple: multiply the new market value of your portfolio by your target mix percentages and compare them to the values in your account.

Aside from maintaining the

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A Three-Step Asset

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If you don't mind the more dramatic ups and downs associated with higher-risk investments, you may see higher return potential. But if you can't stand the thought of putting your hard-earned money in an untested company, you're probably better off sticking with relatively low-risk allocations, even though you may see more modest returns.

Step 2: Write down your financial goals. What are the purposes of your investments? Are you saving to buy your first home? Planning to send your children to college? Looking to retire early? Whatever your financial goals are, knowing them will help you determine how to allocate your assets to help you meet them.

Step 3: Consider your time horizon for meeting those goals. How much time do you have before you need your money for your goals? Is retirement a long-term goal, with 30 years to go? Or is it a short-term goal, with only five years to go? If you're just starting a career, do you have short-term goals, like buying a house, as well as intermediate-term goals, like sending your children to college?

There's no consensus on exactly how much of your portfolio should be in any of the three investment categories at any time. However, broadly speaking, the further away in time you are from your financial goals, the more aggressively you can be invested.

For example, if your financial goal is retirement and you're just starting out, you'll want to have a higher percentage of your assets invested in stocks and the lowest percentage in cash. As you near retirement, you'll want to reallocate your assets more conservatively, so that a larger percentage is in bonds and cash than in stocks.

Please call so we can help you allocate your assets given your unique situation.

Are Stock Splits Always a Good Thing?

There are few announcements that get stock investors as excited as an upcoming stock split. They're often taken as a portent of good things for years to come for the investors who hold shares the day before: solid sales and revenue growth for the company, an upward trajectory for the stock price, and the prospect of even more splits in the future.

According to two studies by David Ikkenberry, now Dean of the Leeds Business School at the University of Colorado, stock splits do usually portend an extended run of healthy gains for a stock. In 1996, he looked at 1,275 2-for-1 stocks splits from 1975 through 1990.

He found that the stocks outperformed similar-sized companies in the same sectors that did not split by 8% in the first year and by 16% after three years. A 2003 follow-up study, covering stock splits from 1990 to 1997 and including 3-for-1 and 4-for-1 splits, found similar results.

Why does this happen? First, let's talk about what stock splits actually mean and what they don't. Companies usually decide to split their stock after a significant increase in its price. The purpose is to reduce the price to make it affordable for more investors to acquire, which they usually do in multiples of 100 shares.

The idea is that company management wants to be sure to tap into the demand that can come from individual investors, in addition to the demand from institutions, who are often willing to buy good growth stocks at almost any price.

While stock splits increase the number of shares, the price comes down proportionately so that their holdings have exactly the same market value at the moment the stock splits. But stock splits often do pique more investor interest, largely because they call attention to the company's results. It is the extent to which management has accurately estimated the untapped demand for the stock, as well as its future prospects, that determines the stock's performance.

But, as the history of business will attest, spectacular rates of growth are difficult to continue. Even just theoretically, there's a limit to how many more widgets any company can sell.

Markets change, economies change, management changes; and sooner or later, nearly every growth stock becomes a more ordinary performer that can no longer meet the aggressive expectations that prompted more investors to buy at a higher price — and at that point, the stock price peaks and then languishes or declines.

Unfortunately, there's no rule of thumb to tell whether a split is a sign of an impending change in fortune for a stock. In general, investors should always be at least a little skeptical about buying a stock that has a long history of spectacular returns, but that alone doesn't mean investors should stay away.

There is one kind of stock split that is a fairly reliable red flag: the reverse split. Reverse splits work exactly opposite to ordinary splits. They reduce the number of shares existing investors hold and raise the price. The motive is usually to maintain standards for listing on an exchange or inclusion in a stock index, or to be eligible for purchase by institutions. Naturally, reverse splits only occur after a stock has fallen a great deal in price.

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

Rebalancing

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level of investment risk that's right for you, rebalancing has two additional benefits.

First, it forces you to lock in your gains, which many investors fail to do. Second, rebalancing can add as much as one-half percent or more to your long-term investment returns. That may not sound like much, but over 20 years, it could mean thousands of dollars more in your pocket.

How Often Should You Rebalance?

A good rule of thumb for rebalancing is once a year. But, depending on market performance, it could be more or less often than that. The best advice is to check your portfolio several times a year and rebalance whenever there have been significant changes in the weighting of its constituent parts.

This is just an overview of rebalancing. It can apply not only to asset classes, but to subasset classes as well.

For example, your asset allocation strategy may call for specific exposure to large- and small-cap stocks or U.S. and foreign stocks, while your bond portfolio may include Treasuries and investment-grade corporate or high-yield bonds, and changes in their weighting may suggest you rebalance among these, too. There's also the question of which particular stocks or bonds you sell or buy.

Finally, there's always the chance that changes in your portfolio may coincide with changes in your objectives — you may actually need to be taking more or less risk than in the past.

Whether and when to rebalance is just one of many considerations that are important to maintaining your investment portfolio. Please call if you'd like to discuss this in more detail or would like to review your overall investment portfolio.

Does Diversification Still Work?

So you paid attention to the advice to diversify your portfolio. You didn't just invest in one stock, you invested in many. And not only did you invest in more than one stock, you invested in large-cap stocks, mid-cap stocks, and small-cap stocks in different industries. You also invested in foreign stocks and bonds, maintaining some funds in a money market fund. And you still lost money, so now you're not so sure diversification really works.

If this is you, you're not alone. Over the last 10 years, the stock market has experienced two bear markets, testing anyone's belief in investment principles. But it shouldn't, for the following reasons:

Diversification reduces risk; it can't eliminate it. The truth is, all investments are subject to risk. Diversification remains one of the primary ways of managing and reducing investment risk. It does so by spreading your investments not only among different securities, each representing a separate entity, but among different sensitivities to phases of the business cycle and to different cycles altogether. By doing this, you decrease the chances that you'll lose money because any one issuer has gone out of business or investors have turned sour on a particular industry, sector, or country.

In bad times, a lot of different kinds of investments perform the same way: poorly. Investment professionals track something called "correlation," which, roughly speaking, measures the degree to which different investments, asset classes, and subasset classes produce gains or losses at the same time. In 2008, for example, four stock sub-asset classes delivered major losses. U.S. large-cap stocks lost 37% of their value, U.S. small-cap stocks lost 34%, the stocks of major developed foreign countries were down 43%, and emerging foreign market stocks lost 53%. Even diversifying by investment style didn't help — large value stocks in the U.S. lost 39%, while large growth stocks lost 35% (Source: Invesco, 2012).

Diversification is for the long term. If you need all of your money in the next year, your best bet is to put it all in cash, where your chances of a loss are mostly theoretical. But if you're planning for the next 10 to 20 years, you're likely to lose the battle against inflation if you don't keep some money in stocks.

Diversifying is an alternative to market timing, which very few get right. How confident are you that you know exactly when to move your money out of stocks at the right time to avoid losses and then move back in when stocks start making money again? Most investors haven't been successful at timing the market that way. The most common mistake is to get out too late and then wait too long to get back in.

Diversifying still avoids the deepest possible losses. 2008 was, we've noted, a very bad year for stocks. But the total U.S. bond market, including Treasuries and corporate, returned 5.24% that same year, and Treasuries increased 12.39% (Source: Invesco, 2012). If you'd had 40% of your money in bonds, that loss would have been trimmed to 20.1% — a reduction of nearly half.

If you're still not convinced that diversification works, look at this way: if you've been investing for a long time, you know that the issue isn't that the stock market hasn't produced a positive return recently, but that it has been below what you're used to. For decades, we've been taught that stocks return, on average, about 10% a year; but for the past 10 years, that number has been about 5% (Source: Invesco, 2012). Even if the stock market continues to perform that way, diversification still protects your portfolio from the worst possible losses.

Business Data

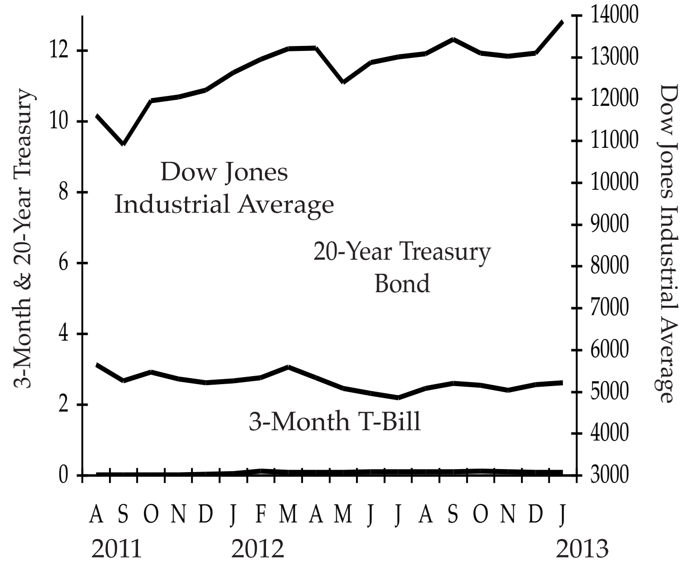
Indicator	Month-end Nov-12	Dec-12	Jan-13	Dec-11	Jan-12
Prime rate	3.25	3.25	3.25	3.25	3.25
3-month T-bill yield	0.10	0.09	0.08	0.03	0.05
10-year T-note yield	1.67	1.80	1.87	1.95	1.96
20-year T-bond yield	2.40	2.56	2.63	2.63	2.68
Dow Jones Corp.	2.68	2.70	2.55	3.74	3.42
GDP (adj. annual rate)#	+2.00	+1.30	+3.10	+3.00	+3.00

Indicator	Month-end Nov-12	Dec-12	Jan-13	% Change YTD	12 Mon.
Dow Jones Industrials	13025.58	13104.14	13860.58	5.8%	9.7%
Standard & Poor's 500	1416.18	1426.19	1498.11	5.0%	14.1%
Nasdaq Composite	3010.24	3019.51	3142.13	4.1%	11.7%
Gold	1726.00	1662.00	1664.75	0.2%	-4.5%
Unemployment rate@	7.90	7.80	7.80	0.0%	-8.2%
Consumer price index@	231.30	230.20	229.60	-0.3%	1.7%
Index of leading ind.@	96.00	93.40	93.90	0.5%	-0.6%

— 1st, 2nd, 3rd quarter @ — Oct, Nov, Dec 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

August 2011 to January 2013



News and Announcements

The Fundamental Investing Principle

The whole point of an investment program is to accumulate sufficient funds to meet your financial goals. So what is the most fundamental investment principle — selecting the proper investments, accumulating the correct combination of assets, timing the market to avoid corrections? Actually, the principle may not even sound like an investment principle at all. To help ensure you meet your financial goals, you must save significant sums of money on a consistent basis. That one habit will do more to help you reach your financial goals than anything else. The sooner you start this habit, the less you need to save. Consider the following example.

Fresh out of college and 25 years old, you decide you'll need $1,000,000 when you retire at age 65. You can save on a tax-deferred basis through your employer's 401(k) plan and expect to earn 8% compounded annually. If you start at age 25, you'll need to invest $3,860 a year for 40 years to reach your goal. However, you decide to wait 10 years. At age 35, you now need to invest $8,827 per year for 30 years. Still seems like too much? Consider that at age 45, you'll need to invest $21,852 annually. The really bad news is that someone waiting until age 55 will need to invest $69,029 annually to reach that goal. By postponing investing, you lose time and, with it, the ability for compounding returns on your contributions to perform much of the work of attaining your goals.*

Let time work for you instead of against you. Please call to review your investment program.

** This example is for illustrative purposes only and is not intended to project the performance of a specific investment. It does not consider the payment of income taxes. Keep in mind that a plan of regular investing does not assure a profit or protect against loss in declining markets.*

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