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Creating income for life.

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FINANCIAL OUTLOOK

APRIL 2023

THE PRACTICAL IMPLICATIONS OF INVESTMENT THEORY

Many investment principles used to develop investment portfolios derive from one investment theory — the capital asset pricing model. What exactly is this theory and how does it apply to your investments?

The capital asset pricing model was developed over 50 years ago by Harry Markowitz, who won a Nobel Prize for his work. His theory centers on the concept that adding an asset to a portfolio that is not highly correlated with other assets in the portfolio can reduce the portfolio's risk. Before his theory, it was common practice to look for undervalued assets to add to a portfolio. His approach evaluated how a particular asset would impact the portfolio's risk and return. Whether it makes sense to add that investment to the portfolio depends as much on how the asset's return will vary with returns of other portfolio assets as it does on its own return prospects.

This theory provides the underlying rationale for asset allocation. The key is that the returns of different assets do not behave in the same manner during different economic times, so adding different assets can reduce the volatility in that portfolio. While the return of a diversified portfolio may be lower than that of investing solely in the best performing asset, this is typically viewed as an acceptable tradeoff for the reduced risk. Many people have also realized it is difficult to identify the best performing asset in any given year, so a diversified portfolio provides more consistent returns.

Some of the investment implications that have been drawn from this theory include:

- A properly diversified portfolio will combine assets that do not have highly correlated returns. Therefore, when one asset is declining, other portfolio assets may be increasing or not decreasing as much.
- Rather than focusing on each investment's risk, investors may want to consider their portfolio's overall risk.
- Including a small percentage of a volatile investment may not increase a portfolio's overall risk, provided the investment's returns do not vary closely with other as-

CONTINUED ON PAGE 2

7 PSYCHOLOGICAL TRAPS

Sometimes, when it comes to investing, volatile markets aren't your worst enemy. It's actually yourself. That's because money and logic don't always go hand in hand. Unfortunately, our brains often play tricks on us, causing even the savviest of investors to make decisions that don't really make a lot of sense, from panic selling to ignoring opportunities.

The problem of psychological investing traps is so pervasive, in fact, that there's a whole field dedicated to studying it called behavioral finance. Researchers in this discipline look at the way psychology affects how we make financial decisions, and some of what they've discovered is pretty interesting. Knowing about these traps can help you avoid them and make you a better investor. Here are seven psychological traps to keep in mind.

SUNK COSTS BIAS — The sunk costs bias has to do with the all-too-common tendency to stick with something, whether a bad boyfriend or a bad investment, long after it's clear that it's not worth it anymore. Still, because you've invested a certain amount of time or money, you're reluctant to give it up. But in these cases, it's better to cut your

CONTINUED ON PAGE 3

The Practical

Continued from page 1

sets' returns in the portfolio.

❍ When small portions of stocks are added to an all bond portfolio, the portfolio's risk initially decreases, even though stocks are more volatile than bonds. Thus, an all bond portfolio is not the lowest risk portfolio.

❍ Investors should consider how varying percentages of different asset classes will affect their portfolio's risk and return before deciding on an asset allocation.

Managing Your Portfolio

Consider this investment process to incorporate this theory:

❍ **Determine your risk/return preferences.** You should assess the potential downsides as well as upsides for various investments to get a feel for how much risk you can tolerate.

❍ **Decide on an asset allocation mix.** Your asset allocation strategy represents your personal decisions about how much of your portfolio should be allocated to various investment categories. After considering your risk tolerance, time horizon for investing, and return needs, you can form a target asset allocation mix. Within broad investment categories, make allocation decisions for each category. Not only will each individual's allocation strategy differ, but your strategy will vary over time.

❍ **Select individual investments.** Investigate a wide range of options, but make sure you understand the basics of each, examining the types of risk they are subject to as well as their historical rates of return. Your selections should fit in with your overall asset allocation.

❍ **Rebalance periodically**[1]**.** Over time, your asset allocation will stray from your desired allocation, due to varying rates of return on your investments. Determine how much variation you are willing to tolerate, perhaps 5% or 10% from your desired allocation. If portions of your portfolio have strayed more than that, you should take steps to get your allocation in line. However, first determine if there are ways to do so without incurring tax liabilities. Selling assets from taxable accounts may result in taxable transactions. Instead, you may want to make new investments in under weighted assets, redirect periodic income to other asset classes, or take withdrawals from overweighted assets.

Please call to discuss your investment portfolio. ❍❍❍

1 Rebalancing/Reallocating can entail transaction costs and tax consequences that should be considered when determining a rebalancing/reallocation strategy.

6 Signs You Need a Financial Plan

A clear financial plan helps you prepare for the future, brace yourself for the unexpected, and position yourself to pursue your goals. Below are six signs that it may be time for you to get a financial plan.

You're planning (or just had) a big life change. New job. New baby. New house. All of those milestones and more are signs that you should be taking a big picture look at your finances. Take this opportunity to put your financial house in order.

You're worried about your finances — and your future. If money worries keep you up at night, a financial plan can help ease your mind. Whether you have immediate worries or are just feeling uneasy about what tomorrow may hold, you can regain control over your life by having a clear direction. Your comprehensive financial plan will not only help you see where you stand today, it will also help you plot a path to where you want to be.

You're making good money, but you're not sure where it goes. If you want to turn today's income into tomorrow's wealth, you need a financial plan. You'll be able to take the money you're earning today and use it to create a secure future.

You have financial goals, but you're not sure how to make them a reality. With a financial plan, you'll know what you need to do financially to make those dreams a reality.

You and your partner are fighting about money. Meeting with an objective third party, like a financial planner, can help you both understand where you stand when it comes to your finances, and then negotiate a path forward that works for both of you.

Your investments and finances are getting so complicated, it's difficult for you to keep track of everything. As your money and life get more complex, it can be difficult to manage all the details without help. A financial plan, developed with the assistance of your financial advisor, will help you identify the best ways to save, find ways to reduce taxes, and protect yourself against risk. With the help of your advisor, you'll be able to understand your total financial picture and take the steps necessary to achieve your goals. ❍❍❍

7 Psychological

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losses rather than hang on to a loser.

Familiarity Bias — Most of us are biased toward that which is familiar to us. We eat at restaurants we've been to before and follow the same roads to work, because we know what to expect. You might prefer to invest in the company you work for or big-name businesses that are in the news. That could cause you to overlook important opportunities you don't know much about.

Anchoring — Anchoring is the process of getting attached to a particular reference point — such as the price you paid for a stock — and using that to guide future decisions. Or you might fixate on a stock's previous high, even though that price was an anomaly.

Whether you're buying stocks or cars, anchoring involves using a single piece of information to determine what a stock or other investment should be worth while also discounting more relevant information, such as a company's fundamentals or broader economic trends. Unfortunately, avoiding anchoring is difficult, but considering all available information before choosing an investment can help.

Focusing Too Much on the Recent Past — Recency bias is the tendency to make decisions or judgments based on information that's relatively new or recent. For example, during times when the market is up, people may ignore or discount the possibility of a market decline. Or, if a certain category of stocks has done poorly recently, people may conclude that those stocks *always* have negative returns, even if the dip is an anomaly. As with other psychological traps, you can avoid this one by doing your best to consider the entire universe of information at your fingertips, not just what happened yesterday.

Following the Herd — While following trends might be fine for fashionistas, it's not always a smart investing move. Yet herd investing is an all-too-easy trap to fall into. If everyone is telling you that now's the time to get into a certain hot investment, you may feel you need to act fast so you don't miss out. But just because something is popular doesn't make it a good investment. Blindly following the herd without first consulting your own financial goals and plan doesn't make you a smart investor.

Overconfidence — Most of us like to think we're smarter than the average person. Yet if you hit it big with a certain investment, you may attribute that success to your skill rather than what it really is — luck. This can cause you to repeat the same behavior again.

Panic — Investing isn't for the faint of heart. When the market takes a sudden dip, it's easy to panic, which can lead you to make bad decisions, such as selling at a big loss, rather than riding out the natural hills and valleys of investing. Making these emotionally-driven choices costs you a lot of money. When making investing decisions, make sure they're based on evidence, not your initial gut reaction to the day's events.

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

Emotional Issues That Prevent Estate Planning

There are many issues that must be faced to prepare a will or a trust, and for some, these issues can become emotional hurdles. If it is important to you to protect your loved ones and your estate when you die, you need to acknowledge these emotions and accept that this is just part of the process.

Facing Mortality — Death is not something that anyone really wants to talk about, but it is inevitable. Some are superstitious that even saying the word death might cause it to actually happen. There really isn't a solution to your fears, but you can at least be reassured that by developing a plan you will be taking care of your loved ones.

Not Being in Control — Many think of estate planning as relinquishing control of their assets, when it is actually quite the opposite. Developing a will or a trust will ensure that your assets will be handled exactly the way you want them to be handled. There are approaches to developing an estate plan where you can maintain control while protecting your assets.

Family Decisions — Depending on your family's situation, there are many decisions that have to be made that can cause family friction. Who should be the executor? What should you leave to each family member? Who is best suited to take over the family business? Does one child need more financial help than others? Should all your children be treated equally?

These are difficult issues, but keep in mind if you don't make them, you could leave your family with a mess to deal with and the potential that your family could be torn apart by arguing over your estate.

Costs — Costs to develop an estate plan will vary depending on your family's situation. Think of your estate plan as a gift to your family and peace of mind for you that your final wishes will be carried out. Make sure you have a full understanding of the costs before proceeding with the development of the plan. ❍❍❍

FINANCIAL DATA

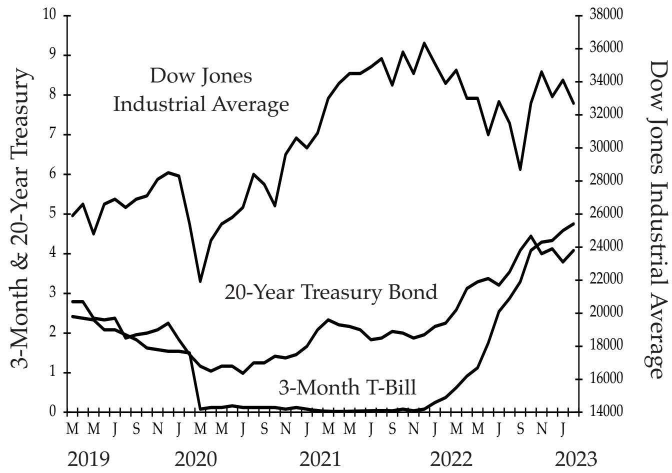
Indicator	Month-end				
	Dec-22	Jan-23	Feb-23	Dec-22	Feb-22
Prime rate	7.50	7.50	7.75	7.50	3.25
Money market rate	0.33	0.35	0.47	0.33	0.07
3-month T-bill yield	4.35	4.60	4.75	4.35	0.36
10-year T-bond yield	3.88	3.52	3.92	3.88	1.83
20-year T-bond yield	4.14	3.78	4.10	4.14	2.25
Dow Jones Corp.	5.54	5.09	5.65	5.54	3.31
30-year fixed mortgage	6.80	6.51	7.07	6.80	3.51
GDP (adj. annual rate)#	-0.60	+3.20	+2.70	+2.70	+6.90

Indicator	Month-end			% Change	
	Dec-22	Jan-23	Feb-23	YTD	12-Mon.
Dow Jones Industrials	33147.25	34086.04	32656.70	-1.5%	-3.6%
Standard & Poor's 500	3839.50	4076.60	3970.15	3.4%	-9.2%
Nasdaq Composite	10466.48	11584.55	11455.54	9.7%	-16.7%
Gold	1812.35	1923.90	1824.60	0.7%	-4.5%
Consumer price index@	297.71	296.80	299.17	0.5%	6.4%
Unemployment rate@	3.60	3.50	3.40	-8.1%	-15.0%

— 2nd, 3rd, 4th quarter @ — Nov, Dec, Jan Sources: *Barron's, Wall Street Journal*

4-YEAR SUMMARY OF DOW JONES INDUSTRIAL AVERAGE, 3-MONTH T-BILL & 20-YEAR TREASURY BOND YIELD

MARCH 2019 TO FEBRUARY 2023



Past performance is not a guarantee of future results.

NEWS AND ANNOUNCEMENTS

FINANCIAL MANAGEMENT FOR COLLEGE STUDENTS

You're off to college. It's important to get off on the right foot with managing your money, because the financial decisions you make now will impact you later. Following are some tips:

DEVELOP A BUDGET — First make a list of your monthly income sources, including wages, savings, and any allowance from your parents or others. Next, you will want to make a complete list of all of your expenses, including school supplies, laundry, meals outside your food plan, and personal care items. You should track your expenses and add new expenses as you discover them.

IDENTIFY WANTS VERSUS NEEDS — You will need to determine the amount of money that is absolutely essential to pay your expenses each month. After a few months, it will get easier to distinguish wants from needs.

SET UP CHECKING AND SAVINGS ACCOUNTS — Find a bank or credit union on campus to establish a checking and savings account. Most financial institutions offer free checking and savings accounts to students, but you should make sure you understand what fees may be associated with your accounts.

USE CREDIT CARDS WISELY — While it can be a double-edged sword, you need to use credit to establish a good credit rating. You should open a credit card and use it to pay for expenses, being sure to pay off the balance each month. By doing this, you are showing you are financially responsible and you are establishing a good credit history. ❍❍❍

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