LIBERTY
ASSET MANAGEMENT INC

Identifying Investment Risk And Coping With It

Are you a risk-taker? To realize rewards, you usually have to take some risks, especially when it comes to finances. But beyond understanding that investment risk and reward go hand in hand, it's important to know how they relate. What is the nature of risk, and how can you handle the different kinds of risk that could affect the performance of your investments?

What is the nature of risk? For many investors, risk is associated with the inherent volatility of the equities markets. You run the risk that your investments will perform worse this year than last year or worse than you anticipated or worse than the markets as a whole.

Risk means you have something to lose—the money you've put into a particular investment or the money you might have made if you had made different choices. You also could run the risk of throwing good money after bad, of buying more of something when the price is low only to see the value fall further.

Although risk and reward are related, there's no direct, predictable connection between the two. You could decide to take fewer risks and still lose money, or you might ratchet up your investment risk without cashing in on higher returns. Nevertheless, it's important to try to keep risk and reward in a balance that fits your situation.

What are the main types of risks? Financial experts often debate this question, but the pros generally agree that two significant risks facing investors are inflation and emotion.

1. Inflation risk. Essentially, this is the risk that money you earn will lose some of its purchasing power over time. For example, if you buy a five-year certificate of deposit (CD) from a reputable bank, there's relatively little risk that the bank won't live up to the terms of the CD. But there's a much bigger risk that the dollars you receive in five years won't buy as much as they would now.

If you're old enough to have experienced the 1980s, you might recall the days when money market funds paid interest at double-digit percentage rates. However, with double-digit inflation occurring at the same time, most savers barely stayed even.

Inflation risk can present problems to all investors, and especially to retirees. Someone who left work in 1978 might have felt pretty comfortable with a pension paying $40,000 a year. But that $40,000 was worth only about $12,200 in 2013, according to the Bureau of Labor Statistics. This represents a loss of almost three-quarters of the money's buying power.

One way to protect against inflation risk is to include an appropriate ratio of stocks and stock funds in your portfolio. Or, if you're more conservative, you might consider

(Continued on page 4)

Your Referrals Are Appreciated Now More Than Ever

It's relatively easy to succeed as an investor—or as a financial advisor—when the stock market is humming and all is right with the world. But during times like these, when the economy is uncertain, the value of smart decisions and good advice really makes itself felt.

We appreciate the trust you've placed in our firm by remaining committed to a long-term investment plan. Savvy investors realize that the stock market often rises and falls with prevailing economic conditions, and that keeping the faith in basic investment principles is likely to provide favorable results. Your investment plan is designed to have staying power, to take advantage of trends that, over time, have favored investors who don't waver in the face of adversity.

Not long ago, much financial "advice" consisted of "hot" tips that were supposed to lead to a quick killing but could just as easily mean big losses. Today, many investors want a different kind of help, based on proven wealth management techniques that can help reach retirement goals without excessive risk. That approach, along with clear and constant communication, is the cornerstone of our partnership with you.

We are heartened and energized by your referrals to our firm. Now, more than ever, it's important to do things the right way, and we're committed to helping all of our clients, old and new, achieve their financial objectives.

Markets May Not Be Certain, But Experience Is

Have you ever wished you could do it all over again? Experience can be a great teacher, and it's natural to imagine that with the benefit of hindsight you would have made better decisions about everything from raising your children to managing your financial affairs. And while that may or may not be true, what is certain is that you can offer younger family members some of the insight you've acquired along the way.

Here are some thoughts you might pass along:

1. When you get a pay raise or a new higher-paying job, consider earmarking at least part of the additional money for retirement savings. You'll be amazed by what tax-deferred compounding can do to even relatively small sums over the course of several decades. And using raises to increase your contribution to a 401(k) can be relatively painless. Ratchet up your saving rate by a percentage point or two each year and you'll soon reach the maximum for annual pre-tax contributions to 401(k)s and similar employer-sponsored plans—$17,500 in 2014 if you're younger than age 50. Beginning at 50, you'll be eligible to save an extra $5,500 a year.

2. Try to resist the siren song of early retirement. Leaving your job in your 50s may be tempting, but it runs counter to several financial realities. Most people have not saved enough to retire comfortably even at the traditional age of 65, and quitting early can mortgage your future in two ways—reducing the amount you can save while extending the time that your savings must support you. By the same token, however, every year you keep working improves your situation. Moreover, as life expectancies increase, more and more people find they want to stay on the job at least part time, and not only for financial reasons. Working can help keep you engaged and healthy, particularly if you find something you really like to do.

3. Consider postponing Social Security. You can begin receiving benefits as early as age 62, but each year you delay will increase the amount of your monthly payment, and if you wait until age 70, you'll get 76% more than if you had started drawing benefits at 62. And most people will live long enough to get a larger total payout if they begin later.

4. Don't feel like you have to go it alone in making financial decisions. Working with an advisor could help you make sense of complex financial markets and chart a comfortable path toward your goals. The right advisor can assist you in deciding how much to save, how to allocate your investments, how to weigh the pros and cons of buying a home and other major financial choices, and, when the time comes, how to deploy your retirement nest egg. ●

Don't Chase After The Market News

Did you read the newspaper today or check the news online? Invariably, the stock market will be heading up or down, with the movement triggered by anything from company earnings announcements to a change in economic indicators or even a political event such as the recent U.S. government shutdown. And, more often than not, financial pundits may respond by urging investors to buy or sell something.

But you can drive yourself crazy, if you haven't already, by making stock market decisions based on what just has occurred or what you think will happen next. In fact, chasing after the news is a common investment mistake. There are at least four good reasons to avoid this temptation like the plague:

1. The stock market usually moves ahead of the news.

There was no "all clear" signal that the severe stock market downturn of 2008-2009 had abated. But the market hit bottom on March 9, 2009, and embarked on a long, profitable climb even as other financial news remained dire. Typically, stocks move about six months ahead of economic developments, reflecting the collective knowledge, trends, and inclinations of investors. If you try to beat the market by reacting to the latest news, you'll probably be much too late to benefit.

2. You don't have all the necessary information.

Markets tend to move based on the decisions of mutual fund managers or professional analysts who monitor and interpret financial data for a living. They have a lot more information than you do, and they get it much sooner than you—and millions of others like you—who will hear it on television or find it on the Internet. That puts you at a decided disadvantage.

3. You can't believe all the hype.

In this electronic age, media reports are often prone to hyperbole, as

5-Year Results Show Diversification Is Key

The term diversification is used so often in marketing investment products that it's easy to take for granted. Yet it is crucial to investment success and diversifying a portfolio correctly is not so simple.

The accompanying bar chart analyzes segments of the U.S. stock market by divvying up U.S. publicly-held companies based on valuation and market capitalization. Look at how small- and mid-cap companies dramatically outran returns from large-cap companies represented by the Standard and Poor's 500 Growth and S&P 500 Value Index.

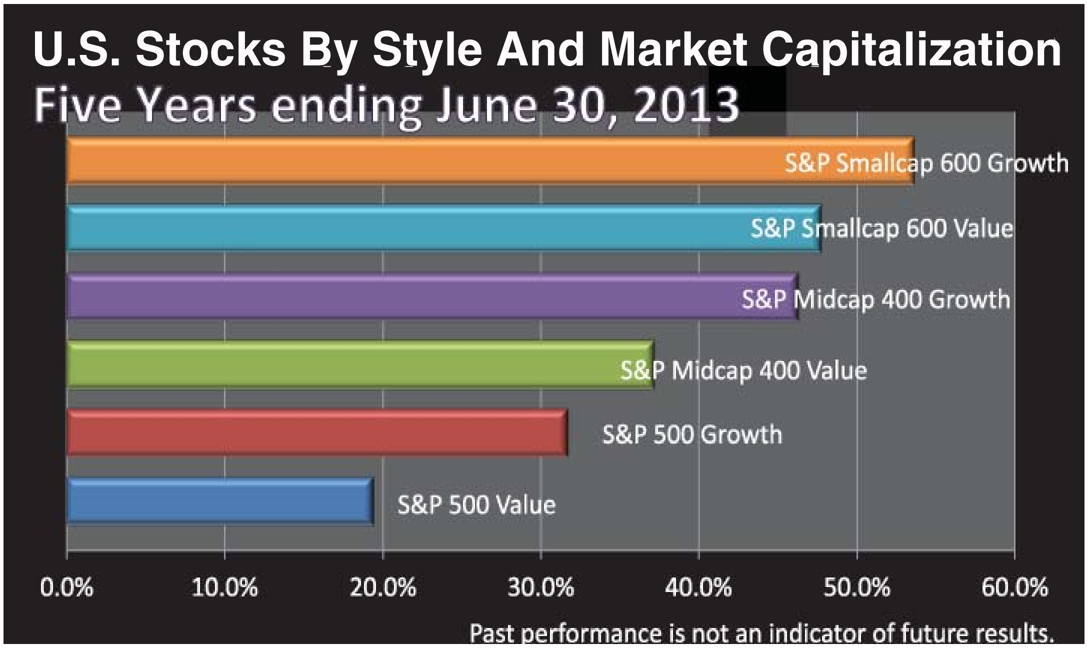
This chart covers the five-year period that ended June 30, 2013, but such differences in performance among different segments of the market are not uncommon. In some five-year periods, large-cap growth companies outperform while small-cap companies or mid-caps might outperform in other five-year periods.

Because no one can reliably predict which market segment will outperform another, it's wise to avoid making bets on a single segment of the stock market. Put another way, it's wise to diversify. But what exactly does that mean?

Diversification of investments is widely defined as not putting all your eggs in one basket. The egg analogy is something anyone can understand. But diversifying is not as simple as buying a lot of different investments.

To diversify investments, it's prudent to apply the statistical analysis prescribed in the Nobel prize winning academic work that forms the basis of Modern Portfolio Theory, or MPT.

Modern Portfolio Theory Statistics are based on the Capital Asset Pricing Model (CAPM) of expected returns, which Nobel laureate William Sharpe is credited with developing in the early 1960s. CAPM (pronounced CAP –EM) was based on the modern portfolio theory first written about in the 1950s by Sharpe's one-time professor, Harry Markowitz. Markowitz and Sharpe shared the Alfred Nobel Memorial Prize in Economic Sciences in 1990 for their work on MPT.



MPT provides a method for analyzing market trends based on measurable characteristics in portfolios, such as standard deviation, which measures volatility, and R-squared, which measures correlation of one market segment to another.

By applying Modern Portfolio Theory, you are able to rebalance and manage your wealth using an organized system of statistical analysis. You are able to measure correlation coefficients to understand how adding an investment to your portfolio has affected a portfolio like yours in the past. You are able to model the future and how your portfolio might behave through different financial and economic cycles. ●

the pressure to generate interest from a fickle public continues to increase. That could lead producers to overreact to news tidbits or sensationalize minor events. One small incident usually doesn't portend a complete economic collapse, so take reports of impending doom with a grain of salt. It isn't likely that the sky is falling!

4. Market timing is difficult, if not impossible.

To be successful at market timing, you have to be extremely skilled or lucky, or both. Over the long term, buying or selling based on what you hear or read almost never beats a consistent, methodical long-term approach. It's better to make investment decisions based on financial particulars rather than on instincts and hunches.

Building a diversified portfolio combining stocks, bonds, and other investments can help you progress toward your financial goals—and it can help you stop worrying about what you hear on the news. ●

How To Choose Trustees For Your Trust

Many high-net-worth people rely on trusts to minimize taxes and keep wealth in the family. But who should serve as trustee? A survey by Spectrem Group shows many wealthy investors who create trusts designate themselves or a family member as the trustee. But are family members the best choice?

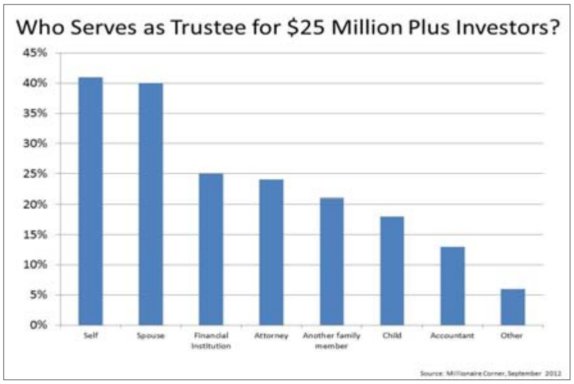
Trustees have many complex responsibilities. The primary obligation is to distribute assets and trust income according to the wishes of the grantor - the person who establishes the trust. But the job also involves keeping records, investing assets, filing tax returns, and resolving conflicts.

Among affluent investors, Spectrem reports, 41% serve as their own trustee, 40% name their spouse, 21% name another family member, and 18% name their child. Just 25% name a financial institution, while 24% name their attorney and 13% appoint their accountant. (The numbers add up to more than 100% because some grantors name more than one trustee, known as co-trustees.)

Many investors appoint family members because they believe they will serve the interests of the beneficiaries. Also, family members often are paid little or nothing for their service.

However, trust experts say family members often have problems trying to administer a trust. They may not understand legal and regulatory issues, and sometimes may grant distribution requests too freely, draining the assets.

An outside professional can provide the expertise needed, along with an objective viewpoint. Sometimes the best solution is to appoint a family member along with a trust expert as co-trustees. The professional ensures the trust is properly handled, while the family member may be in a better position to deal with family issues.



Here are four reasons to consider appointing a trust professional as trustee or co-trustee:

- A corporate trustee will continue as administrator for the term of the trust—even if that covers multiple generations. Any family member appointed as trustee eventually will die or become unable to continue. Grantors usually appoint a back-up, but that person, too, won't be able to serve indefinitely.
- A corporate trustee is held to an even higher standard under state and federal regulations than regular trustees. All trustees must interpret all trust documents to serve the best interests of the beneficiaries. The trustee works for the grantor, not the beneficiaries, and is guided by the trust documents.
- Trust specialists have the knowledge and experience required to comply with all legal and regulatory requirements.

A corporate trustee brings objectivity and ensures that any conflicts or questions are resolved in a legally appropriate manner. In conclusion: There are numerous options at your disposal, so obtain expert advice. ●

Identifying Investment Risk

(Continued from page 1)

inflation-protection bonds. History has shown, however, that holding even a modest equity stake may increase returns without undue risk when compared to a pure fixed-income portfolio.

2. Emotional risk. It's easy to let emotions rule decision-making. Almost everyone is subject to bouts of fear and greed, and investors have an innate tendency to be overconfident about their ability to choose winning positions. But simply doing what feels right—or avoiding what feels wrong—can lead to adverse results.

Consider an investor who sits on the sidelines during a bull market, nervous about following the crowd—a tendency that indeed can be counterproductive. But finally the investor gets tired of losing out and jumps in, buying at the top of the market and without carefully considering the fundamentals of particular investments. Others get into trouble when the market is falling and they sell solid holdings in a panic, losing out on the chance to benefit when they rebound.

The best protection against emotion is to have a carefully considered investment plan and to try to stick with it even when markets are highly volatile. Having a balance of bond funds for stability and income and stocks for growth can help smooth out inevitable market bumps.

How do you manage risk? Everybody has a different risk tolerance. A good approach for managing yours is to stick to investment fundamentals. That may be as simple as refocusing on the key principles of diversification and asset allocation.

Diversification spreads your investments over a broad mix of asset classes, an approach that has the potential to reduce risk. Asset allocation is the process of assigning percentages to those asset classes based on your particular needs and risk tolerance, and then rebalancing your holdings regularly to keep them close to their assigned allotments.

There's no way to avoid risk completely, but you still can generate earnings while staying within your comfort zone. We're here to provide guidance. ●