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FINANCIAL OUTLOOK

SUMMER 2014

AN INTRODUCTION TO STOCK ANALYSIS

There are two classic schools of stock analysis: fundamental and technical.

THE BASIC DIFFERENCE

One of the clichés of Wall Street is that fundamental analysis tells you *what* to buy, while technical analysis tells you *when*. While some money managers disagree with that characterization, it points to a deeper difference between the two approaches: fundamental analysis focuses on the performance of the company behind the stock, while technical analysis focuses on the behavior of the stock.

Put another way, when you're doing fundamental analysis, you have to know which company you're talking about; with technical analysis, you don't. It might help, but you can do quite well without knowing anything about the underlying company, what it sells, or even its name. All you have to know is its symbol.

To understand these concepts, let's review the theoretical assumptions of each school of analysis.

THE FUNDAMENTAL PERSPECTIVE

Fundamental analysts assume that investors will buy the shares of companies that have good potential to make profits and, better yet, make those profits grow every year. Based on this assumption, it makes sense to look at every significant aspect of that company's business, from what its products or services are to how they stack up to the competition's, how much money the company spends and owes versus how much revenue it brings in, how good the management is, whether the market is growing, and the like.

Fundamental analysts spend most of their time collecting and analyzing data on these things and much more, comparing them to the same data of competitors, including stock prices. These analysts also try to assess the future growth of each company's markets and often factor in forecasts of the economy. They

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SECURING YOUR FINANCIAL LIFE

While there might not be much we can do on an individual level to reduce crime, war, or even stock market corrections, we can take all appropriate steps to mitigate the risks under our control. If you're looking for ways to increase your financial security, consider the following tips:

- **GET YOUR ESTATE IN ORDER.** While dealing with your own mortality is often difficult, it is one of the most important things you can do to ensure your family can survive financially in the event of your death. Make sure your will reflects your current desires for the disposition of your assets and names a guardian for your minor children. You should also consider a durable power of attorney, which designates someone to control your financial affairs if you become incapacitated, and a health care proxy, which delegates health care decisions when you are unable to make them.
- **REVIEW YOUR PORTFOLIO.** If you're saving for goals that are decades away, stocks probably should continue to hold a major position in your portfolio. The lesson we should learn from recent stock market fluctuations is that our portfolios should be diversified. A properly diversified portfolio will help protect its value during market declines, while still offering higher return potential.

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An Introduction

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estimate what they think the future earnings of each company will be and use those estimates to predict the price that investors are likely to pay for that company's stock in the future.

Most investors have heard of some of the key analytical measures that fundamental analysts use. One is a stock's price/earnings ratio, or P/E ratio. To calculate it, analysts divide the current price per share of a stock by its per share net earnings, or profit. Since it's possible to calculate the P/E ratio of the entire stock market as well as each industry group and analysts keep track of the history of P/E ratios, analysts use P/E ratios to determine whether a stock is relatively expensive (overvalued) or relatively cheap (undervalued).

Another key metric is a company's estimated five-year earnings growth rate, which is the basis upon which they estimate the stock's future price. The estimated five-year earnings growth rate rests on projections for the company's competitive market position, its product pipeline, and its financial condition.

A third metric combines the P/E ratio and the earnings growth rate to determine whether the stock is fairly priced or not. It's called the PEG ratio, for the price/earnings multiple divided by the projected earnings growth rate. To illustrate, let's take a stock with a P/E ratio of 30 and a projected five-year growth rate of 20% per year. This stock has a PEG ratio of 1.5 (30 divided by 20). Analysts who use the PEG ratio generally avoid recommending stocks with a PEG ratio significantly above 1.0 and generally like stocks with a PEG ratio below that number.

The Technical Perspective

Technical analysis is based on a very widely accepted premise: the price of a stock, just like everything else, is based on supply and demand. If at a given price, people want to buy more of a product than the maker can produce, the price will go up, whether it's a box of cereal, a car, or a stock. Conversely, if there's more product in the market than people willing to buy it at its current price, all things being equal, the price will drop.

So the theory goes, as long as you know the relative balance of supply and demand for a given stock at a given price, you don't really need to know what the product is. Technical analysts say that all the needed information about supply and demand can be found in the chart of a stock's historic price movement, particularly if the chart captures the changing levels of volume with the changes in price.

Yet one thing that makes stocks different from commercial goods is the way technical analysts define supply. Companies can increase the production of manufactured goods or delivery of services at will. Not so with stocks — unless a company issues more shares, the number in the market is fairly stable. The supply of stock shares, from a technical analyst's point of view, is the number of shares already owned by the public that are being brought to the market for sale by brokers.

To illustrate, technical analysts interpret an upward move in a stock price combined with higher volume the previous day as an indication that there is a larger number of buyers (demand) than sellers at the current price, and potential sellers are holding out for a higher price. Conversely, a downward move on higher volume means there are more sellers eager to sell shares of a stock than there are buyers willing to pay the current price.

Unlike fundamental analysts, technical analysts generally don't make predictions of future stock prices. Instead, they try to identify prices that serve either as resistance against any higher movement or support against a further loss in price. The reason these price points exist is because most investors remember what they paid for a stock and base their decision to sell by comparing the current price with what they paid for it.

For example, it's human nature to avoid a loss. So, if a stock that has risen in price comes back down to the price an investor paid, he may be reluctant to sell; but once it falls below that price, he may be eager to sell right away. By the same token, many investors — particularly professionals — know the price at which a stock peaked. As the stock approaches that price again, investors may begin to sell in order to lock in their profits. This shift toward more sellers than buyers may make that price another resistance point from which the stock declines again.

Technical analysts find many different ways to identify points of resistance and support. They can be found in peaks and valleys in the line that connects a stock's closing price over time. They can also be found in prices against which the stock has repeatly bounced from in either direction, or in lines that connect a series of price bottoms or tops, called trend lines.

What Works for You?

Traditionally, more professional investors and advisors have relied on fundamental stock analysis than technical analysis, particularly when the investor is in the market for the long term. But a large and growing number have found both fundamental and technical analysis provide insights that are useful in determining which stocks to buy and when.

Please call if you'd like to discuss this in more detail. ❍❍❍

Securing Your

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- **Take another look at your life insurance.** You need to purchase an appropriate amount of insurance to protect your family in the event of your death. The amount needed will depend on your current net worth, the lifestyle you want to provide for your family, and your personal circumstances and desires. Since your insurance needs will change over time, assess your insurance coverage periodically, especially after major events in your life.
- **Obtain sufficient disability income insurance.** You should consider disability income insurance if your current assets won't support you until age 65. Many companies provide short-term disability insurance, which covers 100% of your salary for three to six months. Long-term disability insurance is typically less common and less generous. Thus, even if you have long-term disability insurance at work, you may want to obtain additional coverage. Your available resources and disability benefits should equal at least 60% of your pretax salary.
- **Make sure you have an emergency cash reserve.** Consider setting aside at least three to six months of living expenses, although the exact amount will depend on your age, health, job outlook, and borrowing capacity. This can help tide you over in case of a job layoff, short-term disability, or large, unexpected expenditure.
- **Consider long-term-care insurance.** This coverage may be especially important for women, who tend to outlive their husbands. You should probably purchase the insurance while you are in your 50s or 60s. After that, the premiums get much more expensive. Also, if you develop a serious health condition, you may not be able to purchase the insurance.
- **Protect your financial identity.** While you typically won't have to pay for anything charged by an identity thief, you will have to work to restore your credit and to ensure all fraudulent accounts are closed. That can be time consuming as well as expensive. To help protect your financial identity, only give out your Social Security number when it is required, shred financial documents, cut up old credit cards, and review your credit reports periodically.
- **Keep your homeowners insurance up to date.** Review your homeowners policy carefully so you understand what would happen if your home was totally destroyed. It is your responsibility to make sure you have adequate policy limits, so inform your insurance company when you make major improvements, get an inflation rider for your policy, and make sure your policy covers the total cost of rebuilding your home.
- **Protect your home.** Obtain a good security system for your home. Make sure all doors are metal or solid wood with deadbolt locks, use bars or locks to secure sliding glass doors, and keep all entrances well lit.
- **Properly store important documents.** Documents that you might need when the bank is closed, such as passports, birth certificates, wills, or insurance policies, can be keep in a fireproof home safe. Other documents, such as deeds, stock certificates, and titles, should be kept in a safe deposit box in a bank.

Please call if you'd like to review these tips in more detail. ❍❍❍

Talking to Your Family about Your Estate Plan

In many families, finances and estate talks are taboo. Other families laugh and make jokes like, "Well, guess who just lost their inheritance!" No matter what kind of family dynamics exist in your life, talking about what will happen after a person dies can be a painful and scary discussion, but a necessary one. It's important to talk with your loved ones about what you want, what they want, and what is laid out in your will.

- **Keep it light** — Keeping the conversation light but to the point can help keep the conversation on track and productive. There may also be tensions that arise through the process — maybe multiple people want the same thing, or someone gets offended by how you've decided to split your money. You might consider having conversations with people individually to avoid upset.
- **Talk openly and honestly** — A decision you have made may hurt someone's feelings, or there may be things you don't want to tell people about, but it is crucial to be open and honest with your beneficiaries. If you have children from more than one marriage, being open and honest with all of them is especially crucial.
- **Discuss values, not just valuables** — When you die, how do you want people to remember you? What parts of you do you want to live on? This may include traditions, values, family names, rituals, religious beliefs, and so on. This is an important matter to bring up during this discussion with your family. Think back on times that have meant a great deal to your family or traditions that have brought you great joy. Maybe it's very important to you to have your grandmother's name passed on from generation to generation. Talk about these things with your family to share how you feel and to see how they feel.
- **Have a professional present** — Having your estate planner present can be very helpful and, in some cases, necessary. In many cases, a professional has a better understanding of how estate planning works and can assist by answering any questions your loved ones may have. You might have a family-only conversation first and then a second conversation with your family and the estate planning professional. ❍❍❍

News and Announcements

The merger between Capital Planning Institute and Saline Wealth Management Group has been quite successful thus far. It has been a pleasure for the whole team to make many new relationships over the past several months. With our planning team's deep knowledge and experience, we have been able to provide all of our clients with meaningful holistic financial services including: Life, Disability, and Long-Term Care Insurance; Estate Planning, Investment Planning, and Retirement Planning.

We are very excited that Anthony Zalesky has joined our Division. Anthony's practice is located in Harelysville, Pennsylvania, and he is a 30-year veteran in the financial industry. Anthony shares our passion for assisting clients to obtain their financial goals, understanding that everyone has different needs.

Summer vacations, barbeques, and spending quality time with family are what makes the summer amazing. We all value the memories that are made this time of year. So often people get caught up in life that stopping to relax and enjoy what is right in front of us often gets forgotten. One of the keys to a happy and healthy life, whether one is working or retired, is relaxing and enjoying opportunities whenever they arise.

We would like to encourage all of our clients and associates to enjoy this summer, making lasting memories with your friends and family. We look forward to hearing about them in the fall! ❍❍❍

When Should You Sell a Stock?

As difficult as it can be for some people to decide to buy a stock, it can be just as difficult — if not more so — to decide when to sell it.

In truth, there's no single rule for determining when to sell a stock. But one thing can help: knowing why you came to own the stock in the first place. If you set a specific goal, it's far easier to let a stock go once it has reached that goal.

To provide a focus here, we're going to consider two kinds of scenarios. The first is when you've made money on the stock. The second is when you haven't, either because the stock price has been flat, or it's lower than when you bought it.

When You Have a Profit

Short of needing money, is there any reason to sell a stock that has made a profit? The very idea seems to fly in the face of the fact that failing to let winners run is one of the most common mistakes individual investors make. Nonetheless, there are several reasons for selling some or all of a position in a profitable stock:

- **The company has fundamentally changed character and is unlikely to continue to grow in value.** This is often very difficult for casual investors to assess until it's too late, but it's not at all uncommon. Think of some leading examples from the last 20 years or so: AT&T, Enron, General Motors, and Lucent, just to name a few.

  There are at least two different ways to detect that kind of change. One is by tracking the company's fundamentals and changes in long-terms trends. Are the company's highest levels of sales, profitability, and market share more than three to five years in the past? Has it been overtaken by competitors that once were far behind? Has it cut its dividends more than once, severely reduced its research and development spending, taken on unusually high levels of debt, or had its credit rating reduced several times in the past few years?

  Another way to detect change at a company is to study the chart of its price changes over time. Adjusted for splits, was the stock's highest price many years in the past? Has the long-term trend line shifted to a flatter or negative slope? Is the stock having trouble piercing through resistance points that are far below its highest levels? These, too, can be signals that there are better places for your money.
- **You need to rebalance your portfolio.** One of the tools professional money managers use for raising long-term portfolio returns and reducing risk is to rebalance. That means selling some shares of positions that have grown out of proportion to your asset allocation strategy and using the profits to buy more shares of issues that have gone down in price. This has the effect of locking in some of your gains while increasing your potential return by leveraging more shares of an investment that later recovers in price.
- **You've identified a better opportunity.** This is closely related to the first reason. The difference here is that the stock you own hasn't changed its intrinsic character, but another stock with similar or better risk characteristics offers better returns, either through growth or dividends.

When You Have Losses

This is the easier of the two scenarios, because it can come down to answering one simple question: if you didn't already own it, would you buy it today? If not, sell. If so, keep it. If you would buy it, it's because the fundamentals haven't changed. But if you're not skilled at this assessment, you could be making a mistake.

The danger is that you may not recognize the need to sell. Sometimes, stocks go down for reasons that have nothing to do with the underlying value of the company. It could be because of a bad economy or bad news to which the market overreacts. These could actually mark opportunities to buy more shares at a cheaper price.

On the other hand, there can be very good reasons that the stock has been going down and will continue to do so. If this is the case, the smart move is to cut your losses, no matter why you own the stock. You may want to prove to yourself that you didn't make a mistake buying it, or you may have inherited it from a dear relative who held it for decades. Neither of those will compensate for more losses.

The bottom line is unless you have the skills of a highly trained and experienced professional, it's best if you don't make decisions to sell a stock on your own. Please call if you'd like to discuss this in more detail. ❍❍❍