



SOCIETY FOR FINANCIAL EDUCATION AND PROFESSIONAL DEVELOPMENT

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financial



U C C E S S

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## Revisit Your Asset Allocation

**N**o one enjoys the recent market fluctuations. But if these fluctuations have caused you extreme discomfort, then it's probably time to reassess your asset allocation. To do so, follow these steps:

**1. Review your desired asset allocation percentages.** When designing your investment strategy, you probably decided what percentage of your portfolio to allocate to different investments. Review those percentages to see if they still make sense for your situation. Over time, how much you want to allocate to different asset classes will probably change as your personal circumstances change. However, don't make significant changes as a result of discomfort over market fluctuations. First, reevaluate these factors:

✓ **Risk tolerance** — Carefully assess your tolerance for risk so that you invest in assets you are comfortable with. While the recent stock market fluctuations have made many investors more risk

averse, don't overreact to these fluctuations.

✓ **Return expectations** — You need to set realistic return expectations for various investments to help assure that you meet your investment goals. While past performance is not a guarantee of future results, reviewing historical rates of return can help you assess whether your return expectations are reasonable. Keep in mind that higher returns are generally accompanied by higher risk.

✓ **Time horizon** — The longer your investment period, the more risk you can typically tolerate. Investing for long periods through

different market cycles generally reduces the risk of receiving a lower return than expected, especially with investments that can fluctuate significantly over the short term.

✓ **Investment preferences** — With such a wide variety of investments to choose from, you should understand the basics of each to decide which are appropriate for you.

In general, you should consider a more conservative allocation if you are older, have short-term needs for your funds, have low earnings, or are uncomfortable with investing. A more aggressive

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### What Are the Advantages of Asset Allocation?

✓ **Providing a disciplined approach to diversification.** An asset allocation strategy is another name for diversification, an important strategy to help you reduce portfolio risk.

✓ **Eliminating the need to time investment decisions.** Market timing is a difficult concept to implement. With an asset allocation strategy, you don't have to worry about timing the market, you just have to ensure your investments stay within the proper percentages.

✓ **Reducing the risk in your portfolio.** Asset allocation combines more aggressive investments with less aggressive ones. This combination can help reduce your portfolio's overall risk.

✓ **Adjusting your portfolio's risk over time.** By anticipating changes in your personal situation, you can make those changes gradually.

✓ **Focusing on the big picture.** Staying focused on your asset allocation strategy will help prevent you from investing in assets that won't help accomplish your goals. Rather than investing in a haphazard manner, it gives you a framework for making investment decisions. Asset allocation does not assure a profit or protect against loss in declining financial markets. ○○○



## Your Asset Allocation

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allocation may be appropriate if you have high earnings, are younger, do not need your funds for many years, or are an experienced investor.

**2. Determine your portfolio's current allocation.** You should consider all your investments. Some investments may not fit totally in one category — for instance, an investment may invest in both stocks and bonds or in both domestic and international stocks. In those cases, allocate a percentage of the market value to each of the categories it is invested in.

**3. Determine how much variation you are willing to tolerate in your asset allocation.** It's unlikely that your actual asset allocation will equal your desired asset allocation, due to varying market values and rates of return. Since it is difficult to maintain precise asset allocation percentages, decide how much variation you will tolerate. For example, you may monitor your portfolio more closely if an asset class varies by 5% of your desired allocation and rebalance when it varies by 10%.

**4. Decide how to move your portfolio closer to your desired asset allocation.** If you have not reassessed your asset allocation for a while, you may find that significant changes are needed to get your allocation back in line. However, you may not want to make drastic changes all at once. Instead, you may want to take a more gradual approach to shifting your asset allocation. For instance, you can make new investments in assets that are underweighted in your portfolio. Periodic interest, dividends, or capital gains distributions can be redirected to other asset classes rather than reinvested in the same asset. Any withdrawals can come from overweighted asset classes.

Please call if you'd like help evaluating your asset allocation.



## Teaching Important Financial Lessons

**E**ven though it seems like money and financial topics are discussed everywhere, these are not concepts your children will learn automatically. Some of the most valuable lessons you can teach your children involve basic money concepts. Some strategies you can use to help teach these concepts include:

 **Impart money concepts along with the children's allowance.** You must decide whether to tie your children's allowance to the performance of chores. Some people feel that doing so instills the concept of working for pay, while others feel chores should be performed without pay as part of children's family responsibilities. When setting the allowance, make sure your children understand what expenses must be paid with it. The allowance should increase as your children grow older and should be large enough so children have money left over to make their own purchasing decisions.

 **Provide opportunities to earn extra money.** Offer to pay your children for additional chores around the house, so they learn the connection between effort and pay. If your children want part-time jobs, make sure they understand that their primary job is to do well in school.

 **Allow your children to make their own financial decisions.** You may not agree with the choices your children make, but it is important for them to learn from their mistakes. That doesn't mean you can't discuss options with them, but the financial decisions should be theirs.

 **Encourage your children to save money.** Saving for tomorrow rather than spending today is a difficult concept for both adults and children. Thus, you

may need to offer incentives to encourage saving. You may require your children to set aside a certain percentage of their allowance for long-term goals. Or you can match your children's savings, perhaps contributing 50 cents or a dollar for every dollar your children save.

 **Explain the basics of investing.** At an early age, open a bank account for your children, explaining concepts like saving and compound interest. Around age eight or so, explain how businesses operate and how investors buy and sell stocks. As their interest grows, help them purchase stocks with their savings. Since minors can't own stocks, you will need to purchase the stock as custodian for your children. Teach your children how to research a stock, follow its price, review its annual report, and decide when to sell it. Exposing your children to these concepts at a young age will hopefully make them comfortable with investing as adults.

 **Encourage your children to take finance courses.** Many high schools and colleges offer courses that teach stock basics and personal finance. Encourage your children to take at least one of these courses.

 **Be conscious of the money messages you send to your children.** Your children watch your actions closely, so how you treat money will be a significant influence on their views. If you make large purchases only after careful research and price comparisons, your children will learn to be careful before making a purchase. If you use your credit cards cautiously and explain how to select a card, what items to charge, and how to pay off the balance every month, your children will learn not to abuse credit cards.



## The Problem with Average Returns

**W**hen setting up an investment program, the assumed rate of return is typically an average return for some historical period. While that is generally viewed as a conservative approach, there are some problems with using an average return:

✓ Average returns are an average of past returns and do not indicate what will happen in the future. Economic and market events may or may not replicate past events.

✓ The average annual return can vary substantially depending on the historical period used. For instance, from 1926 to 2008, the Standard & Poor's 500 (S&P 500) had an average annual return of 9.6%. From 1984 to 2008 (25 years), the average return was 9.2% and 6.4% from 1999 to 2008 (10 years).<sup>\*</sup> Those differences in average return would project a substantially different portfolio value over an extended time.

✓ The average return does not reveal the pattern of returns over that period. Some years will experience higher returns, while other years will experience lower or even negative returns. Even if you select an average return that is exactly right, your portfolio's ultimate balance will depend on the pattern of returns over that period. For instance, if you experience high returns in the early years when your portfolio's balance is low and then lower returns in the later years when your portfolio's balance is higher, you will have a lower value than if the opposite occurred.

✓ Most people don't just allow a lump sum to grow but make deposits and withdrawals over the years. Since your actual return fluctuates from year to year, your pattern of additions and withdrawals can also significantly impact your portfolio's ultimate value.

While it is instructive to

consider average returns when developing an investment program, you can't simply project that return into the future and hope for the best. Instead, consider these steps when deciding on an estimated rate of return:

✓ **Evaluate your expectations for future returns against historical averages.** It may be prudent to assume lower returns in the future. It is easier to save less if you obtain higher returns than to try to save more over a short period of time if your actual return is lower.

✓ **Consider a range of possible returns for your portfolio.** What would happen to your portfolio's balance if you earned your expected return, 1% less, 2% less, etc.? This analysis can help you determine what adjustments would need to be made to compensate for lower returns.

✓ **Review your progress every year.** This will allow you to make adjustments along the way. If your return is lower than expected, you may need to increase savings or change investment allocations.

If you'd like help evaluating an appropriate expected rate of return for use in your investment program, please call. ○○○

<sup>\*</sup> Source: *Stocks, Bonds, Bills, and Inflation 2009 Yearbook*, Ibbotson Associates. The S&P 500 is an unmanaged index generally considered representative of the U.S. stock market. Investors cannot invest directly in an index. Past performance is not a guarantee of future results. Returns are presented for illustrative purposes only and are not intended to project the performance of a specific investment.



## Don't Make These Selling Mistakes

✓ **Holding on to an investment with a loss.** Psychologically, it's difficult for investors to sell an investment with a loss. Many prefer to wait until the investment at least gets back to a break-even level. However, that may never happen or may take a long time to do so.

✓ **Hanging on to capture more gain.** When an investment has increased dramatically, you may be reluctant to sell. There's always the risk you'll sell and the price will keep going up. But sometimes it's best to protect your gains and sell while you're ahead.

✓ **Not setting price targets.** One way to take the emotion out of selling is to set high and low price targets for reevaluating an investment. You don't have to sell when the investment reaches those targets, but at least review whether you should sell.

✓ **Trying to time the market.** It's difficult to predict when the market will rise and fall. Even if the stock market is following a general trend, there will be up and down trading days.

✓ **Worrying too much about taxes.** Taxes can consume a significant portion of your investment gains. However, avoiding taxes may not be a good reason to hold on to an investment. There are typically strategies that can be used to help offset the tax burden, but there's not much you can do about a loss in investment value.

✓ **Not paying attention to your investments.** Your portfolio needs to be evaluated on a periodic basis, or you could miss signals that it may be time to sell. You should reevaluate an investment when the company changes management, when the company is acquired or merges with another company, when a strong competitor enters the market, or when several top executives sell large blocks of stock. ○○○

## Reassess Your Risk Tolerance

**T**ypically, before deciding how much to allocate to different investment categories, you answer several questions about your tolerance for risk. While it can be difficult to judge how you will react to different scenarios, the recent stock market fluctuations have provided a real-world test of theoretical answers. Thus, you should now have a better understanding of your comfort level with risk, making this a good time to reassess your risk tolerance. There are at least two components to your risk tolerance. One is the appropriate level of investment risk based on your personal situation. Factors such as your time horizon for investing, income level, total assets, debt levels, liquidity, and family responsibilities will affect that aspect.

The other element is your emotional tolerance for risk. Even if your personal situation indicates a high level of risk, that may not be prudent if you don't feel emotionally comfortable with that risk. How you have handled the recent stock

market fluctuations should provide a good indication of your emotional comfort level with risk. How have you reacted during this volatile period? Have you taken the fluctuations in stride, or have you been anxious about your portfolio's value? Have you frequently calculated your portfolio's value or only occasionally checked? Have you been tempted to sell all of your stock investments, or did you realize that this is a normal part of the investing process? What would you do if the market continued to decline? How long could you withstand a declining market before feeling compelled to sell?

By knowing yourself and understanding your financial needs and goals, you will be better able to gauge how you may react to market fluctuations. In turn, this will help you determine what levels of risk to assume in your portfolio to help meet your financial goals.

Please call if you'd like to discuss your risk tolerance in more detail. ○○○

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## Check Your Property Tax Assessment

**I**t's possible that your property tax value isn't accurate, which might entitle you to a reduction in property taxes. To get that reduction, you'll have to make an official challenge, following these steps:

✓ **Organize your files.** Dig out your records of each year's tax bills and any notices of changes in your assessment.

✓ **Start your research in the assessor's office.** Check the records of your assessment and those of about half a dozen homes you believe are comparable. Your chances of a successful appeal are typically greater when you cite several relevant examples.

✓ **Know your municipality's appeal procedures.** What are the deadlines for an appeal? What forms do you need to fill out?

✓ **Look for errors in the assessor's report.** Many assessments are conducted on a "drive-by" basis, with the assessor never leaving his/her car and referring to only existing records.

✓ **Secure an independent appraisal from a respected professional.** The closer the appraisal is to the date of your appeal hearing, the more effective it will be. ○○○

## Save the Date — October 25–26, 2010

"By Popular Demand" — Third Annual Financial Literacy Leadership Conference

Hosted by: Society for Financial Education and Professional Development, Inc.

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The Third Annual Financial Literacy Leadership Conference will give you the opportunity to gain important information, strategies, and partnerships to help you enhance the financial literacy of your constituent group, institution, organization, or community. The theme of the conference is: "Financial Literacy: Next Steps."

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