Investor Insights & Outlook

December 2010 | Vol. Num. 2 | Investment Updates

The End of the Recession

In September 2010, the National Bureau of Economic Research announced the long-awaited news: an end date for the recession that had begun in December 2007. The NBER determined the official end date as June 2009, quieting down (if not completely silencing) double-dip fears. NBER defines a recession as a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. Looking back at the performance of the main asset classes during the recession and in the months following the official end date, gold was the best overall performer, and long-term government bonds offered consistent positive returns. Out of the investments with the worst performances during the recession, REITs posted the most-impressive return in the 16 post-recession months.

Returns During and After the Most Recent Recession

	Recession Dec 2007 to Jun 2009*	**Aftermath** Jul 2009 to Oct 2010*
Gold	19.3%	44.1%
Long-term government bonds	8.4%	14.5%
Treasury bills	1.9%	0.1%
Small stocks	–33.8%	42.5%
Large stocks	–35.5%	32.2%
International stocks	–39.7%	28.4%
REITs	–48.1%	81.8%

**Returns in table represent cumulative returns during time periods indicated, not geometric returns.*

Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Holding a portfolio of securities for the long term does not ensure a profitable outcome, and investing in securities always involves risk of loss. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards. REITs are subject to certain risks, such as risks associated with general and local economic conditions, interest rate fluctuation, credit risks, liquidity risks and corporate structure. Small stocks are more volatile than large stocks, are subject to significant price fluctuations, business risks, and are thinly traded. Government bonds and Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks, REITs, and gold are not guaranteed.

Source: Gold—Wall Street Journal London P.M. closing price. Long-term government bonds—20-year U.S. government bond. Treasury bills—30-day U.S. Treasury bill. Small stocks—Dimensional Fund Advisors, Inc. (DFA) U.S. Micro Cap Portfolio. Large stocks—Standard & Poor's 500® Index, an unmanaged group of securities considered to be representative of the U.S. stock market. International stocks—Morgan Stanley Capital International Europe, Australasia, and Far East (EAFE®) Index. REITs—FTSE NAREIT Equity REIT Index®.

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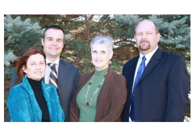

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Achieving the Proper Balance of Risk and Return

An important decision that every investor must make is determining the amount of investment risk to assume while maintaining a level of comfort. Risk is simply defined as the probability that the actual return for an investment will differ from that which was expected. It is possible that some or even all of an investor's original investment may be lost. In other words, there are no sure things in the investment world.

All investments contain some degree of risk; however, some investments are considered more volatile (riskier) than others. Low levels of uncertainty, or low risk, are usually linked to investments with low potential returns. On the other hand, investments with high levels of uncertainty, or high risk, are generally accompanied by high potential returns. The relationship between risk and return is such that one must be willing to accept greater risk if one wants to pursue greater returns.

A common misunderstanding among investors is that higher risk will lead to greater returns. According to the risk/return tradeoff, however, higher risk investments provide an investor with the possibility, not the certainty, of higher returns.

Consider the table below showing the periodic returns of three hypothetical investments. Investment A fluctuates very little from period to period. It has low volatility or a low amount of risk. However, this low risk is accompanied by low average returns. Conversely, Investment B has greater periodic fluctuations from one period to the other and has even lost money in one of the periods. On the flip side, Investment B's average return is higher than that of Investment A, corresponding to this higher level of risk. The riskiest investment of the three is Investment C, which has experienced a double-digit loss in one period. The returns for Investment C have also been periodically quite high, resulting in the highest average return of all three investments.

As the saying goes, "There is no free lunch"; in many cases, investments that generate high returns also come with high levels of volatility or risk. These high returns act as a compensation for investors, for assuming high risk. Further, it is very important to realize that taking on a high level of risk in hopes of attaining a high level of return is not for everyone.

An investor's risk tolerance varies according to age, income requirements, financial goals, and other considerations particular to each investor's unique situation. It is essential to determine your attitude toward—and your tolerance for—risk, while (all the time) keeping in mind that past performance is by no means a guarantee of future results.

Periodic Performance of Three Investments

	1	2	3	4	5	6	7	Average
Investment A	4%	7%	5%	7%	5%	2%	5%	5.0%
Investment B	2%	12%	–4%	21%	12%	1%	8%	7.4%
Investment C	5%	22%	–14%	32%	16%	–4%	13%	10.0%

The Late-Start Guide to College Savings

Is your child hurtling toward college but you haven't given more than a few anxious thoughts to how you're going to pay for it? School is drawing closer and tuition projections seem to grow more outlandish by the year. Avoiding the issue won't make it go away, and the sooner you tackle it, the better off you are. Read on for some tips.

Resist the urge to stand still: If you haven't done anything yet, you think, why start now? Well, with compounding, a dollar saved today is much more valuable than a dollar saved 10 years from now. And even if you manage to save only a small amount between now and the time your child is ready for college, he or she is going to have to borrow that much less for tuition. The key is taking that first step.

Don't play catch-up by chasing overly risky investments: Instead of sitting still, some parents who fear that they won't be able to afford skyrocketing college costs might be tempted to do the opposite: swing for the fences in the hope of hitting it big. The best way to save for college isn't to concentrate in a single risky stock or sector but instead to build a well-diversified portfolio with a stock/bond mix that suits your child's time horizon. Bear in mind that if your child's college years are drawing near, you'll want to be taking fewer risks with any money you have earmarked for college, not more. While savings for children under 10 may be invested in stock funds, storing more and more of your child's college savings in cash and bonds as they make their way through high school is sensible.

Consider a 529 plan: 529 college-savings plans can have their downsides, which include high expenses and substandard investment choices. But given that 529s permit extremely generous contributions and offer tax benefits to boot, these programs can be ideal for late-start college savers who need to sock away as much as possible in a short period of time. The key is to choose carefully.

Although Section 529 prepaid-tuition programs essentially allow you to lock in today's tuition rates, such plans can be somewhat inflexible. If your child wants to go to school in another state, for example, some of the tuition costs may not be covered.

In contrast to the prepaid programs, money invested in Section 529 college-savings plans can be used at any college in the United States. Your contributions to a 529 plan can grow free of federal taxes, you can take tax-free withdrawals to pay for college expenses, and you may also enjoy a state-tax break. Finally, the 529 assets are held in the parents' names, meaning that these assets receive more favorable treatment than the child's assets in financial-aid calculations. Make sure to speak with your financial advisor/tax professional to get information on the latest rules governing 529 plans.

Cheap out: If your investment horizon is relatively short, it's all the more important to pay attention to how much you're shelling out in fund fees. Cash and bonds—which should form the bulk of your child's portfolio as college draws near—have low returns to begin with. If you layer on excessive expenses, your take-home return will be that much lower. Moreover, late-start college savers should pay attention to brokerage charges and other administrative fees.

Government bonds and Treasury bills are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. Diversification does not eliminate the risk of experiencing investment losses.

Dollar-Cost Averaging: Slow and Steady

The concept of "dollar-cost averaging" might initially appear intimidating to some, but the practice is actually quite simple. All you have to do is invest the same amount of money each and every month. Pretty simple, right? But what's really nice is that something as straightforward as dollar-cost averaging actually helps you invest smarter.

Say you want to invest $900 in a certain mutual fund. Over three months, the fund's price is $30, $20, and $25. If you invested all of your money immediately, you'd wind up with 30 shares of the fund. However, if you invested $300 into the fund each month, you'd end up with a total of 37 shares. By dollar-cost averaging you were able to obtain seven more shares. Of course, if you knew ahead of time that the fund would fall to $20, you could have bought all of your shares then. But you obviously can't predict the future. Dollar-cost averaging is a smart strategy that forces you to keep investing, even if the market is dropping. It encourages discipline. Instead of being tempted to sell your investments when prices are falling, you actually buy more.

One great thing about an employer-sponsored retirement plan is that it automatically uses dollar-cost averaging—the same amount is taken out of every paycheck. You can also set up automatic dollar-cost averaging programs with most individual retirement accounts (IRAs).

Please keep in mind that dollar-cost averaging does not ensure profit or protect against a loss in a declining market. However, its benefits are quite clear: Dollar-cost averaging minimizes the effects of market fluctuations, encourages discipline, eliminates the need to decide when to invest, and avoids the temptation to time the market.

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