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Financial & Retirement Planning for Life

Forget 'Safe' – Inflation Risks Trump 'Safety'

Here's an investment cliché that bears repeating, especially in the wake of recently volatile financial markets when "flight to safety" became common: a risk-free investment doesn't exist.

Even burying all your cash in a strongbox won't do, because when you eventually retrieve it, the value of your cash will very likely have been diminished by inflation. You simply can't make an investment that is "safe" as the dictionary defines

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The Importance of Being Average

It's not uncommon for investors to check their portfolios against the equity indices that are tallied daily after financial markets close, but they're not all designed to be portfolio measuring sticks. The Dow Jones Industrial Average, for example, is meant to gauge the market as a whole and, in the process, reflect the entire U.S. economy. Although investors cannot invest directly in an index, here is a brief look at some of the major ones.

Dow Jones Industrial Average

Any time you hear "the market's up," the reference is probably to the Dow Jones Industrial Average, first published in 1896 when Charles Dow listed a dozen companies he thought represented the industrial economy of his time. Among them was General Electric, the only original member in today's list of 30 companies. There's nothing permanent about membership in the Dow. In June, faltering General Motors Corporation (after 83 years) and Citigroup, Inc. (after 12) were replaced by Cisco Systems, Inc., and Travelers Companies.

The Dow is certainly the most referenced financial index. Despite the fact

that there are only 30 companies listed, they represent a select group of the most highly capitalized and influential U.S. companies.

NASDAQ Stock Market Composite Index

Created in 1971, NASDAQ was an acronym for National Association of Securities Dealers Automated Quotation, an electronic stock market. Computer systems facilitate trading and provide price quotations for actively traded over-the-counter stocks, and compute daily the value of its composite index of 2,811 companies (as of August 2009). No longer considered the province of obscure companies, among NASDAQ members are Amazon.com, Inc., Staples, Inc. and Microsoft Corp.

S&P 500

In 1941, Standard Statistics merged with Poor's Publishing (founded in 1860 by Henry Varnum Poor to publish railroad manuals) to form Standard and Poor's. For decades, it rated corporate and municipal bonds, but in 1957 Standard & Poor's created the S&P 500, which today is one of the most respected benchmarks

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Cash Management *(continued from page 1)*

the word. Instead of pursuing a kind of safety that doesn't exist, you might assess the degrees of risks throughout your portfolio, then choose a mix that meshes with your risk tolerance level.

Investing in Treasury bonds, for example, may be as "safe" as you can get, because they are backed by the full faith and credit of the U.S. government. But at today's low yields, even the historical average inflation rate (3.1%) would easily overwhelm those yields, and that doesn't account for the concern that government stimulus programs might lead to higher inflation rates in the years ahead.

Inflation's Reality Show

For some, there is no entirely comfortable answer to the search for safety

There is an inverse relationship between interest rate movements and bond prices. Generally, when interest rates rise, bond prices fall and when interest rates fall, bond prices generally rise. U.S. government bonds are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. U.S. government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should comprise only a modest portion of your portfolio.

because, historically, diversification and equity investments are key to outpacing inflation. Even if you're focused on fixed income investments, you are more likely to beat inflation if, in addition to bank accounts, CDs and Treasuries, you mix in corporate bonds and other potentially higher-yielding instruments. According to studies done by Ibbotson, since 1926, a portfolio of investment-grade corporate bonds mixed with equities has been required to outstrip inflation.

It's clear that if you want your portfolio to grow in real value, you must accept greater risks. What exactly those risks are depends on your market-tested level of risk tolerance. If you'd like to discuss how your portfolio is designed to cope with inflation, give me a call. ■

Being Average *(continued from page 1)*

of the overall U.S. stock market. The S&P 500 index consists of 500 stocks chosen for market size, liquidity and industry group representation. Larger and more diverse than the Dow, it is considered more representative of the U.S. market.

Dow Jones Wilshire 5000 Total Stock Market Index

True to the term "total" in its name, the Wilshire 5000, first published by Wilshire Associates in January 1975, today includes more than 6,500 tradable securities. Dow Jones began calculating this index in April 2004.

The Wilshire 5000 includes all U.S.-headquartered equity securities with readily available price data, and is one of the broadest indices to track overall market performance. It is updated monthly to add new listings and remove delisted equities. ■

Financial Planning:

Portfolio Neglect Could Prove Dangerous to Your Wealth

You've undoubtedly heard that, just as watched pots never boil, portfolios under constant scrutiny and adjustment don't perform well. There is at least a grain of truth to that, sometimes because those who constantly toy with their portfolios may be chasing performance, often a losing strategy. But the flip side of this isn't good, either.

In other words, don't let admonitions against micromanaging turn into port-

folio neglect. Financial strategies are not meant to last forever. Rather, they are like adjustable, living organisms that can – and perhaps should – be changed as your goals and market conditions shift. A wise strategy for 2006 and 2007, as the market cheerfully ratcheted past threshold after threshold, may not be very useful in this post-recession market.

Studies of what retirement plan investors did or didn't do during the

recent market meltdown show that very few adjusted their holdings, an indication that investors either decided their original strategies are still valid, or simply avoided considering adjustments that might better position their portfolios to bring them in line with new market realities and, perhaps, their own somewhat altered financial goals.

Inaction can be a strategy – or it can represent a lost opportunity. ■