Financial Principles, LLC

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Financial Advisors Provide Tips For Today's Investors

Managing Partners at Financial Principles Remind Investors Repeating the Past May Lead to Tremendous Portfolio Risk

Fairfield, NJ (December 2, 2013) — It is clear to anyone reviewing a 401k statement this past year, that stocks are up and bonds are down. But with the 2013 run-up in the stock market, Brad Bofford and Mike Flower, managing partners of Fairfield-based Financial Principles, LLC, worry that some investors are getting greedy, again.

"Following the 2008 crisis a lot of people were gun-shy about getting back into stocks," says Flower. "But after a year like 2013, people are grabbing stocks with gusto, often buying at higher prices, while abandoning bonds altogether. In their enthusiasm, they are taking on significant risk all over again which just might backfire."

"When everything is going well, we fail to recognize that risk remains an inevitable part of any reward," says Bofford. "In fact, studies of human nature show that people have a short-term memory when it comes to risk - we simply forget until we lose again."

Least the lessons in risk, that were learned just five years ago, be forgotten, Bofford and Flower suggest three strategies to help ensure investment balance is maintained.

1. **Review Asset Allocation Strategies:** Advocates of strategic management and tactical management often argue the pros and cons of each investment approach.

   Strategic asset allocation typically entails a long-term, diversified selection of investments. Trades are made when personal circumstances change or asset allocations drift too far from the investor's specified percentages. The broad market exposure is designed to reduce portfolio risk, historically producing higher returns with lower volatility compared to similar, less diversified portfolios. However, this model was challenged following the financial crisis in 2008 when all of the major asset classes simultaneously suffered steep declines within a fairly short time-period.

   "When implementing a strategic portfolio, it's not enough to set it and forget it," says Flower. "Once you have selected your asset allocation, periodic rebalancing is necessary to keep your risk level in check. This should be done to protect existing wealth while also positioning you to take advantage of emerging opportunities." Still, during the extreme volatility in late 2008 and early 2009, while rebalancing was able to help, market risk could not be eliminated entirely.

Tactical asset allocation is an active strategy that involves selecting stocks and bonds deemed likely to outperform the market. The aim is to invest more money in lower risk undervalued assets and less money in higher risk overvalued assets in an effort to boost total returns and mitigate risk. To capitalize on potential opportunities, this strategy may require more frequent trading based on various factors, including current economic conditions, market moves, company earnings, and even political and current events.

So which is the *right* strategy? According to Bofford and Flower, it depends on the market condition and the investor.

"Strategic asset allocation might have greater success during secular bull markets," suggests Flower. "While, secular bear markets tend to require more effort to produce better returns and reduce risk. That's when a tactical asset allocation may be the model of choice."

Personal situations also play a part in determining the right strategy.

"Basically, the more years someone has to invest before they plan to start withdrawing their money, the greater the level of risk they can take," says Flower. "However, some people just can't tolerate too many highs and lows. In their case, the need for less risk just to sleep at night may dictate the strategy that works for them."

As circumstances change, strategies may need to change. An independent financial advisor can help assess which strategy most closely addresses an individual's goals, tolerance for risk, and time frame then make any adjustments necessary to implement a more strategic or tactical approach – or possibly a mix of both.

"While we believe portfolio diversification and strategic allocation continue to play a critical role in mitigating long-term risk for many investors, there is simply not a one-size-fits-all strategy" says Bofford. "At Financial Principles, we employ both strategic and tactical strategies, and sometime a blend of passive and active management investments."

2. **Manage Risk and Expectations:** No matter which asset allocation strategy is utilized, achieving long-term financial goals means striking a balance between risk and reward in the form of a diversified portfolio made up of the three primary asset classes: stocks, bonds and cash. "Despite what the talking heads on cable news say, there is no magic formula for achieving the right mix of stocks and bonds," says Flower. "It is different for each investor depending upon your goals and circumstances."

   By understanding the kind of risk that is typically associated with each type of asset class, investors can make choices about the amount of risk they are willing to take, build a portfolio tailored to their needs, and better align their expectations for short- and long-term growth. Historically, stocks have delivered higher returns than bonds or cash, but they've also carried more risk. Bonds have offered consistent returns with low risk. Cash has served to lower overall portfolio risk but it also nets zero return – which can equate to an overall loss when calculating for inflation.

3. **Make Room for Bonds:** Traditionally, the bond market was where conservative investors socked away money – forgoing growth potential for relative stability. However, bonds have taken an unprecedented beating, leading many to say they will never be the hedge against stocks that they once were. Bofford and Flower disagree.

   "Despite low interest rates, there is still a place for bonds in a diversified portfolio," says Bofford. "The key is to be very selective about what kind of bonds you choose – focus on high quality and short duration which may pay lower interest rates but tend to yield lesser losses for a rate increase."

   Individual bonds, opposed to bond mutual funds and ETFs, have the benefit of coming due at a defined time, paying their face value in cash at maturity. When purchasing individual bonds, the investor can select the specific characteristics of the bonds that they wish to own.

   "Assuming the bond does not default, there are very few investment options where we can tell exactly what the return is going to look like. But the investor has got to be willing and able to stomach some volatility until the maturity date," says Bofford.

   According to Bofford, some corporate and municipal (muni) bonds can also make good sense for the right investor. For example, munis may have favorable tax implications, particularly for those in high income tax brackets.

About Financial Principles, LLC

Financial Principles understands the importance of planning – whether it's for retirement, saving for college or protecting your estate and legacy. Two senior partners, Bradley H. Bofford, CLU, ChFC, CFP® and Mike Flower, CFP® bring a combined 30+ years of financial services experience to their clientele. Both are recognized as qualifying life members of the prestigious Million Dollar Round Table, "The Premier Association for Financial Professionals®". Bofford and Flower have contributed to articles in several leading trade publications including *Investment News*, *Financial Advisor*, and *Research* magazine, as well as consumer outlets such as *BusinessWeek*, *Money* and *New Jersey Business* magazine. Learn more at www.financialprinciples.com.

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Bonds are considered fixed income securities and if sold or redeemed prior to maturity may be subject to a additional gain or loss.”

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