

The Lynde Group
Hal Lynde
Managing Director

Morgan Keegan
The Lynde Group
4400 Post Oak Parkway
Suite 2670
Houston, TX 77027
(713)840-3640
hal.lynde@morgankeegan.com
hal.lynde.mkadvisor.com

First Rule of Successful Investing: Setting Goals

Table of Contents

Setting Investment Goals	3
Setting investment goals	3
Generating Current Income	5
What is creating and managing an investment portfolio to generate current income?	5
What assets should I select for my portfolio?	5
Mutual funds or individual securities	5
Taxable or tax-free investments	5
Timeline	6
Risk tolerance	6
Understanding Risk	7
What you probably already know about risk	7
What makes volatility risky?	7
Other types of risk	8
The relationship between risk and reward	8
Understanding your own tolerance for risk	8
Reducing risk through diversification	9
Evaluating risk: where to find information about investments	9
Steps to Financial Planning Success	10

Setting Investment Goals

Setting investment goals

Setting goals is a very important part of life in general and in financial planning in particular. Before you actually invest your money, you should spend some time considering and setting your personal financial goals. For example, do you want to retire early? Would you like to start your own business soon? Do you need to pay for your children's college education? Would you like to buy or build a new house? In addition to these, there are several other questions you should consider to help you and your financial advisor develop an appropriate financial plan. First, what is your time horizon for your goals? Second, what is your investment risk tolerance? Third, what are your liquidity needs? Finally, what are the most appropriate investments to achieve your goals?

Time horizon

Probably the first question you should ask in setting your investment goals is: What is my time horizon? In other words, when will you need the money? Are you investing for your young child's college education, or for your retirement 30 years in the future? Or are your goals nearer, such as buying a house in 3 years, or starting your own business in 5 years? Your time horizon will have a significant impact on the type of investments you should make.

The general rule is: The longer your time horizon, the more risky (and potentially more lucrative) investments you can make. Many financial advisors believe that with a longer time horizon, you can ride out fluctuations in your investments for the potential of greater long-term returns. If that's true for you, you might be able to allot a greater portion of your portfolio in investments such as common stock or real estate. On the other hand, if your time horizon is very short, you may want to concentrate your investments in less risky vehicles, because you may not have enough time to recoup any losses you might experience.

Risk tolerance

Another question you should consider is: What is my investment risk tolerance? How do you feel about the potential of losing your hard-earned money? Many investors would forgo the possibility of a large gain if they knew there was also the possibility of a large loss (these investors are known as risk averse). This type of investor should concentrate on less risky investments, such as Treasury bills, money market accounts, high-quality bonds with short maturities, and other similar investments.

Other investors, so-called risk seekers, are more willing to take the chance of a large loss if there were also the possibility of a large gain. Such investors often focus on common stock, real estate, or other higher-yielding investments.

It is not always easy to determine if you are risk averse or a risk seeker. Before making any investment, each investor should think about how he or she feels about losing money. Keep in mind that, as noted above, your time horizon can affect your risk tolerance. For example, if investing for retirement 30 years down the road, you may be more willing to take chances than if you're saving to send your child to college in 4 years.

Liquidity needs

Another question you should ask when setting your investment goals is: What are my liquidity needs? Liquidity refers to how quickly an investment can be converted into cash (or the equivalent of cash). Real estate, for example, tends not to be very liquid; it can take a very long time to sell either residential or commercial real estate. Publicly traded stock, on the other hand, tends to be relatively liquid, though you might suffer a loss if you need to sell when the market is down. Cash and cash alternatives such as money market accounts are extremely liquid (though even here, some types of cash alternatives may be more liquid than others).

Your liquidity needs will affect the type of investments you might choose to meet your goals. For example, if you don't have short-term liquidity needs, you can probably afford to invest in less liquid investments where the

potential for gain is much higher than for more liquid investments. However, if you have two children going to college in the next couple of years, you probably don't want all of their tuition money invested in less liquid assets. Like your risk tolerance, your liquidity needs are also related to your time horizon.

Matching investments to goals

Once you have determined your time horizon, risk tolerance, and liquidity needs, the final step is to match your goals with various investment options. Investment options now available to individual investors range from those generally considered relatively safe, such as Treasury bills and money market mutual funds, to the very risky, such as commodities futures, venture capital deals, and real estate. There are literally thousands of different investment vehicles. Just remember this: In general, the safer the investment (i.e., the less risk of loss), the less potential for future gain. And on the flip side, the riskier the investment, the greater potential for gain (but also the greater potential for loss).

Caution: An investment in a money market mutual fund is not insured or guaranteed by the FDIC or any other government agency. Although money market mutual funds attempt to preserve the value of your investment at \$1 per share, it is possible to lose money investing in one.

Generating Current Income

What is creating and managing an investment portfolio to generate current income?

There are times when you might want to set up an investment portfolio to generate current income. For example, you may be retired (or near retirement) and need additional income to supplement the amounts you receive from Social Security and your pension plan. You may be a younger person, with adequate savings for retirement and your children's education, but would like to generate additional income to increase your current standard of living. Another possibility is that you may simply need extra income to pay existing bills.

What assets should I select for my portfolio?

Assets that produce income

If your primary goal is to generate current income for yourself, focus on investments such as dividend-paying stocks, bonds, money market mutual funds, and dividend-paying mutual funds. These types of investments can provide you with regular additional cash-flows.

Mutual funds or individual securities

How much money to invest

Whether you buy a mutual fund or an individual investment will depend on two factors. The first is how much money you have to commit to your investment portfolio. If you have a relatively small amount, you may be better off purchasing mutual funds. You should focus on mutual funds that generate current income (e.g., money market funds, utility stock funds, and bond funds). This makes sense if you have only a small amount of money because you can get diversification of your assets through the mutual fund. It would be very difficult to get adequate diversification through individual securities with a small amount of money.

On the other hand, if you have a substantial amount of money to commit to the portfolio, you might want to consider buying individual T-bills, dividend-paying stocks, and other types of dividend- (and interest-) paying securities. If you have sufficient funds, you can diversify your holdings by purchasing different securities.

Professional management

A second factor in deciding whether you should invest in mutual funds or individual securities is the degree of investment sophistication that you possess. If you have a substantial amount of investment experience, you might feel comfortable selecting and managing your own portfolio of securities. If you are less experienced (or simply do not have the time to constantly monitor your portfolio), you might consider investing through mutual funds that offer automatic diversification and in some cases, professional management of your assets. Before investing in a mutual fund, you should carefully consider its investment objectives, risks, fees, and expenses, which are outlined in the prospectus available from the fund. Obtain a copy and read it carefully before investing.

Taxable or tax-free investments

Another consideration in setting up an investment portfolio to generate current income is whether you should purchase tax-free securities (such as municipal bonds) or taxable investments (corporate bonds). Taxes naturally reduce earned income. But it does not necessarily follow that tax-free securities will provide more income. How much income you will net depends on the investment's yield and your personal tax bracket. So, to make a determination, you will need to compare after-tax yields. Compare taxable and tax-exempt investment returns as follows:

- Convert your tax bracket into a decimal and subtract it from one (e.g., the 35 percent tax bracket becomes 0.65)
- Divide the yield of the tax-exempt investment by the result (e.g., if the tax-exempt yield is 5 percent, then divide 5 by 0.65 to obtain 7.6923 percent)

If you were in a 35 percent bracket, you would need a taxable investment that yields greater than 7.6923 percent to beat the yield of a tax-exempt investment that yields 5 percent.

Timeline

Time horizon for investing money

Another factor is your timetable. When will you need the principal amount in your portfolio? For example, if you are setting up an investment portfolio both to provide you with current income and to help pay for your child's college education in 3 years, you may want to fund the portfolio with short-term securities. However, if you have just taken early retirement at age 60 (and you expect to live for at least 20 more years), you may want to fund your portfolio with longer-term instruments such as bonds.

Risk tolerance

Risk averse or risk tolerant

Another factor is your investment risk tolerance. If you are risk averse, you probably want to purchase high-quality money market instruments such as T-bills, or short- to medium-term bonds. If you are more of a risk taker, you might consider high-yield bonds and other securities that may have more volatility but the potential for greater income.

Understanding Risk

Few terms in personal finance are as important, or used as frequently, as "risk." Nevertheless, few terms are as imprecisely defined. Generally, when financial advisors or the media talk about investment risk, their focus is on the historical price volatility of the asset or investment under discussion.

Advisors label as aggressive or risky an investment that has been prone to wild price gyrations in the past. The presumed uncertainty and unpredictability of this investment's future performance is perceived as risk. Assets characterized by prices that historically have moved within a narrower range of peaks and valleys are considered more conservative. Unfortunately, this explanation is seldom offered, so it is often not clear that the volatility yardstick is being used to measure risk.

Before exploring risk in more formal terms, a few observations are worthwhile. On a practical level, we can say that risk is the chance that your investment will provide lower returns than expected or even a loss of your entire investment. You probably also are concerned about the chance of not meeting your investment goals. After all, you are investing now so you can do something later (for example, pay for college or retire comfortably). Since every investment carries some degree of risk, it makes sense to understand the kinds of risk as well as the extent of risk that you choose to take, and to learn ways to manage it.

What you probably already know about risk

Even though you might never have thought about the subject, you're probably already familiar with many kinds of risk from life experiences. For example, it makes sense that a scandal or lawsuit that involves a particular company will likely cause a drop in the price of that company's stock, at least temporarily. If one car company hits a home run with a new model, that might be bad news for competing automakers. In contrast, an overall economic slowdown and stock market decline might hurt most companies and their stock prices, not just in one industry.

However, there are many different types of risk to be aware of. Volatility is a good place to begin as we examine the elements of risk in more detail.

What makes volatility risky?

Suppose that you had invested \$10,000 in each of two mutual funds 20 years ago, and that both funds produced average annual returns of 10 percent. Imagine further that one of these hypothetical funds, Steady Freddy, returned exactly 10 percent every single year. The annual return of the second fund, Jekyll & Hyde, alternated--5 percent one year, 15 percent the next, 5 percent again in the third year, and so on. What would these two investments be worth at the end of the 20 years?

It seems obvious that if the average annual returns of two investments are identical, their final values will be, too. But this is a case where intuition is wrong. If you plot the 20-year investment returns in this example on a graph, you'll see that Steady Freddy's final value is over \$2,000 more than that from the variable returns of Jekyll & Hyde. The shortfall gets much worse if you widen the annual variations (e.g., plus-or-minus 15 percent, instead of plus-or-minus 5 percent). This example illustrates one of the effects of investment price volatility: Short-term fluctuations in returns are a drag on long-term growth. **(Note: This is a hypothetical example and does not reflect the performance of any specific investment. This example assumes the reinvestment of all earnings and does not consider taxes or transaction costs.)**

Although past performance is no guarantee of future results, historically the negative effect of short-term price fluctuations has been reduced by holding investments over longer periods. But counting on a longer holding period means that some additional planning is called for. You should not invest funds that will soon be needed into a volatile investment. Otherwise, you might be forced to sell the investment to raise cash at a time when the investment is at a loss.

Other types of risk

Here are a few of the many different types of risk:

- **Market risk:** This refers to the possibility that an investment will lose value because of a general decline in financial markets, due to one or more economic, political, or other factors.
- **Inflation risk:** Sometimes known as purchasing power risk, this refers to the possibility that prices will rise in the economy as a whole, so your ability to purchase goods and services would decline. For instance, your investment might yield a 6 percent return, but if the inflation rate rises to double digits, the invested dollars that you got back would buy less than the same dollars today. Inflation risk is often overlooked by fixed income investors who shun the volatility of the stock market completely.
- **Interest rate risk:** This relates to increases or decreases in prevailing interest rates and the resulting price fluctuation of an investment, particularly bonds. There is an inverse relationship between bond prices and interest rates. As interest rates rise, the price of bonds falls; as interest rates fall, bond prices tend to rise. If you need to sell your bond before it matures and your principal is returned, you run the risk of loss of principal if interest rates are higher than when you purchased the bond.
- **Reinvestment rate risk:** This refers to the possibility that you will have to reinvest funds at a lower rate of return than the original investment. Your five-year, 3.75 percent certificate of deposit might mature at a time when a new certificate of deposit pays just 3 percent.
- **Default risk (credit risk):** This refers to the risk that a bond issuer will not be able to pay its bondholders interest or repay principal.
- **Liquidity risk:** This refers to how easily your investments can be converted to cash. Occasionally (and more precisely), the foregoing definition is modified to mean how easily your investments can be converted to cash without significant loss of principal.
- **Political risk (for those making international investments):** This refers to the possibility that changes in foreign governments or politics will adversely affect the financial markets there or the companies you invested in.
- **Currency risk (for those making international investments):** This refers to the possibility that the fluctuating rates of exchange between U.S. and foreign currencies will negatively affect the value of your foreign investment, as measured in U.S. dollars.

The relationship between risk and reward

In general, the more risk you're willing to take on (whatever type and however defined), the higher your potential returns, as well as potential losses. This proposition is probably familiar and makes sense to most of us. It is simply a fact of life--no sensible person would make a higher-risk, rather than lower-risk, investment without the prospect of receiving a higher return. That is the tradeoff. Your goal is to maximize returns without taking on an inappropriate level or type of risk.

Understanding your own tolerance for risk

The concept of risk tolerance is twofold. First, it refers to your personal desire to assume risk and your comfort level with doing so. This assumes that risk is relative to your own personality and feelings about taking chances. If you find that you can't sleep at night because you're worrying about your investments, you may have assumed too much risk. Second, your risk tolerance is affected by your financial ability to cope with the possibility of loss, which is influenced by your age, stage in life, how soon you'll need the money, your investment objectives, and your financial goals. If you're investing for retirement and you're 35 years old, you may be able to endure more risk than someone who is 10 years into retirement, because you have a longer time frame before you will need

the money. With 30 years to build a nest egg, your investments have more time to ride out short-term fluctuations in hopes of a greater long-term return.

Reducing risk through diversification

Don't put all your eggs in one basket. You can potentially help offset the risk of any one investment by spreading your money among several asset classes. Diversification strategies take advantage of the fact that forces in the markets do not normally influence all types or classes of investment assets at the same time or in the same way. Swings in overall portfolio return can be moderated by diversifying your investments among assets that are not highly correlated--i.e., assets whose values may behave very differently from one another. In a slowing economy, for example, stock prices might be going down or sideways, but if interest rates are falling at the same time, the price of bonds likely would rise. Diversification cannot guarantee a profit or ensure against a potential loss, but it can help you manage the level and types of risk you face.

In addition to diversifying among asset classes, you can diversify within an asset class. For example, the stocks of large, well-established companies may behave somewhat differently than stocks of small companies that are growing rapidly but that also may be more volatile. A bond investor can diversify among Treasury securities, more risky corporate securities, and municipal bonds, to name a few. Diversifying within an asset class helps reduce the impact on your portfolio of any one particular type of stock, bond, or mutual fund.

Evaluating risk: where to find information about investments

You should become fully informed about an investment product before making a decision. There are numerous sources of information. You can find information in third-party business and financial publications and websites, as well as annual and other periodic financial reports.

Third-party business and financial publications can provide credit ratings, news stories, and financial information about a company. For mutual funds, third-party sources provide information such as ratings, financial analysis, and comparative performance relative to peers.

Obtain a prospectus if the investment is a mutual fund or an initial public offering, or an offering circular if the investment is a limited partnership or hedge fund.

Note: *Before investing in a mutual fund, carefully consider its investment objectives, risks, fees and expenses, which can be found in the prospectus available from the fund; read it and consider it carefully before investing.*

If you are considering investing in an initial public offering (IPO), it's also extremely important that you read its prospectus, which contains information about the company's products and/or services, operating history, future prospects, and management. The offering circular of a limited partnership or hedge fund should contain information similar to that of a prospectus for an IPO, as well as information regarding the general partner, special risks of investing in the product, and liquidity.

You can also check with the Securities and Exchange Commission (SEC). There, you can obtain reports disclosing significant events (e.g., the CEO plans to sell a large amount of shares; an investor plans to purchase a large amount of shares for a takeover) and financial reports. One of the easiest ways to get information is to go to the SEC's website.

Steps to Financial Planning Success



Keep your investment plan fresh

Step Six: Annual Review



Sign necessary documents
Purchase necessary insurance
Make changes as needed

Step Five: Create a Plan



Review team suggestions

Step Four: Recommendations



Determine if current needs are being met
Determine if future needs have been contemplated

Step Three: Examine the Data



Assets/Liabilities	Tax Plan
Goals	Cash Flow
Insurance Plan	Objectives
Business Plan	Estate Plan
Investment Plan	Retirement Plan

Step Two: Fact Finding



Attorney	Stockbroker
Financial Planning Professional	Tax Advisor
Insurance Professional	

Step One: Pick a Winning Team

The Lynde Group
Hal Lynde
Managing Director

Morgan Keegan
The Lynde Group
4400 Post Oak Parkway
Suite 2670
Houston, TX 77027
(713)840-3640
hal.lynde@morgankeegan.com
hal.lynde.mkadvisor.com

This information is for illustrative and discussion purposes only. Morgan Keegan does not provide legal or tax advice. You need to contact your legal and tax advisors for additional information and advice before making any investment decisions.

Morgan Keegan & Company, Inc.
Members FINRA, SIPC

Securities and insurance products are not FDIC insured, not a deposit, not an obligation of or guaranteed by Regions Bank, its affiliates, or any government agency and may lose value.

**Morgan
Keegan**