



Advisor's Corner

What Then? ...and What Now?

Big Stock Market Swings Test Our True Risk Tolerance

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In this issue of "Lighting The Way", we'll take a look at how we've responded as investors to the tumultuous financial crisis that has yet to fully loosen its grip on the economy and markets. By doing so, we can gain valuable insight into our perceptions of risk, and better prepare for volatility in our investments.

No doubt, it's been one 'gut check' after another for investors over the last year. Most of us have never experienced eroding economic conditions and stock market volatility like it in our lifetimes. The 'Great Recession' of 2008-09 jolted us to our senses, and now we know what it feels like to go through an economic downturn and attendant stock market slide that economists rank second only to the great depression of the 1930's. However, even in light of the losses and hardships we've endured, was this financial crisis actually a blessing in disguise? For the investor who may have not fully understood the meaning of risk, and their attitude toward it, the answer to this question is Yes.

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Planning for Success

Year-End Steps Toward Your Financial Goals

Employee Benefits, Retirement Plans, and Taxes Deserve a Look This Time of Year

As we approach the end of 2009, it's a great time to review our financial goal progress, identify needs, and take action to develop plans for 2010. Here are a few topics that you might find relevant and useful to your personal finances as we close out the year.

Employee Benefits

Most employers offering benefits to their employees will conduct 'open-enrollment' in the 4th quarter of this year, or very early next year. This is your opportunity to pick and choose the various plan features that meet your needs for health, dental, disability, and life insurance; flexible spending accounts; and employer-sponsored retirement plan elections such as 401(k)'s and other defined contribution plans. If you will be enrolled in a 'high deductible' health care plan for 2010, pay special attention to the Health Savings Account option, or HSA. HSA's can provide tax-free benefits to save and pay for both current and future health care expenses.

Retirement Savings

This is a critical time to evaluate your retirement savings progress. You have until April 15th, 2010 to complete your traditional or Roth IRA contributions for 2009. However, you only have until your final 2009 paycheck to complete your employer-sponsored plan contributions for this year (such as 401(k), 403(b), and 457 deferred compensation plans). If you find that you are a bit behind schedule with your retirement savings goal for this year, you should take action now to adjust

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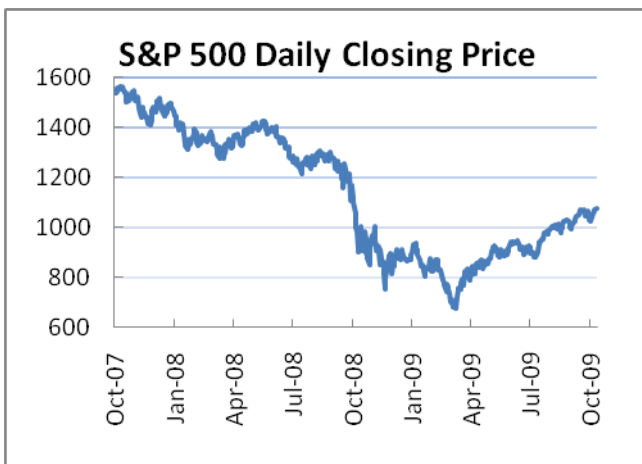
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To understand why there may be a valuable lesson to extract from our suffering this past year, we must look back on what has shaped our investor 'psyche' over nearly three decades.

The historic and profitable bull market of the 1980's and 90's came to an end in early 2000 as the famous 'dot-com' bubble quickly lost air. There was pain for sure during the sharp bear market decline of 2000-02, especially for portfolios laden with over-valued technology company stocks. Many of these 'tech stocks' have not recovered from their highs of ten years ago, and indeed, more than a few dot-com era high-flyers are no longer in business. Then, even without a tail-wind from tech stocks, the broader stock market was off and running on a new bull market run that commenced in early 2003. This powerful rally carried us into 2007, and by October of that year we reached new all time highs for the broad market. The stage was set where investors had experienced over 25 years of generally upward stock market movement. Yes, there were other setbacks and even 'crashes' along the way (e.g. Black Monday, October 1987), but we learned over time that the market would reward us if we stayed the course with our stock investments.



Source: Yahoo! Finance

Then came the financial collapse of 2008. Courtesy of sub-prime lending practices, securitization of toxic mortgage debt, bank failures, and a credit market that simply dried up - the economy fell into a tailspin. Many investors' shaken confidence quickly turned to fear and panic as they dumped stocks. Portfolio values plummeted, mutual fund redemptions soared, and people lost faith in the viability of their 401k plans. When we finally hit bottom in March 2009, the stock market (as measured by the S&P 500 index) had fallen 55% from its high of October 2007. The chart at the bottom of this page shows how a slow, steady grind downward from the 2007 market high eventually gave way to a free-fall in stock prices between September 2008 and March 2009. The financial crisis was fully upon us.

For self-proclaimed 'long-term' investors who fled the stock market during the height of the storm, their actions likely indicated at least one of two existing conditions: a lack of appreciation for their 'true' risk tolerance, and an asset allocation that was inconsistent with their appetite for risk.

First let's look at the importance of asset allocation, or the blend of investment classes that an investor has chosen to spread their dollars among (e.g. stocks, bonds, and cash). Setting and managing your asset allocation is fundamental to controlling risk. True, if a person has accurately identified their attitude toward risk, their asset allocation should fall in line with this self-assessment. Still, even among people with a good handle on how much volatility they can stomach, it takes some knowledge and diligence to manage asset allocation over time and keep things in balance. Once a financial storm like the Great Recession hits, it's too late to find out your asset allocation isn't what you thought it was, exposing you to risk beyond your comfort level.

Now let's consider risk tolerance – the most important attribute investors must learn about themselves before committing dollars to risky assets like stocks and

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bonds. The crisis of 2008-09 revealed that many people maintained an asset allocation out of line with their true risk tolerance. Investors with excessive stock market exposure, relative to their real tolerance for risk, experienced the most pain. Some sold large portions of their stock investments at the market lows. It's not surprising that these investors were shaken out of the market, especially since we had been treated to such a long and prosperous run by stocks for nearly three decades. Over this period our 'metal' as buy-and-hold stock investors had largely gone untested, and it's a safe bet that many people now have a different view and understanding of risk than they had had prior to the Great Recession. The lesson bestowed upon us is to get in touch with and embrace our real tolerance for risk, and to do it now as the experience of our losses and reactions to the crisis are fresh in our minds.

How do we measure our risk tolerance? A great place to start is with a risk tolerance questionnaire available from many mutual fund company websites, such as Vanguard, T. Rowe Price, or Fidelity. If you work with a fee-only Financial Planner, such as Gover Financial Planning, you will complete a questionnaire and discuss it with your Advisor as part of any planning engagement. This discussion is a very effective way to dig deeper into your ideas and feelings about risk, and how your investments can be allocated accordingly to reach your goals. Given recent events, another very good measure of your risk tolerance may be determined by your answer to one question: How did you feel, and how did you respond during various stages of the financial crisis of 2008/09?

Take another look at the stock market chart on page 2. As the chart shows, the recovery off the March 2009 low has been remarkable to this point. Though we are nowhere near setting new stock market highs, the bounce off the bottom has been historic, climbing 60% in about 7 months. The steep slide in stocks, followed by a breathtaking

recovery, has 'stress tested' our emotions and risk thresholds. So, as a first measurement of your risk tolerance, ask yourself these questions with respect to your long-term investments:

Back *then*, during the sharp decline in stock prices through March, what did you do?

And *now*, as the market has recovered significantly, what have you done, or considered doing, with your stock investments?

If you reacted *then* by selling into the market slide, only to regret missing the ride back up, you are not alone. However, it's quite likely that your asset allocation did not match your risk tolerance. And if you are considering buying back into the market *now*, after a sizable recovery, I recommend that you first take steps to get in touch with your true tolerance for risk, and consider the timeframe of your savings goals.

Only by learning more about yourself, and how you are influenced by and respond to investment risk, will you be prepared for the next stock market move - up or down. -GG

"WE'RE HERE TO HELP"

GOVER FINANCIAL PLANNING CAN HELP YOU BETTER UNDERSTAND YOUR RISK TOLERANCE AND DEVELOP AN APPROPRIATE PERSONAL INVESTMENT POLICY. A GREAT FIRST STEP IS TO DOWNLOAD AND COMPLETE A RISK TOLERANCE QUESTIONNAIRE FROM THE CLIENT FORMS PAGE OF OUR WEBSITE, WWW.GOVERFINANCIALPLANNING.COM. THEN GIVE US A CALL TO SCHEDULE YOUR NO-OBLIGATION GET-ACQUAINTED MEETING, WHERE WE CAN DISCUSS YOUR RISK TOLERANCE OR ANY FINANCIAL PLANNING NEED.

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your paycheck deferrals. Don't forget, in most cases your salary deferrals are made on a 'pre-tax' basis, and you will reap a current income tax benefit from every dollar saved in your plan.

The rules for Roth IRA conversions are changing beginning in 2010. There will no longer be an income limit imposed on those who wish to convert from a traditional IRA to the Roth. And there are steps you can take now to increase the amount you would otherwise be able to convert beginning in 2010. The Roth IRA is a very attractive and flexible retirement savings vehicle. Even though contributions are made with 'after-tax' dollars (that is, dollars you've already been taxed on), future withdrawals, including earnings, after age 59 1/2 will be tax-free in most cases.

Federal Income Tax Savings

If you have investment losses in your taxable accounts (e.g. stocks, bonds, mutual funds), you may be able to reduce your 2009 federal income tax liability. With 'loss-harvesting', these investments can be sold to realize losses, which can then be used to offset capital gains realized during the same year. And even if you haven't realized any capital gains, your investment losses can still be used to offset tax liability on up to \$3000 of ordinary income. Care must be taken not to buy back the same or 'substantially identical' security within 30 days before or after the sale date, or the loss will be disallowed under the IRS 'wash sale' rule.

Another potential opportunity exists for taxpayers in the 10% and 15% tax brackets - harvesting capital gains. For 2009, the long term capital gains tax rate for these brackets is zero. This might be a good time to realize gains without incurring a tax liability.

Contrary to the wash sale rule, there is no restriction on immediately repurchasing the same security. So, an investor can sell now at zero tax cost, repurchase the security to establish a new higher cost basis, and incur lower tax liability on a future sale. Prior to executing any tax strategy, consult your Financial Planner or Income Tax professional to understand the impact on your unique situation. -LTW

IN YOUR INTEREST

Here are few noteworthy recommendations, reminders, and mentions from your Gover Financial Planning Advisor.

RECOMMENDED READING

"THE LITTLE BOOK OF MAIN STREET MONEY", BY JONATHAN CLEMENTS

If you've been a reader of the Wall Street Journal over the years, you're probably familiar with Jonathan Clements. He no longer writes as a personal finance columnist for the paper, which made me eager to read his new book. Clements has a gift for writing about personal finance matters in a clear, concise way that speaks to readers at all levels of experience. His "21 Simple Truths" hit the essential points of keeping investment costs low, saving for retirement, making your retirement income last, and many other practical aspects of managing your money. Clements' s advice on controlling investment risk through asset allocation is timely to our discussion of risk tolerance in this issue's *Advisor's Corner* column found on page 1.

REMINDERS

As a Registered Investment Advisor, Gover Financial Planning is required to offer clients a copy of our ADV-II form annually. For your convenience you may download a copy from our website, www.GoverFinancialPlanning.com. We would also be happy to mail a copy to you at your request.

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