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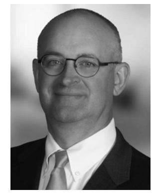
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To Buy or Not to Buy?

If you've been investing for years without a defined strategy, it's never too late to define your strategy and align your portfolio accordingly. Or perhaps you have a strategy that needs some dusting off. Maybe it's simply time to sit down and realign your portfolio with your investment strategy. After all, the markets aren't static; your portfolio shouldn't be either.

Whether you're investing for the first time or buying new stocks to augment your current portfolio, there are five important questions to ask yourself:

1. What's my objective? Is your ideal stock one that pays a high dividend or one that doesn't pay dividends at all, but has a high rate of growth? Is it a stock with relatively little price volatility but lower potential gains, or one with a lot of potential risk and higher potential rewards?

How you answer those questions — and the stocks you choose — depends on your objectives. If capital preservation is your goal, for example, a lower-risk stock is probably your best bet. On the other hand, if you're young and growth is your target, a higher-risk, higher potential return stock may be the right one for you. Whatever your objective, defining that goal is the first step to selecting stocks for your portfolio.

2. Is my portfolio diversified? When considering which stock to purchase, determine whether you need to target your investment in certain areas to balance out your diversification.

Diversification is the single most important factor in managing the risks of a stock portfolio. You should be sure that your portfolio isn't concentrated in just one industry, but spread out over at least four or five. And there are other dimensions to consider as well: cap weighting (large-, mid-, and small-cap), style (value or growth), and geography (U.S.-based, developed foreign markets, and emerging markets).

The benefit of diversification is

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The End of The Era of Low Rates and Magical Thinking

In my office hangs a Warren Miller poster with a man looking like a banker kneeling and praying "And please let Alan Greenspan accept the things he cannot change, give him the courage to change the things he can and the wisdom to know the difference."

To which we say, Amen!

Alan Greenspan was the Chairman of the Federal Reserve during much of the greatest bull market of all time, from 1987 until 2000. He had just the right touch. Let's hope that today's Chairman, Jerome Powell, has that same touch.

In early 2021, the Wall Street Journal ran an article titled "The Era of Low Rates and Magical Thinking." In it, author Greg Ip writes that "Wall Street bulls embracing sky-high stock market values and the Washington pols embracing big deficits may be ideological opposites, but they have something important in common. Both draw sustenance from near-zero interest rates, which make stocks more valuable and debt more supportable." Everyone seemed to be in on the "magical thinking" about low interest rates.

That era is over. According to the Federal Reserve, money supply has grown by over 40% in the two years plus since the start of the pandemic. Trump, Biden, Yellen and the Federal Reserve were all in on it. It was as if there were no consequences. Except that we are now dealing with the one big consequence — inflation.

Inflation is like traffic, snakes and mosquitos. No one likes it. It leads to higher

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To Buy or Not to Buy?

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that the up and down movements of different asset subclasses are not completely correlated, so that over time losses in one industry or subclass may be offset by gains (or lesser losses) in another.

3. What's my expected holding period? If you're looking to speculate or trade for fast gains, your expected holding period is short. In that case, you need to be sure you are timing your purchase so you're getting in near the beginning of an upswing, not the end of one.

If you are buying for the long term, on the other hand, the price you pay is less critical, as long as you don't purchase a stock in the early stages of a steep decline in value.

4. What's the prevailing market trend? Recently, the market was so strong that almost any stock you bought was likely to go up in value. But in a trendless or bear (declining) market, it's a lot harder to find a winner, at least in the short and intermediate terms. That's because the majority of stocks move in the same direction as the market, no matter how fundamentally strong a stock may be.

5. At the current price, would I be paying too much? To answer this question, you'll have to consider some basic fundamentals.

First, look at the stock's price/earnings (P/E) ratio, which is its price per share divided by earnings per share. How does it compare to the stock's normal range, and how does it compare to its direct competitors? If the P/E ratio is high, maybe the stock is overpriced. On the other hand, if it's low, it could either be a bargain or an indication of a fundamental weakness.

In addition to the P/E ratio, you should examine the stock's past and future earnings growth rate. Then look at its price/earnings growth ratio (PEG ratio). The PEG ratio compares the stock's P/E ratio to its five-year projected earnings growth rate. A PEG ratio of 1 to 1.5 is typically considered normal. A PEG of 2.0 or higher is often a sign that a stock is overpriced, while a PEG below 1.0 may be an indication that the stock is a good bargain.

Even the most seasoned investor, one who's comfortable with the five factors to consider when evaluating a stock, can benefit from the objective advice of a professional. As hard as we try, it's dif-

5 Reasons to Start Saving

Saving money is a bit like exercising. We all know how important both are, but it can be hard to actually get into the habit of doing either. Here are five reasons to help keep you motivated.

1. You'll Be Prepared for Emergencies

Here's an alarming fact: most Americans don't have enough money saved to cover even relatively small unexpected expenses, such as emergency room co-pays, minor car repairs, or a broken furnace. Without cash on hand to cover these irregular but inevitable costs, you're more likely to turn to credit cards or loans when the need arises. Not only are you forced to take on debt, but you don't have time to shop around, making it more likely that you'll end up with an expensive, high-interest loan.

2. You'll Be More Independent

Having savings gives you more flexibility and independence. With a healthy amount of savings, you can feel more free to take risks, like starting your own business, heading back to school to train for a new career, purchasing a home of your own, or moving to a new city. Plus, without savings, you're living on the financial edge, and you're more likely to find yourself stuck in situations that you may not be satisfied with. Committing to savings today, even if it's just a small amount, will start to give you the freedom to make different choices in your life.

3. You'll Be Able to Reach Your Goals

We all have goals. Whatever your dreams, they likely have one thing in common — you're probably going to need some money if you want them to become a reality. Few of those dreams are achievable if you don't save for them.

4. You'll Be Able to Earn More Money

Saving isn't just about setting aside what you've already earned. It's also about putting your money to work for you. Depending on where you save and invest your money, you can earn more just by being diligent about saving, rather than spending. And because of the power of compounding earnings, even relatively small amounts can grow significantly, provided you don't touch your principal.

5. You'll Be Happier

No one wants to suggest money is the only thing that can make us happy. But there's also evidence that *saving* money, even in small amounts, can make you happier. In contrast, having debt (often a consequence of a lack of savings) tends to lead to more unhappiness.

Convinced that saving for the future is the right thing to do? Please call to discuss how you can make regular saving part of your financial plan. ❍❍❍

Finding a Balance between Risk and Return

One of the most basic investment principles is that returns reward you for the risks you take. While investors are often uncomfortable with the concept of risk, it is this uncertainty that makes higher rates of return possible. Some basic investment principles related to risk and return include:

✔ Returns on specific investments are not known in advance. Investors can review historical rates of return, but there is no guarantee that past returns will be indicative of future returns.

✔ There is usually the possibility that an investment will not meet your return expectations.

✔ The uncertainty regarding your actual return creates risk. Greater uncertainties typically lead to greater risk.

✔ Investments are subject to many different types of risk. Cash is primarily subject to purchasing power risk, or the risk that its purchasing power will decrease due to inflation. In addition to purchasing power risk, bonds are subject to interest rate risk, or the risk that interest rates will increase and cause the bond's value to decrease, and default risk, or the risk that the issuer will not repay the principal or interest on the bonds. Stocks are primarily subject to nonmarket risk, or the risk that events specific to a company or its industry will adversely affect a stock's price; and market risk, or the risk that a particular stock will be affected by overall stock market movements.

✔ There is generally a tradeoff between risk and return. Low levels of risk are the most desirable and typically have lower return potential, while higher levels of risk are typically undesirable and must offer higher return potential to encourage investors to invest. Be cautious of claims of high returns with low risk.

There are strategies that can be used to reduce the total risk in your investment portfolio:

✔ **Diversify your portfolio.** You should diversify among several different investment categories, including cash, bonds, and stocks, as well as within investment categories, such as owning several types of stocks. A properly diversified portfolio should contain a mix of asset types whose values have historically moved in different directions or in the same direction with different magnitudes. By owning several investments rather than just one, a downturn in any one should not have a significant impact on your total return. Of course, the opposite is also true — if you have one investment with exceptional returns, your total return will be lower than if that were your only investment.

✔ **Stay in the market through different market cycles.** Remaining in the market over the long term helps to reduce the risk of receiving a lower return than expected, especially for more volatile investments, such as stocks.

✔ **Use dollar cost averaging to invest.** Rather than accumulating cash so you have a large sum to invest, invest small amounts regularly. Dollar cost averaging involves investing a certain sum of money in set amounts at regular intervals. This spreads your purchases over a period of time, preventing you from making one major purchase at high prices. Since you are investing a set amount, you purchase more shares when prices are lower and fewer shares when prices are higher. While a valuable investment strategy, dollar cost averaging does not ensure a profit or protect against losses in declining markets. Before starting a program, consider your ability to continue purchases during periods of low price levels. This strategy requires the discipline to invest consistently, regardless of market prices, and can help develop a habit of regular investing.

If you'd like to discuss how to balance risk and return in your portfolio, please call. ❍❍❍

The End of The Era of Low Rates and Magical Thinking

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prices and higher interest rates, which mean higher mortgage rates, declining bond values and possibly revised retirement plans. And we have been spoiled. We have not seen significant inflation in 40 years.

Inflation can be sneaky. An 1860 penny is the size of a silver dollar. That actually makes sense, an 1860 penny had the purchasing power of a 2022 dollar, but slowly, inflation has eroded the value of a penny so much so, that most people will not bend over to pick up a penny on the sidewalk. When inflation accelerates to higher levels, it is not so sneaky and that is where we are today. All one needs to do to be incensed by inflation is to fill up your tank with gas or go to the grocery store.

This is why, like the banker in my poster, we are all looking to the Federal Reserve Chairman for help. It is the right place to turn. The Federal Reserve was established by President Woodrow Wilson in 1913 and is charged with "overall stability of the nation's economy." That includes price stability, something that we have certainly lost. For the past two months, CPI growth was reported at more than 8%, the highest level in 40 years. If the average price of everything has gone up by 8%, you'll need your paycheck to go up by 8% or your portfolio to go up by 8% just to break even. For retirees and those saving to retire, our clients, things look even more dire because portfolio returns are negative, magnifying the effect of inflation.

A full explanation of the Federal Reserve is beyond the scope of this article, but it is not too much of a simplification to say that it has two tools to affect inflation. One is the money supply and the other is interest rates. To increase money supply, the Federal Reserve buys securities, mainly U.S. Treasuries, and settles the purchase by making an electronic payment. That is, it creates the money to complete the purchase of the bond that it buys.

The second way that they can potentially control inflation is with interest rates. Contrary to what many believe, the Fed (as they are called) does not control interest rates in general. Interest rates are set in the marketplace, by lenders and borrowers, and by investors who buy and sell bonds. But the Fed does control the Fed Funds rate by setting a target range and using open-market operations to keep the rate within its range. The Fed Funds rate is the rate that U.S. financial institutions charge each other for overnight loans. If that sounds confusing, the key understanding is that the Fed controls the shortest of all rates, the overnight rate. They do not control any other rate. But control of that rate also affects money supply because it affects the money in circulation. The lower the Fed Funds rate, the less money that institutions want to keep on deposit. The financial institutions will invest or loan out the money instead, getting it into the economy.

In summary, and again this simplification does not miss the point, the Fed controls the money supply, not interest rates. With this, the Fed has a great deal of sway over the economy. When the money supply grows, the economy grows, but if overdone that growth can cause inflation. When the money supply shrinks, the economy should slow down, but if it slows down too much, we could go into recession.

And that's where we are now. The Fed has started to decrease the money supply and will do so until the inflation rate comes down. They admit that they were late, so it is hard to know how high they will need to go. And it is very hard to predict interest rates. The graph at the bottom of this page shows how the Fed has consistently erred on their interest rate forecasts.

They are now moving to slow the economy. If they get it right, the economy slows just enough without falling into a recession, and inflation comes down. They can get it wrong two ways - 1) Inflation can remain high for too long, or 2) they over-do it and cause a recession.

We'd like to think that 2022 is going to be like 1951, when inflation (CPI) jumped to 7.9% and then faded away quickly. One reason that might happen is that we are living in an abnormal time, the abnormality being the pandemic. The pandemic certainly contributed to higher inflation because of bottlenecks in supply chains. Suppliers are motivated to clear the bottlenecks as they have a profit motive to do so. As bottlenecks reduce, that will have the fortunate effect of helping the economy and slowing inflation at the same time.

Mark Twain once said that a banker is someone who lends you an umbrella when the sun is shining and wants it back when it starts to rain. Let's hope the Federal Reserve Bank is more helpful than that. We won't know if the Fed is going to be nimble and do just the right thing. We also don't know how long the supply chain bottlenecks will take to clear. We don't know how long energy prices will remain elevated. We will be taking steps to help by monitoring risk in portfolios, reviewing financial plans and keeping you informed.

Sincerely,

John B. Burke

John B. Burke, MS, CFP®
Financial Advisor

Chart sourced from The Bespoke Report 6/14/19.