



Paul R. Ried Financial Group, LLC
Security for your future

A MESSAGE FROM YOUR FINANCIAL TEAM

Second Quarter 2011

May 25, 2011

Dear Clients,

There has been no shortage of news events since our last letter in February. Nor has there been a shortage of opinions about how you should interpret these events. There was the earthquake/tsunami and resulting nuclear crisis in Japan, uprisings in the Middle East, an announcement of Bin Laden's death, as well as the continued escalation of debt issues both here and abroad.

Meanwhile, the market (as measured by the S&P 500) remains about where it was during our last letter, up approximately 6% for the year.

Anxious Complacency

The heading above is indeed an oxymoron. However, it is a very fitting description of current investor attitudes. While getting ready to write this letter, I came across a speech given by mutual fund manager, Steven Romick, at a recent investment conference. The excerpt below sums up the current situation quite well:

"...the pain of '08 seems to have been forgotten in '11, leaving anxious complacency in its place. An oxymoron though it may be, it won't be the first time that people act one way, despite feeling another. Some investors may prefer safety, but when faced with paltry cash yields, they quickly embrace riskier alternatives."

World events have certainly caused investor anxiety. However, the fact that markets continue to rise seems to put investors at ease.

Market trends and even short-term market movements have an amazing ability to shape perceptions. If markets rise in the face of increasing risks, it is easy to downplay the importance of those risks. Similarly, if markets fall sharply on a news event, it is easy to assign more importance to that event than you otherwise would have.

A market which rises month after month has an uncanny ability to lull investors into complacency. A market that falls month after month easily leads to panic. The more persistent the trend, the more amplified the emotions can become.

The Biggest Obstacle

Worldwide events and corporate earnings announcements dominate the press and most financial conversations. However, it is how investors deal with their emotions that is often the biggest obstacle to meeting their long-term goals.

Having emotional responses to a rising or falling market is not the problem; that is natural. It is the actions taken in response to those emotions that often cause problems. Actions that, in hindsight, lead to the time-tested mistake of buying high and selling low.

The damage investor emotions can cause is illustrated well by an annual DALBAR study of investor returns. This study looked at equity mutual fund investor returns over the last 20 years (January 1991 through December 2010). The results showed that while the S&P 500 averaged 9.1%, the average equity fund investor only earned 3.8% per year over the same period.**

Reducing Losses

For long-term investment success, reducing losses can be many times more important than maximizing gains in any given year. Please see the yearly returns for two hypothetical investors below.

	Year 1	Year 2	Year 3	Year 4	Avg. yearly return	Cumulative Return
Investor A	-50%	+100%	-20%	+25%	13.75%	0%
Investor B	-10%	+20%	-4%	+5%	2.75%	8.9%

Initial investment of \$10,000 by investor A at the start of year 1 would have resulted in an ending value of \$10,000 at the end of year 4. Initial investment of \$10,000 by investor B at the start of year 1 would have resulted in an ending value of \$10,886.40 at the end of year 4. The investment results are for illustrative purposes only and should not be deemed a representation of past or future results. Actual investment results may be more or less than those shown. Does not represent any specific product and/or service.

While these years were not particularly great for either investor, they do help illustrate the importance of reducing losses. Investor B probably felt like he was being left behind in year 2 but the reality is that he needed only an 11.1% gain to make up for his year 1 losses. Investor A, however, needed the full 100% to get back to where he started.

The example above illustrates, mathematically, the destructive nature of large losses. In addition, it should not be overlooked that Investor A was also exposed to a huge opportunity to make a bad situation worse. After all, had he abandoned his plan after year 1 and adopted Investor B's approach, he would have ended the four year period with a cumulative loss of 40%.

In Conclusion

There have been plenty of newsworthy events since our last letter. However, our key concerns of government debt, jobs and market valuations remain essentially unchanged. Therefore, we thought it was important to address the emotional side of investing. Emotions rarely remain unchanged, but have influence which is often overlooked. Successful investment strategies rely not only on navigating long-term economic trends, but also on the avoidance of emotional traps.

We are dedicated to assisting you in meeting your long-term goals and objectives. As always, we encourage your calls and e-mails.

Sincerely, Your Financial Team

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**Source: DALBAR, Inc., Quantitative Analysis of Investor Behavior, March 2011. This is an annual survey and data is through 2010. Index performance and the DALBAR study results shown are for illustrative purposes only and do not predict or depict the performance of any investment.