

Investor Insights & Outlook

November 2010

Vol. No. 5

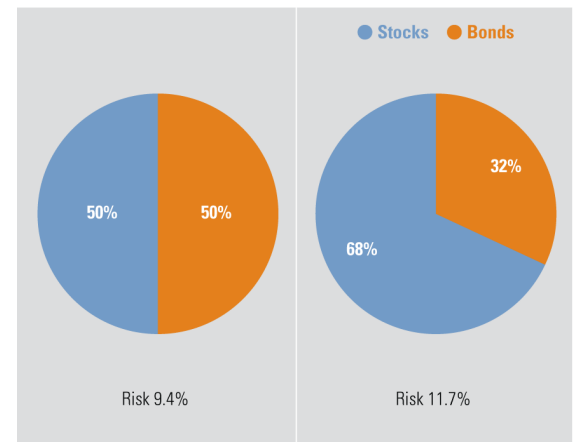
Investment Updates

The Importance of Rebalancing

Over time, your asset-allocation policy can veer off track because of market ups and downs. This is illustrated quite clearly in the image below; a strong stock performance can cause a simple 50/50 portfolio mix to become unbalanced over time. After 30 years, what was once a 50% allocation to stocks now sits at 68%—quite a jump. Moreover, not only does the portfolio's allocation change, but the portfolio's risk also changes, rising sharply from 9.4% to 11.7%. If your needs and/or risk tolerance have not changed, your allocation shouldn't either.

But why would anyone want to sell investments that have done great in order to purchase laggards? While rebalancing might seem odd at first, it is all about risk control. If more and more of your total portfolio winds up in one investment, you risk losing a lot should that investment stumble.

Change of Portfolio Allocation:
January 1980–December 2009



Keep in mind that an investment cannot be made directly in an index, and past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. The sale of an investment for the purposes of rebalancing may be subject to taxes. Risk is measured by standard deviation. Standard deviation is a statistical measure of the extent to which returns vary from the expected returns. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. Stocks are not guaranteed and have been more volatile than bonds.

Source: Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and is considered to be representative of the stock market in general; Bonds—five-year U.S. Government Bond.



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Monthly Quote

"Coming together is a beginning.
Keeping together is progress.
Working together is success."

Henry Ford

How to Invest in a Deflationary Environment

While inflation was the hot topic not too long ago, it's downright tame right now. Instead, some market participants are now concerned that we could confront a period of declining prices, particularly if unemployment stays high and the housing market stays in the doldrums.

Declining prices for stuff may not sound that bad, particularly for consumers who might be able to take advantage of lower prices for everything from groceries to televisions. But a persistent need to slash prices can be bad for businesses and could ultimately lead to layoffs, reduced consumer spending, and declining prices for assets ranging from real estate to commodities. Those forces, in turn, could put pressure on corporate profits and stock prices. Inflation is a force to be reckoned with, too. But it's deflation that really makes economists shudder.

It may not be a good idea to go overboard in anticipation of one specific economic scenario or another. For such a bet to pan out, you'd need to get your arms around numerous difficult-to-predict factors, including growth rates not just in the United States but overseas, as well.

If you're truly concerned about deflation, you can take comfort in knowing that the investments that will tend to perform best in a declining-price environment are probably already in your portfolio. The classic deflation hedge is a simple fixed-rate investment—cash or government-issued bonds (corporate bonds will tend to be more vulnerable in a deflationary period because charging lower prices will tend to cut into the profitability—and viability—of many companies). Because their payouts are fixed, the cash you receive via income from such vehicles is effectively worth more and more each year as prices fall. For the same reason, fixed annuities can also be attractive in such an environment.

And while bonds will typically hold up better than stocks in a period of declining prices, it should be noted that dividend-paying stocks should hold up

better than non-dividend-payers in a period of declining prices.

Although these investments are mainstays for investor portfolios regardless of the economic environment, it can be a mistake to go full-throttle into deflation-protection mode. That's because the to-avoid/downplay list for deflationary times is a pretty long one, encompassing equally important investments such as most stocks, corporate bonds, commodities, real estate, and inflation-protected bonds.

And over the long haul, it's also worth noting that inflation has been a bigger issue in the U.S. than has deflation. So hedging your portfolio against the former threat, particularly if you're retired and relying on fixed-rate investments for much of your day-to-day income, might be a better bet than getting too fancy about defending your portfolio against deflation.

Finally, bear in mind that the usual prescription for a deflationary period—government bonds and cash—aren't currently offering much in the way of yield today. Cash investors are lucky to earn 1% on their money, whereas investors in intermediate- or long-term government bonds would be grateful to pick up 3% or 4%. Those yields would shrivel to next to nothing if inflation were to pick up.

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 are not guaranteed and have been more volatile than other asset classes. With corporate bonds, an investor is a creditor of the corporation and the bond is subject to default risk. Transactions in commodities carry a high degree of risk, and a substantial potential for loss. In light of the risks, you should undertake commodities transactions only if you understand the nature of the contracts (and contractual relationships) into which you are entering and the extent of your exposure to risk. The annuity income guarantee is based on the claims-paying ability of the insurance company that issued the annuity product.

A Quick Guide to Preferred Stocks

When a corporation needs capital, it generally has two options for raising it: by issuing equity (stock) or debt (bonds). A stock is a financial instrument that gives the holder ownership in the company; an investor who buys a stock owns a part of the corporation. A bond, on the other hand, is a debt instrument. When an investor purchases a bond, he or she lends money to the company. The company, in turn, agrees to pay the investor interest every year, as well as to give back the amount borrowed (the principal) when the loan comes due.

When investors and financial professionals talk about stocks, they refer, in most cases, to common stock, the more popular form of equity. However, there exists a second, less-known type of stock: preferred stock. Preferred stock can be seen as a hybrid investment vehicle combining characteristics of both stocks and bonds. Similar to common stock, preferred stock also gives investors ownership in the corporation, but the advantages and drawbacks of such ownership are a little different.

On the upside, holders of preferred stock are entitled to a fixed dividend payment before any common stock dividend is paid. If the company decides to pay a dividend in any given year, it must pay the preferred stockholders first, and only then can it distribute a dividend to common stockholders. In general, preferred dividends are distributed quarterly. Another preferred privilege is that investors are entitled to a claim on the company's assets in the event of a bankruptcy or liquidation right after bondholders and before common stockholders. In other words, creditors have to be compensated first, then preferred stockholders, and only in the end (if there is anything left) do common stockholders get a piece of the liquidated assets.

On the downside, preferred shareholders are typically not awarded voting rights like common shareholders and therefore do not have a say when the company's board of directors is elected. In addition, there is less potential for price appreciation for preferred stocks when compared

with common stocks, which may translate into lower capital gains. The preferred dividend payment is fixed; this is where preferred stock behaves more like a bond. Therefore, even if the company is prosperous and common stockholders enjoy dividend growth, preferred stockholders might not get extra profit from this prosperity. For these reasons, preferred stock is generally viewed more as a current income investment rather than a growth investment.

Some preferred stocks might contain a call provision, meaning the company has the right to buy back shares from shareholders at any time, usually at a premium. When a callable (or redeemable) preferred stock is called, investors are obligated to sell it back to the company. Preferred stocks can also be cumulative (unpaid dividends accumulate) or convertible (investors have the option to convert preferred shares into common shares).

Just like common stocks, preferred stocks normally trade on the major exchanges (NYSE, NASDAQ), and sometimes even over the counter. Institutional investors are usually the largest players in the preferred market, but more and more individual investors are joining in. In general, preferred stocks trade like corporate bonds, and are affected by changes in interest rates (because of the fixed dividend payments).

In conclusion, even though it shares characteristics of both common stocks and bonds, preferred stock is an asset class in itself, with its own particular privileges and risks, and should be regarded as such in analysis and portfolio construction.

Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed. Historical data indicates stocks have been more volatile than bonds.

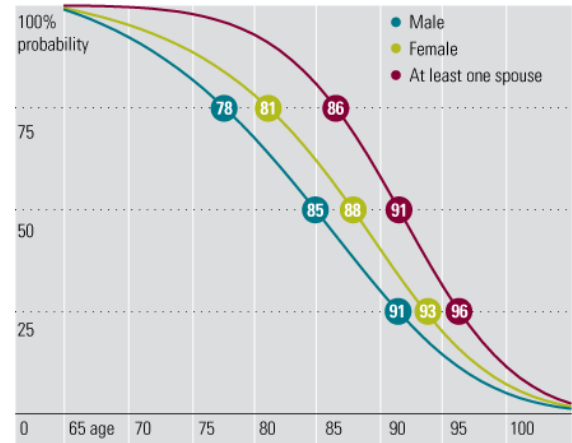
Bittersweet

The Merriam-Webster Dictionary defines bittersweet as something that is pleasant alloyed with pain. This could also be associated with retirement. The sweet part is that people are living longer thanks to innovations in healthcare. The bitter reality is that when people live longer they risk outliving their assets.

Longevity risk is the possibility of outliving one's retirement savings. While longevity is generally a good thing, the risks associated with it are becoming a major concern for individuals entering retirement.

Luckily, longevity risk can be managed through proper planning and products. To plan properly, consider when you would like to retire, the number of years you anticipate in retirement, and your desired income level.

Probability of a 65-Year-Old Living to Various Ages



Source: Annuity 2000 Mortality Tables—Transactions, Society of Actuaries, 1995–1996 Reports.

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