Investor Insights and Outlook

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Keep Your Eye on Your Goals

If someone asked you, "Why is wealth important to you?" what would be your answer? In a recent survey of high-net-worth families, financial security was the most popular answer, followed by help children become successful, educate children and help the less fortunate.[1]

Financial security is more than money in our portfolios; it is the confidence that we can continue to live in dignity and support ourselves financially rather than rely on our children.

A diversified portfolio that follows a prudent investment plan can help get us to our long-term goals — like financial security and helping our children — yet we worry daily as we watch markets go up and down.

The booms and busts of markets unnerve all of us, even those not investing in the markets. Anita Radcliff and Karl Taylor of the University of Sheffield in Britain found in a recent study that higher stock prices are associated with better mental health, whereas greater volatility of stock prices is associated with worse mental health. This was true even for people holding no stocks. Their research found that stock prices "matter to mental health because they perform the role of economic barometer."[2]

Yet we must be resilient in the face of daily stock market volatility, even decades-long volatility, because our emotions can make us do things that lead us away from our financial goals rather than closer to them. Here is an example of how our emotions can get in the way of making good investment decisions.

Many investors believe that high returns come with low risk and low returns come with high risk, when in reality the opposite is true. Back in January 2000, at the height of the internet bubble, expectations of risk were very low and expectations of returns were very high. This was due to our tendency to extrapolate into the future the very high returns of 1999 and the exaggerated exuberance accompanying the internet bubble.

In contrast, expectations of returns were very low in February 2009, the darkest

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Advisor Corner

Thank you for the opportunity to serve as your advisor.

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Keep Your Eye on Your Goals, continued

time of the financial crisis, and expectations of risk were very high. This combination was due to our tendency to extrapolate into the future the very low returns of 2008 and early 2009 and the exaggerated fear accompanying the financial crisis.

Investors who acted on their exuberance and piled into stocks in January 2000, ended up as losers. So did investors who acted on their fear in February 2009, abandoning stocks and missing out on large gains.

We are wise to remember that we are not immune to misleading emotions, but we can be smart enough to resist them. Once we recognize these emotions, we should pause, take a deep breath and consult with our advisors, making sure to include a review of our Investment Policy Statement.

We can't control the markets, but we can control our emotional reactions to them.

*Written by **Meir Statman** Glenn Klimek Professor of Finance Santa Clara University*

Diversification neither assures a profit nor guarantees against loss in a declining market.

[1]The SEI Family Wealth and Succession Survey, "The Generation Gap," June 2011

[2]Ratcliffe, Anita and Taylor, Karl B. (November 2012), "Who Cares About Stock Market Booms and Busts? Evidence from Data on Mental Health," IZA Discussion Paper No. 6956. ssrn.com/abstract=2170644

Understanding Risk Tolerance and Risk Capacity

When determining an appropriate asset allocation mix, it is important to consider not only one's risk tolerance, but also one's risk capacity.

An investor's risk tolerance refers to his or her aversion to risk, while an investor's risk capacity relates to his or her ability to assume risk. Sometimes, an investor's risk capacity and risk tolerance do not match up. If an investor's capacity to take risk is low but the risk tolerance is high, then the portfolio should be reallocated more conservatively to prevent taking unnecessary risk. On the other hand, if an investor's risk capacity is high but the risk tolerance is low, reallocating the portfolio more aggressively may be necessary to meet future return goals. In either case, speaking with a financial advisor may help to determine if your risk tolerance and risk capacity are in sync.

Risk Strategy Matrix

		Risk Capacity	
		High	**Low**
Risk Tolerance	**High**	No action required	Consider reallocating more conservatively
	Low	Consider reallocating more aggressively	No action required

There is no guarantee that diversification or asset allocation will protect against market risk. These investment strategies do not ensure a profit or protect against loss in a declining market. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss. It is highly recommended that you consult with a financial professional for advice specific to your situation.

Want to review your risk tolerance? We're sending out questionnaires. Watch for yours in the mail over the next few weeks.

No Need to Fear, Capitalism is Here!

by **Sheldon McFarland** Vice President, Portfolio Strategy and Research Loring Ward

Whether you call it the fiscal cliff, the fiscal slope or the apocalypse, it has many in this country worried about the future of their investments and our market system in general. Let's take a look at how Capitalism and the markets work so that we can put fear behind us.

While Capitalism is not a perfect system, it is one of the greatest creators of wealth, progress and innovation in human history.

Capitalism is the freedom individuals have to maximize their economic potential — the fostering of the entrepreneurial spirit that allows individuals to start and grow businesses that provide products and services we need and want.

Take the example of a $2 cup of coffee. Somewhere near the equator a farmer is harvesting and processing coffee beans to sell. The beans are bought then transported by a shipping company to a distribution center where they are put on a truck and delivered to a coffee shop where a barista brews them into coffee.

At each step in the process, companies make a profit by providing a valuable product or service to the next buyer in the chain. But we're not finished yet! Don't forget about the cup, the cardboard sleeve and the lid. Each step in the chain is an opportunity to make a profit…even though the cup of coffee sells for just $2.

As long as people still demand and need products and services, there will be opportunities to earn a return on investments. Despite what you may read in the headlines, the system in this country still rewards the entrepreneurial spirit and innovation.

Before you let ominous headlines and portents of stormy weather for the economy and stock markets cause you to second guess your investment plan, here are some things to keep in mind.

- With your financial advisor, make sure that you have the right balance between security and growth in your portfolio. You can do this by allocating between stocks and bonds—more bonds for security and more stocks for growth.
- Diversify your holdings to diminish the risks of owning one single investment. Invest in many different companies across the globe in different industries.
- Maintain a long-term investment horizon.

There will always be bumps in the road but if you have a well thought- out plan in place and work closely with your financial advisor, the journey can be a good one. It is as simple as a $2 cup of coffee.

Diversification neither assures a profit nor guarantees against loss in a declining market.

The Flavors of Investing

It is tempting to jump on the investment bandwagon when certain parts of the market soar based on a trend or analyst report. While great potential exists, sector investing can also come with great risk.

As seen in the image, what is hot one year isn't always hot the next. Interested investors should be willing to follow a sector's ups and downs, as timing the market is difficult. Investing in specific sectors can add volatility to a portfolio, but exposure to the right sectors can contribute to improved financial performance. Keep in mind that while sector investing can fill a gap or serve as a speculative play, a balanced asset allocation should be the core of any portfolio.

10-Year Sector Winners and Losers

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Highest return	50.3	38.1	40.8	39.4	32.9	–16.1	61.9	30.5	18.5	32.5
Basic Mat.	41.0	32.1	14.8	36.2	27.5	–23.3	53.6	27.4	13.4	29.1
Comm. Ser.	37.6	23.3	12.2	21.8	17.2	–28.1	50.2	24.9	11.9	24.6
Cons. Cyclical	37.3	19.2	8.1	19.7	16.6	–38.2	35.6	24.2	6.9	19.3
Cons. Def.	34.8	17.9	6.0	17.6	12.6	–38.4	34.0	23.4	5.1	18.6
Energy	32.1	15.4	6.0	15.4	12.0	–39.4	29.3	23.2	4.1	16.5
Financial	26.1	14.4	5.2	15.1	8.0	–39.8	24.0	14.5	0.6	15.3
Health Care	24.7	12.5	3.7	15.0	0.2	–41.2	21.0	13.4	–0.4	13.3
Industrials	19.8	10.1	3.0	11.9	–8.7	–42.0	15.6	11.8	–0.7	10.1
Real Estate	18.9	3.5	–1.4	10.9	–17.9	–48.1	14.5	7.3	–14.1	4.3
Technology	17.4	0.8	–6.0	6.7	–18.3	–51.3	11.8	5.1	–16.5	2.2
Utilities										
Lowest return										

This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Past performance is no guarantee of future results. Sector investments are narrowly-focused investments that typically exhibit higher volatility than the market in general. Sector investments will fluctuate with current market conditions and may be worth more or less than the original cost upon liquidation. Returns and principal invested in stocks are not guaranteed.

Source: Sectors in this example are represented by the Morningstar Sector Indexes.

Words to Live by... and not Just for Graduates

Steve Jobs: Live Each Day As If It Was Your Last

When I was 17, I read a quote that went something like: "If you live each day as if it was your last, some day you'll most certainly be right." It made an impression on me, and since then, for the past 33 years, I have looked in the mirror every morning and asked myself: "If today were the last day of my life, would I want to do what I am about to do today?" And whenever the answer has been "no" for too many days in a row, I know I need to change something. ~
Stanford University, 2005

Bill Gates: From Those To Whom Much Is Given, Much Is Expected

My mother, who was filled with pride the day I was admitted here-never stopped pressing me to do more for others. A few days before my wedding, she hosted a bridal event, at which she read aloud a letter about marriage that she had written to Melinda. My mother was very ill with cancer at the time, but she saw one more opportunity to deliver her message, and at the close of the letter she said: "From those to whom much is given, much is expected." ~Harvard University, 2007

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