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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

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Welcome to the October 2011 edition of The Financial Formula! If you have any questions, please let me know - enjoy the newsletter!

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In This Issue

Three Keys to Surviving Market Turbulence

All too often, investors react to a sharp drop in prices by panic selling or digging in their heels despite deteriorating fundamentals. But more thoughtful investors see a correction or downturn as an opportunity to review the risks in their portfolios and make adjustments where necessary.

Heightened Volatility: The New Normal?

The U.S. economy can't find its footing -- and every piece of bad news, whether at home or abroad, has the potential to send the markets reeling. All that volatility can make it tough on investors to stay the course.

Common Mistakes of Asset Allocation

Allocating and managing portfolios successfully in today's marketplace is difficult. There are many pitfalls along the way to complicate matters. Learn how to avoid some common mistakes that may place your portfolio at risk.

Tax Code Changes = Jobs Created in the U.S.A.

If we just change that one law alone to give companies tax breaks for creating jobs here in the good ol U.S. of A., Id be willing to bet that this economy would begin to see some true growth again.

Most stock market investors are looking for the same result: strong and steady gains of their investments. Dealing with a period of sustained falling stock prices is not easy. All too often, investors react to a sharp drop in prices by panic selling or digging in their heels despite deteriorating fundamentals. But more thoughtful investors see a correction or downturn as an opportunity to review the risks in their portfolios and make adjustments where necessary.

When confronted with any adverse market event -- whether it is a one-day blip, a more lengthy market correction (a decline of between 10% to 20%), or a prolonged bear market (a decline of more than 20%) -- take time to review your portfolio. Dealing with volatility can be difficult. Here are three suggestions to help you and your portfolio survive market turbulence.

When confronted with any adverse market event -- whether it is a one-day blip, a more lengthy market correction (a decline of between 10% to 20%), or a prolonged bear market (a decline of more than 20%) -- take time to review your portfolio.

1. **Talk with a professional.** A financial professional can help you separate emotionally driven decisions from those based on your goals, time horizon, and risk tolerance. Researchers in the field of behavioral finance have found that emotions often lead investors to read too much into recent events even though those events may not reflect long-term realities. With the aid of a financial professional, you can sort through these distinctions, and you'll likely find that if your investment strategy made sense before the crisis, it will still make sense afterward.
2. **Organize and review your financial records.** Crisis events highlight the importance of knowing where your assets are and maintaining organized financial records. Following the September 11, 2001, terrorist attacks, markets closed for several days and many records in the heart of New York City's financial district were destroyed. Yet the nation's financial systems were up and running in a matter of days, and your securities accounts were safe even when the stock exchanges were closed. While you cannot trade investments or access your assets during a market shutdown, securities firms maintain backup facilities and have contingency plans to help them service customers when trading resumes.
3. **Keep a long-term perspective.** The only certainty about the stock market is this: It will always experience ups and downs. That's why it's important to keep emotions in check and stay focused on your financial goals. A buy-and-hold strategy -- making an investment and then holding on to it despite short-term market moves -- can help. The opposite of buy-and-hold investing is market timing -- buying and selling investments based on what you think the market will do next. Market timing, as most investment professionals will tell you, is risky. If your predictions are wrong, you could invest when the market is on its way down or sell when it's on its way up. In other words, you risk locking in a loss or missing the market's best days.

It's important to remember that periods of falling prices are a natural part of investing in the stock market. While some investors will use a variety of trading tools, including individual stock and stock index options, to hedge their portfolios against a sudden drop in the market, perhaps the best move you can make is reevaluating and limiting your overall risk position.

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Heightened Volatility: The New Normal?

Although you may be rightfully gun shy in the wake of the recent market turmoil, one strategy you should seriously consider is selectively adding to your portfolio.

It's not your imagination: The stock market is bumpier than normal. The U.S. economy can't find its footing -- and every piece of bad news, whether at home or abroad, has the potential to send the markets reeling. All that volatility can make it tough on investors to stay the course.

Historically speaking, the market today is about three times more volatile than it has been in the past. Specifically, the S&P 500 rose or fell by 2% or more an average of 5 times per year from 1950 until 1999. Since 2000, however, that average jumped to 12.5 times per year for advances and more than 14 times for declines.[1] What's more, 10 of the 20 largest daily upswings and 11 of the 20 largest daily drops since the beginning of 1980 have occurred within the last three years.[2]

Who or what deserves the blame for heightened market volatility is difficult to say. On the economic side, uncertainty about when and how fully the economy will recover is a major factor. So are factors such as the heightened reliance on government monetary policy, unsustainable fiscal trends, and the apparent lack of collaboration among legislators in Washington. On the investment side, high-frequency trading, hedge funds, and inverse and leveraged ETFs all contribute to the volatility.

What Can You Do?

Regardless of the drivers, heightened volatility requires individual investors and their advisors to exercise specific investment strategies. While many of these strategies are basic investing concepts that can be applied at any time, they are particularly important in a volatile environment.

- **Don't follow the herd.** Don't sell into a rapidly declining market and don't buy into a rapidly rising market. You'll just be following the herd and locking in losses. Panic selling also runs the risk of missing the market's best-performing days. For example, missing just the 5 top-performing days of the 20 years ended December 31, 2010, would have cost you more than $19,000 based on an original investment of $10,000 in the S&P 500. Missing the top 20 days would have reduced your average annual return from 9.14% to 3.00%.[3]
- **Keep a long-term perspective.** It is all too easy to get caught up in the stock market's daily roller-coaster ride. This type of behavior is natural, but can easily lead to bad decisions. Instead, focus on whether your long-term performance objectives, i.e., your average returns over time, are meeting your goals.
- **Take advantage of asset allocation.** During volatile times, more risky asset classes such as stocks tend to fluctuate more, while lower-risk assets such as bonds or cash tend to be more stable. By allocating your investments among these different asset classes, you can help smooth out the short-term ups and downs.
- **Consider buying opportunities.** Although you may be rightfully gun shy in the wake of the recent market turmoil, one strategy you should seriously consider is selectively adding to your portfolio. This is especially true when prices are low versus historical averages.

[1]*Source: Standard & Poor's Equity Research Services, "Shaken and Stirred," August 29, 2011.*

[2]*Source: The New York Times, "Market Swings Are Becoming New Standard," September 11, 2011.*

[3]Source: Standard & Poor's. For the period indicated. Stocks are represented by the S&P 500, an unmanaged index that is generally considered representative of the U.S. stock market. Past performance is not a guarantee of future results.

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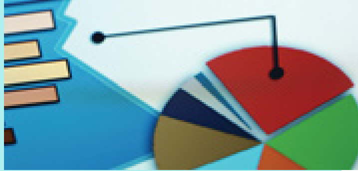

Common Mistakes of Asset Allocation

The best way to manage your assets is to have a steady and consistent asset mix that is developed with realistic expectations and modified only by a judicious reevaluation of your goals, needs, and risk profile.

Smart people make dumb mistakes all the time. Allocating and managing portfolios successfully in today's marketplace is difficult. There are many pitfalls along the way to complicate matters. When investors fail to avoid mistakes, they place portfolios at risk. At stake are not only the growth and safety of the investor's portfolio but also their future financial independence, control, and security. As a result, investors need to be aware of the common mistakes that can be made when employing asset allocation so that they can avoid them.[1] Some of the more common mistakes are highlighted below.

Failing to Set Realistic Financial Goals

You cannot hit a target you are not aiming for. Investors need to do a fair degree of preparation. Unfortunately, a large number of investors manage their portfolios in a haphazard, sporadic, and ineffective manner. Often they fail to set financial goals, which is a basic tenet of investing. Without a solid understanding of your specific goals and investment needs, you will be unable to design or manage your portfolio properly. An accurate assessment of specific goals and needs is essential in order to establish the right mix and specific allocations of asset classes. Your goals and needs are the driving force upon which your portfolio is built.

Having Unrealistic Return Expectations

One of the most difficult and subjective tasks associated with investing is having realistic expectations. Investors need to exercise significant discretion and resist sabotaging their portfolios simply because of what everyone else is doing or is earning on their investments.

Switching from asset class to asset class in the hopes of earning a higher return hardly ever works out and could spell disaster. You could miss out on nice gains in the asset classes you switched out of, or experience a significant loss from having too much in an asset class you emphasized. The best way to manage your assets is to have a steady and consistent asset mix that is developed with realistic expectations and modified only by a judicious reevaluation of your goals, needs, and risk profile.

Misinterpreting Risk Tolerance

Many investors confuse risk tolerance with risk capacity and vice versa. Your risk tolerance is your willingness to assume risk in order to earn the return you need. Misinterpreting risk tolerance may result in a portfolio that inherently has more risk than appropriate or one where the returns will be less than needed because it was designed to maximize returns with a lower risk tolerance. A well-designed risk tolerance questionnaire, together with a face-to-face meeting with a financial professional, is a prudent approach to identifying your tolerance for risk.

Misjudging Risk Capacity

Don't invest what you can't afford to lose. This wisdom gets at the heart of addressing your risk capacity when investing. Risk capacity is your ability to assume risk. An investor's capacity for risk is not determined by or affected by his or her tolerance for risk. The two are completely different. Some investors do not take into account their capacity to assume risk. Unfortunately, their tolerance for risk often masters their capacity for risk. Remember to always think in terms of your capacity for risk taking. Don't let your emotions get the best of you so that you would invest more than you can afford to lose.

Underestimating Time Horizon

Your time horizon is the period from the present to a future point in time when you will no longer need the assets in your portfolio. Many investors mistakenly believe their time horizon is from the present to the day they plan to retire. Unfortunately, that could not be farther from the truth. At retirement, it is not their time horizon that may change, but rather their risk tolerance and liquidity needs.

Portfolios based on shorter time horizons will be overallocated to fixed-income assets and possibly underperform as a result. Life-changing events, such as retirement, are taken into consideration through asset allocation modifications. Your time horizon typically extends well into your retirement. Once you retire, you can alter your asset allocation, but prior to that point it is wise to have a well-diversified and allocated portfolio that uses an appropriate time horizon.

[1] *Asset allocation does not ensure a profit or protect against a loss in a declining market.*

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Tax Code Changes = Jobs Created in the U.S.A.

Since the U.S. is predominantly a service-oriented economy, we have many people working in jobs that just arent right for them. Lets face it, some of these people are NOT cut out to do customer service work and it shows (ever hear how many people complain daily about poor customer service? I complained twice today alone!). Thats really not these peoples faults theyre probably better suited building or making things. But where are those jobs? They are few and far between unfortunately for many U.S. workers. This is a direct result of our current tax codes.

Tax Code Changes = Jobs Created in the U.S.A.

By Martin A. Federici, Jr., CEO of MF Advisers, Inc.

I find it sad that in what is supposedly the greatest country on the face of the earth we have unemployment currently hovering above 9%. Sure, economies like ours which are based on capitalism will have their ups and downs but it seems like there's something more that's preventing a more robust recovery. Perhaps it's because our tax code is RIDICULOUS compared to nearly every other country's code in the world, and it doesn't help our country's biggest problem now - a jobless recovery that's going slow (and sometimes stalling).

Since our current tax laws give corporations tax breaks for shipping jobs overseas, of course companies will build plants elsewhere and hire plenty of cheaper foreign labor - it just makes good business sense for them to do that. Let me ask this question though: why would we do that as a country? I know we want our corporations to be able to compete globally for business, but we've shoved good manufacturing jobs to the brink of non-existence in this country and that is why our economy isn't where it should be right now.

Since the U.S. is predominantly a service-oriented economy, we have **many** people working in jobs that just aren't right for them. Let's face it, some of these people are NOT cut out to do customer service work and it shows (ever hear how many people complain daily about poor customer service? - I complained twice today alone!). That's really not these people's faults - they're probably better suited building or making things. But where are those jobs? They are few and far between unfortunately for many U.S. workers. This is a direct result of our current tax codes.

If we just change that one law alone to give companies tax breaks for creating jobs here in the good ol' U.S. of A., I'd be willing to bet that this economy would begin to see some true growth again. Some people might argue that's protectionism, or that the U.S. is isolating itself from the global economy - last I checked though, the global economy isn't doing all that well either. Sure, companies would have to pay the American workers more than our foreign counterparts elsewhere, but we should incentivize companies to do this.

After all, we see the results of doing it the current way - and it isn't pretty for the U.S., is it? Just ask the millions of unemployed and underemployed people in this country what they all think - I'm sure they'll be glad to offer their opinions. Let's hope this proposed tax law change comes sooner rather than later - millions of U.S. families are depending on it.

For more information, please visit http://www.mfadvisers.com , email marty@mfadvisers.com , or call (570) 760-6524.

About **MF Advisers, Inc.**

MF Advisers, Inc. is a full-service, fee-only RIA firm and fiduciary based in PA & FL specializing in wealth management, investment advice, and financial planning.

With 20+ years of licensed experience, over 10 years of professional education, and an unwavering commitment to improving your financial situation, MF Advisers is the advisory firm to best serve YOU.

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