



The Importance of a Diversified Portfolio

By Shawn P. McLaughlin

Diversification is a term that many of you have heard at one time or another, but do you really know what it means? Proper diversification is arguably the most important aspect of your investment portfolio; it helps you capture gains in an up market, but more importantly helps to insulate you from loss and volatility in a down market.

Portfolio diversification should be a very individualized process. How an investment portfolio is diversified depends on a number of factors including your age, your assets, your tolerance for risk and your investment goals. A portfolio that is spot on for one investor may be entirely inappropriate for another investor.

Diversification is an investment strategy in which monies are spread over different industries, markets and securities. The ultimate goal is to protect your monies in the event that a single security, industry or market takes a serious downturn or becomes out of favor. Think of the employees at Enron. Many of them were too heavily invested in Enron stock and lost everything that they had. Proper diversification could have aided in preventing this tragedy.

A well diversified portfolio should contain a number of investments that we have discussed in earlier newsletters including cash, cash equivalents, stocks, bonds, and numerous other investment choices. Many individuals rely on mutual funds to provide them with their stock, bond, and cash investments. It is important to understand that there are three main categories of stock: large cap, medium cap, and small cap. Companies such as General Electric, Pepsi and Disney represent large cap stocks; CVS is a mid cap stock, and the Applebees restaurant chain is considered small cap. "Cap" stands for capitalization or the overall value of a company's stock in the market. Large Cap stocks tend to be the least volatile, while Medium and Small cap are considered more volatile. An interesting fact is that since 1926 Small Cap stocks have had the highest rate of return, while also being the most volatile. We should also concern ourselves with the Value and Growth categories of the market. Growth companies tend to invest their profits to grow and expand the company, and tend to do well when the economy is thriving. Value companies have money in the bank and investors tend to look to value during difficult times. Many value companies are "Blue Chip" or pay dividends on their outstanding shares.

Diversification is a tool, that when properly utilized can help to take some risk and volatility out of an investment portfolio. If you invest in the financial marketplace, be sure you have every advantage on your side.



The Role of Rebalancing Your Portfolio

By John G. Clouden CRS®

While we feel that asset allocation is one of the most important parts of taking a prudent road with your investments, there is another piece of the puzzle that many investors may be missing: the importance of rebalancing your portfolio to its original allocation.

Taking the time to find which portfolio allocation is appropriate for your situation is only half of the battle; the real key is maintenance. We all know someone who has lost a great deal of weight on a "fad" diet, only to gain that weight back. Those who truly succeed in weight loss are those who continue to eat well and maintain an active lifestyle. The same is true of managing an investment portfolio. The financial market place is an always changing and evolving creature. The only way to be sure that your investments represent *your* goals is through annual portfolio maintenance. We must stay active with our investments and review our asset allocation at least annually to take the profits or losses that the market has dealt us, make our changes and move on. This may not seem like a terribly important concept, however just think back a few years when from 1995 to March of 2000 growth stocks and technology stocks had astronomical returns year after year. Many investors made the mistake of letting their investments ride and these individuals were the ones who suffered the most dramatic losses when the tides changed.

The most basic rule of investing, and what we all strive to accomplish is to purchase an investment while its cost is low, and to sell it while its cost is high. This seems like a simple concept but the majority of investors tend to do the opposite. However, through proper rebalancing this practice becomes law. Lets assume that we have established a well diversified portfolio. Lets also assume that after a year our Large Cap stocks have done particularly well, and Small Cap stocks have suffered. This means that Large Cap now represents a larger percentage of our portfolio than we would like, and Small Cap represents a smaller proportion. In adhering to the laws of portfolio rebalancing we would trim back out Large Cap holdings to purchase some additional Small Cap holdings to bring our portfolio back into proper alignment. What have we accomplished? We sold when the one investment was high, we bought when our other investment was low, and we repositioned the portfolio to fit the needs of the individual investor.

Why are we telling you this now? Because over the last 12 months the market has done particularly well and it may be time to rebalance your portfolio. Call and schedule in today.

A personal thank you from Joe

Dear Valued Friend,

With April 15th behind us and the weather breaking, we're all looking forward to that first game of golf, tennis or just a walk thru the neighborhood. This is one of my favorite times a year as I love our change of seasons...especially coming out from our winter weather. ☺ ☺

The investment weather has also significantly improved. We're now 12-14 months into a nice bull run after the 3 worst years I have ever personally witnessed for equities. Thank goodness we've come out of it. The future for equities, which no one can precisely predict, does look brighter and brighter. There are, of course, some stocks that are over-valued but the majority are not. Inflation is in check and interest rates continue to hover in an all time low range. Productivity seems to be continuously improving and corporate profits, by and large, are improving also. Also remember that there is still 6-8 trillion of cash parked on the sidelines and bonds still represent almost 85% of all equity investments (stocks ~ only 15%). And with pension contributions so dramatically increased, that money has to go somewhere and history has taught us that the best long range potential for return is good companies (we



prefer stock mutual funds) and real estate. So as long as you have an investment horizon of 5 years or more, you'll likely do better long term in well managed stock funds and real estate. When it comes to your investments don't concentrate on Iraq or the election, focus on your long term objectives and risk level.

My personal biggest concern is in the bond (fixed income) market. Interest rates are so low it doesn't take a rocket scientist to figure out that they'll likely go up (there is no where else for them to go). So, if you're in long-term bonds or a long-term bond fund, you might want to re-evaluate your portfolio. If you insist on staying in the fixed income arena, my advise is to keep your maturities short to reduce your risk. We have other alternatives to the bond market that make much more sense. Be sure to call and schedule in, especially if you have not had an appointment in the last year.

For those of you who were able to attend our area's world premier of Bobby Jones...A Stroke of Genius at Shea's, thanks for coming. I want to personally thank Tim Greenan, Mark Lazzarro (Americorps), John Webber, Patti Jordan, Fred Zillner and a host of volunteers who pulled the event off on incredibly short notice. The movie will be opening in theatres world wide right around the time you receive this newsletter. This film is not just about golf, it is about integrity and values...I highly recommend it to all.

Enjoy this wonderful weather and good health to you. If you haven't yet had your annual financial check-up, please call the office and schedule in.

All the Best,



Inflation Protected Securities *By Jeffrey E. Hahn CFP®*

Inflation Protected Securities offered by the U. S. Treasury, also known as TIPS, were first issued in 1997. The Europeans have been using these types bonds since 1945.

As with all bonds, they are a loan to the borrowing entity, the Federal Government in this case. On a periodic basis the amount of the loan is adjusted for the rate of inflation as measured by the CPI. The interest that the bond pays is adjusted also. A vastly simplified example would go as follows: say you held a TIP with a face value of \$1,000 that earned 3% interest. That bond would earn \$30 interest in it's first year. If inflation was measured at 2% at the end of that first year, the bond would then be revalued at

\$1,020 and in the second year would earn 3% interest on \$1,020 which would equal \$30.60. Over time you would have compounding of both the face value of the bond and interest the bond earns by the rate of inflation.

Like other Treasury bonds, TIPS are backed by the full faith and credit of the US government and are exempt from state income taxes. They offer an excellent portfolio diversification tool because their performance is not effected by the same factors as other investment types. Specifically, bonds tend to suffer in the face of inflation. TIPS would not. All of this could help reduce overall portfolio volatility. A risk associated with TIPS is deflation (decreasing consumer prices) which may result in falling interest payments.

TIPS are generally considered one of the lowest risk investments on the market. For those who are sitting with significant sums in bank savings or money market accounts a good TIPS fund might be an appropriate alternative (Savings accounts are FDIC insured and may offer a fixed rate of return, whereas both the principal and yield of investment securities will fluctuate with market conditions).



Fixed-Income (Bond) Front *By Brian M. Clouden*

Current low interest rates may be attractive to borrowers, but they're a thorn in the side to traditional saving vehicles and retirees. Income-producing investments such as certificates of deposit, money market funds and Treasury bills are paying historically low rates of return -- 0 percent to 3 percent annually. Longer-term bonds and CDs may pay a bit more but present significantly more risk. Investors in search of higher income face something of a lose-lose situation over the next several months.

If the Federal Reserve holds fast to today's rates, yields on relatively low-risk investments such as money market funds will continue to suffer. If the Fed decides to raise interest rates (which many analysts think will happen sometime this year), money market yields will rise, and new bond and CD investors will get more for their newly invested cash. But the bonds and bond mutual funds investors already own probably will decline in value, because existing fixed-income securities generally lose value when interest rates rise.

What's a fixed-income investor to do? Go short; and be realistic about yields. A total return of 5 percent to 6 percent in a bond fund is acceptable and desirable. (Total return is interest income plus any price appreciation.) BE ADVISED: while it may be tempting to pick up long-term bonds because they're yielding significantly more than short-term bonds right now, they also present more risk to your investment.

Here is an example. The value of a 30-year Treasury bond falls about 12 percent for each percentage point that market interest rates rise. Shorter-maturity securities, such as five-year Treasuries, also get hit, but less dramatically. The five-year Treasury loses about 4 percent of its value with each one-point rise in market interest rates (Bonds are interest rate sensitive, when interest rates go up bonds go down and the reverse holds true also). Think of a teeter-tauter with short term bond investments being closer to the middle and long-term bond investments where you would sit. The most movement (or volatility) is where you sit. Closer to the middle moves, but not as much (less volatile).

Note: CDs are FDIC insured and offer a fixed rate of return, whereas both the principal and yield of investment securities will fluctuate with market conditions. For more information on your fixed-income (bond) investments, call the office.



Tax Benefits of Long Term Care (LTC) Insurance *by Don R. Fohrd*

Are you taking advantage of the tax law in regards to your LTC policy premiums? Both Individuals and Businesses have been given tax savings opportunities for purchasing LTC policies.

For Individuals – Premium paid for a Tax Qualified LTC policy is a deductible personal medical expense for those taxpayers that itemize their taxes (7.5% medical expense threshold). For 2004 the Premium Dollar Limits are:

<40 - \$260	41-50 - \$490	51-60 - \$980	61-70 - \$2,600	>70 - \$3,250
-------------	---------------	---------------	-----------------	---------------

For Self Employed and Sole Proprietors – Up to 100% of the individual premium dollar limits can be deducted as self employed health insurance. Any remaining balance is deductible as a medical expense on personal return.

Partnerships and C-Corps – Business can deduct LTC premium that they pay for their **employees** as medical insurance expense.

Call your Sgroi Financial Consultant to determine if you and your family or employees are adequately protected against the impact of LTC expenses. As with all tax situations, we would be happy to work with your tax consultant to determine compliance with tax law, and maximizing your benefit.

The Cost of Waiting

Take a look at two hypothetical retirement investors and the power of compounding interest over time. In this illustration we use an assumed rate of 12% as the return on investment.

Graduation - Early Earl and Catch-up Carl are two investors who went to college together. When they graduated at age 25, the more responsible Earl began investing the maximum, \$3,000, into his IRA every year. (\$3,000 is the 2004 IRA contribution limit, up to age 50.) Catch-up Carl spent his money more frivolously, as young people often do.

Marriage - At age 33, both Earl and Carl got married. Earl decided his new family needed to use that \$3,000 a year elsewhere and stopped his regular investments. Marriage made Carl want to plan better for the future, so he opened an IRA and began investing \$3,000 a year.

Retirement - Early Earl and Catch-up Carl retired at age 65. Earl's total investment was still just the \$24,000 made when he was young. Carl had continued with his yearly contributions and invested a total of \$99,000.

	Early Ed	Catch-up Carl
Ages of regular investing	25-33 (1/1/1963 to 12/31/1970)	33-65 (1/1/1971 to 12/31/2003)
Total amount invested	\$24,000	\$99,000
Total value as of 12/31/03	\$1,553,139	\$1,150,563

Moral of the story - start saving as early as possible, it can really pay off in the long haul.

**This example is for illustration purposes only and is not intended to depict the actual performance of any investor.

The Power of Inflation

Inflation is defined as an increase in the average price level in the economy (a weighted average reflects the importance of the different products). Most people have heard or read that the inflation rate today is around 3%. What does this mean in real life? Here are few examples using 1980 vs. 2003:

Product	1980	2003	Increase
Stamp	.15	.37	130%
Denny's Grand Slam Breakfast	.99	2.99	202%
Cadillac DeVille	12,950	42,000	220%
Movie Ticket	3.50	8.00	130%

One thing that you can be sure of is that inflation is not going to stop just because YOU retire.

Think Summer!

Make an Informed Rollover Decision

How many jobs have you had? Two? Three? Five? Chances are, you had a retirement savings plan at each of those jobs.

But what happened to the assets when you left? Did you roll them over into an IRA? If not, consider a rollover IRA. Here are a few reasons why:

1. Consolidate into a single IRA to reduce the cost associated with multiple accounts. Consolidating can simplify the way you view your overall retirement portfolio.
2. You may reduce your portfolio overlap by rolling your retirement assets into an IRA.
3. A rollover IRA can offer more flexibility in terms of estate planning. With an IRA you can choose any beneficiary. But with a 401k, you can only choose someone other than your spouse if your spouse consents in writing.
4. You have the option of moving the rollover IRA assets into a future employer's plan.
5. If you leave your retirement assets in your former employee's plan, your investment options may be limited. A rollover IRA may offer a wider choice of investment options.

Here are a few reasons a rollover IRA might be right for you. But ultimately, your choice depends on your own individual financial situation. Contact your planner to help you make that choice. Schedule your annual portfolio review today.

Global vs. International Mutual Funds - What is the difference?

The terms "global" and "international" are often used interchangeably when referring to investing around the world. For mutual fund investors, however, there is an important distinction between a global fund and an international fund. These two types of funds have different goals and investment objectives.

Global Funds - A global mutual fund can invest in all parts of the world, including the United States. A global fund may lessen the country-specific risk of an all-foreign portfolio. It does not, however, exclude U.S. stocks. The funds portfolio manager is not limited by geography, but has the opportunity to select countries and regions based on the prospects of individual companies.

International Funds - Generally, an international mutual fund invests principally in the securities of foreign countries. The funds allow you to diversify outside the domestic equity market. In effect, you get foreign exposure in an asset class that may have less correlation to the U.S. market. International funds may reduce the risk of an all-U.S. portfolio and provide opportunities for growth. If you're looking for a purely international component to an asset allocation plan in your portfolio, use international funds.