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LMK Wealth Management

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The Prudent **I** NVESTOR

JUNE 2010

Revisit Your Asset Allocation

No 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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News and Announcements

In the *LMK Wealth Management Market Update* dated October 21, 2009, we reviewed our March 2009 strategy of going double long the S&P and double short the 20-year Treasury bond (copies available on request). We believed the "Sea of Liquidity" would turn the domestic economy to positive territory around mid-year 2009. Indeed, the GDP turned positive during Q3. At the start of 2010, we anticipated a correction to the 60% advance, since the March 2009 lows (January 20, 2010 Market Update). We barely got a 5% correction. Then the market moved to new highs, stretching the advance to 70% from the March lows of the S&P 500. We stated that we thought we would "experience a moderately improving Global economy." Apparently, the market has seized on that assumption as well.

The market has climbed the proverbial "WALL OF WORRY"! We reviewed the issues that challenged the markets in the *January Update*. China Bubble in real-estate, high unemployment at home, sovereign debt

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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.
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Teaching Important Financial Lessons

Even 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.
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The Problem with Average Returns

When 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).* 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. ○○○

* 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.

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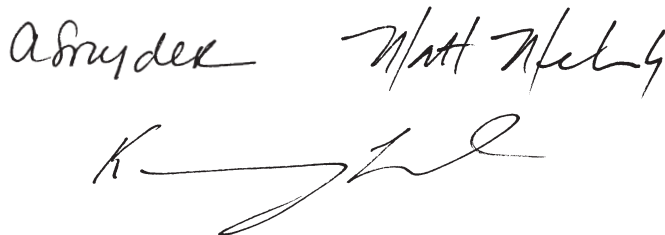
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worries globally, increase in tax rates, possible second leg down in real-estate prices, etc. Yet in the end, it is "EARNINGS" expectation that really determine the prices of stocks. Although there are always things to be concerned about, this time around, there are significant challenges to overcome. We need to "keep our eyes on the ball." That being said, there has been a lot of good economic news as well. Industrial production, exports, retail sales, and earnings have all been good news stories. At least in the short run, we should continue on a "Favorable Path." 2011 is a little cloudier as we anticipate unwinding a Fed policy of extremely low interest rates, raising U.S. Government debt, and the sun setting of the prior tax cuts. So we "keep our eye on the

ball" and see how the game plays out. In the meantime, enjoy the thawing of a very cold winter and the formerly frozen credit markets as financial assets continue to recover.

Overall, we are pleased with the improving economy and still see a "moderately improving global economy," as stated in our January 2010 *Market Update*. In his April 14, 2010 testimony to congress, Dr. Ben S. Bernanke stated, "On balance, the incoming data suggest that growth in private final demand will be sufficient to promote a moderate economic recovery in coming quarters." We think he is spot on. We are doing a lot of thinking about 2011. We will share those assumptions as they are made. Dow 11,000 and the return of the "Robin Red Breast." Life is good!



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Check Your Property Tax Assessment

It'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. ○○○

Financial Thoughts

A recent study found that 63% of American families headed by someone age 55 or older had some debt in 2007, up 10% since 1992. In addition, the average total debt for this group increased almost 120% during this time period. The percentage of families with debt payments greater than 40% of income grew from 7.3% in 2004 to 9.9% in 2007 (Source: Employee Benefit Research Institute, 2009).

Another recent study of workers who lost their jobs in 2008 found that 46% took a cash distribution from their retirement plan accounts. Younger employees were nearly twice as likely as older employees to cash out (Source: Hewitt Associates, 2009).

Approximately 51% of households are at risk of being able to maintain their standard of living during retirement, up from 44% in 2007. Almost three-quarters of the

increase in the percentage of households at risk resulted from declines in housing values, reflecting the fact that homes are the most valuable asset for many individuals. Also, the percentage of household income replaced by Social Security for an average earner retiring at age 65 is expected to decline from 39% in 2002 to 31% in 2030 (Source: Center for Retirement Research, 2009). ○○○