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Financial Briefs

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Five Steps to Creating an Investment Plan

Like anything in life, having a plan for your investments will help you reach your investment goals. Below are five steps for crafting your investment plan.

1. Determine Your Goal

Every good investment plan begins with a clear goal in mind. Ask yourself: "Why am I investing? What do I hope to do with the money I save and earn?" For example, you might invest to:

- Fund a child's college education
- Retire comfortably
- Buy a house
- Start a new business
- Leave a charitable bequest to a favorite cause
- Pay for a wedding

Write down your investment goals. Make them as specific as possible. Think about the kind of lifestyle you want in retirement, the cost of your dream vacation home, the cash you'll need to start your business, or the cost of tuition where your children might go to college. Write down a realistic estimate of how much you think you'll need. Making these estimates can be challenging, but it's an essential investment planning step. After all, if you don't know where you're going, you'll never get there.

2. Decide on Your Time Frame

After you outline your goals, you need to establish your time frame for investing. Typically, your goals will fall into one of three categories:

- **Short-term:** Short-term goals are those you expect to achieve in five years or less.
- **Medium-term:** Medium-term goals are those you expect to achieve in five to 10 years.
- **Long-term:** Long-term goals are those you expect to achieve in more than 10 years.

Your investing time frame has a direct relation to the investments you'll choose. Generally, the shorter your time horizon, the less risk you want to take. If you will need your money in three years to pay for your daughter's college education, then putting all your money in riskier investments is probably not wise, as the chances of losing money are greater. Instead, less risky investments like bonds will likely make up a larger portion of your portfolio. But if you're investing for the long haul (say, for a retirement that's 30 years away), you can invest in higher-risk investments, since you

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Asset Allocation and Diversification

So, it's time to start selecting investments for your retirement account. You sit down at your desk, start looking over the list of investment options, and are quickly overwhelmed. How do you build your retirement portfolio (or any other investment portfolio)? What's right for you? The answer to those questions lies in two essential investing concepts: asset allocation and diversification.

Asset Allocation

Asset allocation sounds complicated, but it's actually a fairly simple concept. It involves selecting a variety of different types or categories of investments — called asset classes — for your portfolio as a way to hedge against risk. The asset classes the average investor is most likely to encounter include cash equivalents, stocks, and bonds. Other asset classes include commodities, real estate, and other investment alternatives.

Why invest in different asset classes? Because asset classes are affected differently by economic events and market factors, investing in a variety of asset classes is a way to reduce risk in your portfolio. For example, if stocks fall dramatically, the other asset classes will likely help mitigate your losses.

Diversification

Choosing your asset allocation

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will have more time to recover from a loss.

3. Evaluate Your Tolerance for Risk

All investments come with risk — the chance you could lose your money. But riskier investments also come with the possibility of greater return. As an investor, you must decide how much risk you're willing to accept. Your personal risk tolerance is closely related to your goals and your time frame, as well as your experience with investing and your feelings about the possibility of losing money.

4. Decide How Much You Want to Invest

Once you've considered your time horizon, goals, and risk tolerance, you can consider how much money you want to invest. You should keep a portion of your savings in a stable, easily accessible account to use for emergencies and other immediate needs.

Once you have the funds for your initial investment, you need to decide how much you want to invest on an ongoing basis. This number will be determined by your budget, your investment goals, and your time frame. For smaller, short-term goals, determining ongoing investment amounts is fairly easy. If you want to buy a home in five years, you might open an account with $2,000 you've already saved, and then invest $400 a month for the next five years.

Deciding how much to invest for longer-term goals can be more challenging. When saving for retirement, you need to consider how much yearly income you'll need, your anticipated investment returns, when you want to retire, how long you expect to live, the impact of inflation, and the money you'll receive from other sources like Social Security. It can be a complicated equation, which is why many people turn to a financial advisor for help running the numbers.

5. Choose Your Investments

Given the thousands of possible options, choosing investments can be overwhelming. But completing the first four investment planning steps should help you make those decisions. Again, your goals, risk tolerance, and time frame will point you in the right direction, such as toward target-date funds designed for retirees or college savers, or perhaps a money market fund for short-term goals. But if you're baffled by all the options, it's always a good idea to seek a second opinion. Please call if you'd like help with your investment plan.

Avoid These Investor Mistakes

Avoid these common investor mistakes:

- **Chasing performance.** Investors often move out of sectors that are not performing well, investing that money in high-performing investments. But the market is cyclical; and often those high performers are poised to underperform, while the sectors just sold are ready to outperform. Rather than trying to guess which sector is going to outperform, broadly diversify your portfolio.
- **Looking for get-rich-quick investments.** When your expectations are too high, you have a tendency to chase after high-risk investments. Your goal should be to earn reasonable returns over the long term, investing in high-quality investments.
- **Avoiding the sale of an investment with a loss.** When selling a stock with a loss, an investor must admit he/she made a mistake, something that is difficult to do. When evaluating your investments, objectively review the prospects of each one, making decisions to hold or sell on that basis.
- **Selecting investments that don't add diversification benefits to your portfolio.** Diversification helps reduce your portfolio's volatility, since various investments respond differently to economic events and market factors. Yet, it's common for investors to keep adding investments that are similar in nature. This does not add much in the way of diversification, while making the portfolio more difficult to monitor.
- **Not checking your portfolio's performance periodically.** While everyone likes to think their portfolio is beating the market, many investors simply don't know for sure. So analyze your portfolio's performance periodically.
- **Letting market predictions cause inaction.** No one has shown a consistent ability to predict where the market is headed in the future. So don't pay attention to either gloomy or optimistic predictions. Instead, approach investing with a plan.
- **Expecting the market to continue in its current direction.** Investors have a tendency to make investment decisions based on current trends in the market. However, there is a tendency for markets to revert back to the average return when they have an extended period of above- or below-average returns.
- **Not understanding that saving and investing are two different concepts.** Saving involves not spending current income, while investing requires you to take those savings and invest them to earn a return. Saving often becomes easier when separated from the choice of where to invest. Find ways to make saving as automatic as possible, then take your time to research and select specific investments.
- **Considering only pretax returns.** One of the most significant expenses that can erode your portfolio's value is income taxes. Thus, don't just consider your pretax returns, but look at after-tax returns. If too much of your portfolio is going to pay taxes, look at strategies that can help reduce those taxes.

Asset Allocation

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is just the beginning. In order to minimize your risk, you also need to think about diversification. But if you just built a portfolio out of several different asset classes (say, stocks, cash, and bonds), aren't you already diversified? Not necessarily. In addition to diversifying among asset classes, you also need to diversify *within* asset classes.

Diversification is simply another way of saying, "Don't put all your eggs in one basket." If 60% of your portfolio is in stocks, 30% in bonds, and 10% in cash equivalents, you are diversified among asset classes. But if you only own two or three different stocks, you're not diversified within that asset class. If one of those stocks plummets in value, your portfolio could take a big hit.

Diversification may sound fairly simple, but it can be more complicated than many realize. For example, you may think you're well diversified by investing in eight or nine different stocks. But if each of those stocks is in the same industry, they'll each have roughly the same performance. To better diversify, you might want to select nine stocks in nine different industries. Another big diversification error people make is investing too much in their employer's stock. No matter how confident you feel about the future of your company, it's rarely smart to place too much of your assets there — if the business goes under, you could be out of a job and much of your savings.

Asset Allocation and Diversification in Practice

How do you determine the right asset allocation or diversification for your portfolio? It depends on your investment goals and time frame. If you are young and investing for retirement, you can afford to have a significant portion of your assets in equities, with the goal of maximizing your investment return. As your retirement date nears, you'll likely want to shift to a more conservative portfolio with a smaller allocation to stocks, so that you can better protect the wealth you've already accumulated.

In the intervening years, you will periodically tweak your asset allocation so that it changes with your situation. You will also monitor your specific holdings in each portfolio, making occasional adjustments so that you are properly diversified. The ultimate result is a portfolio that evolves with you and the current market situation, so you are prepared for whatever economic weather comes your way. However, please note that asset allocation and diversification do not assure a profit or protect against loss in declining financial markets. Please call if you'd like to discuss asset allocation and diversification in more detail.

Harness the Power of Compounding

In the world of investing, among a seemingly endless variety of complicated systems, stands one simple but powerful concept. It's one that when mastered and correctly applied can contribute more to creating wealth for the average investor than perhaps any other: the power of compounding.

The secret to the power of compounding is instead of growing arithmetically it grows *exponentially*, as long as you do one very important thing: instead of spending the returns on your money, reinvest all of it. It works like this: say you invest in a bond that pays 5% a year with $10,000. At the end of 12 months, the bond matures with a value of $10,500. If you spend the $500, you're left with $10,000 to roll over into another bond at the same rate. But if you roll over the entire amount, at the end of the year, that $10,500 bond will have earned $530 and grown in value to $11,030. In the third year, rolled over at 5% again, earns $550.

Zoom forward 20 years, with the bond earning 5% every year. By rolling over principal and interest, your investment will have more than doubled in value to $26,530, without ever contributing any more money. You've collected $6,350 more in interest than the saver who spent all the interest he earned each year.

Danger: Suffering Big Losses

Although the advantage of compound returns was illustrated with an interest-bearing investment, the same applies to a stock portfolio by reinvesting any dividends or realized capital gains. But when it comes to investments like stocks whose prices fluctuate, it's essential to avoid large losses if you want to maximize the power of compounding.

Whenever an investment position loses money, you need a larger gain than the percentage lost to return to its prior value. The chart below makes this clear:

% loss	% gain needed to recover loss
1%	1.01%
5%	5.26%
10%	11.11%
20%	25.00%
30%	42.86%
50%	100.00%

When an investment (or a portfolio) loses less than 5% in a year, it doesn't take very long to recover your losses, because on average, stocks return between 9% and 10% a year. As a result, you can expect to wait for as long as several years or even more to recover from losses that are greater than 20%. And since compounding gathers power over time, such delays can be costly.

What's more, big losses can tempt you to try to recover more quickly by choosing higher-risk investments, which exposes you to the possibility of further and deeper losses. The moral of the story is, the less volatile your portfolio returns are over time, the more you will benefit from the power of compounding through the reinvestment of your returns.

News and Announcements

From the Alexander Household

Have you ever caught yourself in a negative frame of mind when life didn't go as planned or found yourself criticizing a friend, coworker, or yourself? Will Bowen, the founder of "A Complaint Free World," started a movement in 2006 that encourages shifting our mindset from negative thoughts and communication to positive thinking and problem solving. Bowen's challenge is simple: go 21 days without complaining. You wear a purple bracelet and if you gossip, criticize, or complain, you shift the bracelet to your other wrist and start again from day 0.

I found the concept intriguing, so I tried it. Wearing the purple bracelet did make me more aware of my negative words and thoughts. As I worked on minimizing negativity, I found that my overall frame of mind improved, and I focused more on problem solving.

To date, more than 10 million people in 106 countries have taken this challenge. Bowen's goal is to distribute 60 million bracelets — 1% of the world's population. Bowen comments, "Every day, people interact with dozens if not hundreds of others. Our helping shift the attitudes of as little as 1% of humanity cannot help but have a ripple effect, which will become a cascade of positivity around the world bringing about greater harmony, understanding, prosperity, and peace."

You can learn more by visiting:
www.acomplaintfreeworld.org.

Happy New Year!

Carol Ringrose Alexander,
CFP®, AIF®, CDFA™

From the Flinton Household

"We find delight in the beauty and happiness of children that makes the heart too big for the body."

~Ralph Waldo Emerson

The Flinton household enjoyed a wonderful Christmas season and hope yours was delightful, as well. Our annual Christmas Eve was another spectacular showing with 50-plus family members from three states, and including four generations.

Samantha and Emerson's joy and anticipation to see Santa Claus on Christmas Eve was enough to make the lump well up in my throat as they waited eagerly to be noticed by the special guest. I've said it before, but the brief window in life when I get to view the world through the lens of a child is quite a special gift. My wife and I have made a concerted effort to teach our girls that Santa and gifts are only a byproduct of the true gift that is Jesus' birth.

Watching my daughters on Christmas Eve, I came to the realization that we adults are no different. I believe each of us is waiting eagerly to be noticed by the Guest of Honor, and that anticipation can be met with utter joy when it occurs or a saddened defeat when we feel overlooked. The great news is we are never overlooked, and each of us is always the guest of honor in the eyes of our Father.

I wish you and your family a wonderful year full of all the blessings He has in store for you.

Happy New Year,

Andrew Flinton, CFP®

From the Bolander Household

Something hanging on our garage wall caught my eye the other day. It is the old wooden sled with metal rails we bought years ago in a Guthrie antique store. When we first came upon the sled, my husband, John, recounted stories from his childhood in Michigan and Missouri of sledding, building snow forts and digging long snow tunnels. Though we seldom have enough snow in Oklahoma for serious sledding, we bought it, just in case.

A few months later, the perfect opportunity came after a great snowstorm. Our street has two steep hills right together, perfect for sledding. John went down the first hill a couple of times to make a trail. After that, he took our daughter and then our son down the hill on his back. Over and over they flew to the bottom and halfway up the other side before stopping. I joined in the fun, too. It was exhilarating to sail so close to the ground, face first, and to feel the cold air stinging my cheeks. Though the snow lasted only a few days, the memories live on, and now I wonder if my granddaughter is old enough to go sledding after the next snow.

Best wishes for a prosperous and exhilarating new year!

Brenda C. Bolander,
CFP®, CPA/PFS