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Morgan Stanley Wealth Management

U P D A T E

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Focus on the Basics

How do you choose the right combination of investments to help you work toward a goal that may be decades away? The answer is to focus on the basics:

✔ **Don't wait — invest now.** To put the power of compounding to work for you, start investing now. It's easy to put off investing, thinking you'll have more money or time at some point in the future. Typically, however, you'll be better off saving less now than waiting and saving more later.

✔ **Live below your means so you can invest more.** The amount of money you have left over for investing is a direct result of your lifestyle. Don't have any money left over for investing? Ruthlessly cut your living expenses. Redirect all those reductions to investments. This should help significantly with your retirement.

✔ **Maintain reasonable return expectations.** When developing your financial goals, you'll typically decide how much you need, when you'll need the money, and how much you'll earn on those savings. Those factors will determine how much you'll need to save on an annual basis to reach your goals. The higher the expected return on your investments, the less you'll

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Your Emotions and Investing

The current bull market began in March 2009 and continues through today. While it has been a good market for investors, it also makes them nervous wondering when the market will turn. All investors know the market goes through cycles, but that doesn't make people any less concerned about their financial future. The key, however, is to avoid letting your emotions deter you from a solid investment strategy.

During any portion of a market cycle, an investor's emotions can lead to irrational decisions, as they could be on a high from a great bull run or in a panic when the bear enters. Both have the potential of negatively impacting investment performance.

So how do you control those emotions? You will never be able to eliminate your emotional responses to your investments, but you can hold on tight to a solid investment plan that looks at performance over the long term.

Having a plan based on your objectives and risk tolerance with an asset allocation and diversification that is aligned to your financial situation is key. Additionally, you will want to stress test your plan to understand how poor market conditions can affect it. Performance modeling can bring you peace of mind knowing you will be able to ride out a market decline, or it can also lead you to make adjustments to your plan to better meet your needs.

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

Focus

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need to save every year. However, if your assumed rate of return is significantly higher than your actual rate of return, you won't reach your goals. Thus, it's important to come up with reasonable return expectations. Assessing your progress every year will allow you to make adjustments along the way.

✔ **Understand that risk can't be totally avoided.** All investments are subject to different types of risk, which can affect an investment's return. Cash is primarily affected by purchasing-power risk, or the risk that its purchasing power will decrease due to inflation. Bonds are subject to interest-rate risk, or the risk that interest rates will rise and cause the bond's value to decrease; and default risk, or the risk that the issuer will not repay the bond. Stocks are primarily subject to non-market risk, or the risk that events specific to a company or its industry will adversely affect a stock's price; and market risk, or the risk that a stock will be affected by overall stock market movements. These risks make some investments more suitable for longer investment periods and others for shorter investment periods.

✔ **Diversify your portfolio.** Typically, you do not know which asset class will perform best on a year-to-year basis. Diversification is a defensive strategy — it helps protect your portfolio during market downturns and helps reduce volatility. Diversify your investment portfolio among a variety of investment categories.

✔ **Only invest in the stock market for the long term.** Stocks should only be considered by investors with an investment time frame of at least five years. Remaining in the market over the long term reduces the risk of receiving a lower return than expected.

✔ **Pay attention to taxes.** Taxes are probably your portfolio's largest expense. Using strategies that defer income for as long as possible can make a substantial difference in the ultimate size of your portfolio.

If you need help with investing, please call. ✔✔✔

The ABCs of Risk Premiums

Investing in the financial markets is inherently risky. There's never a guarantee you'll make a certain return on your investment or even that you'll get back what you put in. Of course, some investments are riskier than others, but they tend to offer potentially higher rates of return. That difference in expected return for riskier investments is called the risk premium. It's the investor's reward for taking greater risk.

To better understand risk premiums — what causes risk and why risk premiums are important — let's take a look at the anatomy of an investment's return, which has three components:

✔ **Inflation** — Inflation is the rate at which prices increase, typically hovering between 2% and 4%.

✔ **Risk-free rate of return** — A risk-free rate of return is the return on an extremely low-risk (so low it's termed risk free) investment. Typically, investors look at the short-term interest rate on a Treasury bill (T-bill) as a risk-free rate. Investors view the backing of the U.S. government and their short maturity as signs of the investment's stability and liquidity, in other words, low risk.

✔ **Risk premium** — The third component of an investment's return is the risk premium. On short-term T-bills, the risk premium is zero — those investments are considered risk free. But other investments, including stocks, have added elements of risk. A risk premium is the excess return of an investment that is greater than the risk-free rate of return.

Broadly, there are three reasons that some investments are more risky than others:

✔ Returns on stock investments can fluctuate, unlike predictable bond coupon payments.

✔ Corporate bond holders have the first claim to corporate earnings before stock holders, who have a residual claim.

✔ Stock returns tend to be more volatile.

Historically, bonds and cash equivalents tend to be less risky than stock investments. But even among stocks, risk premiums vary.

Understanding risk premiums is the first step in creating an asset allocation plan for your investments. To determine which assets to invest in, you'll have to determine the optimal risk-premium mix for you.

Some investors tolerate risk quite well, while others do not. You need to honestly assess your risk tolerance level, so you can determine the amount of risk that best suits your particular needs.

Please call to discuss the implications of risk premiums on your portfolio. ✔✔✔

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Assessing Your Risk Tolerance

While investors want the highest returns possible, returns compensate you for the risks you take — higher risks are generally rewarded with higher returns. Thus, you need to assess how much risk you are willing to take to obtain potentially higher returns. However, this can be a difficult task. It is one thing to theoretically answer questions about how you would react in different circumstances and quite another to actually watch your investments decrease significantly in value. What you are trying to assess is your emotional tolerance for risk, or how much price volatility you are comfortable with. Some questions that can help you gauge your risk tolerance include:

✔ **What long-term annual rate of return do you expect to earn on your investments?** Your answer will help determine the types of investments you need to choose to meet that target. Review historical rates of return as well as variations in those returns over a long time period to see if your estimates are reasonable. Expecting a high rate of return may mean you'll have to invest in asset classes you aren't comfortable with or that you may be tempted to sell frequently. A better alternative may be to lower your expectations and invest in assets you are comfortable owning.

✔ **What length of time are you investing for?** Some investments such as stocks should only be purchased for long time horizons. Using them for short-term purposes may increase the risk in your portfolio, since you may be forced to sell during a market downturn.

✔ **How long are you willing to sustain a loss before selling?** The market volatility of the past several years will give you some indication of how comfortable you are holding investments with losses.

✔ **What types of investment do you own now and how comfortable are you with those investments?** Make sure you understand the basics of any investments you own, including the historical rate of return, the largest one-year loss, and the risks the investment is subject to. If you don't understand an investment or are not comfortable owning it, you may be tempted to sell at an inopportune time. Over time, your comfort level with risk should increase as your understanding of how risk impacts different investments increases.

✔ **Have you reassessed your financial goals recently?** Due to the significant market volatility of the past few years, your financial plan may need to be revamped. Otherwise, you may find you won't have sufficient resources in the future to meet your goals. Based on your current investment values, determine what needs to be done to meet your financial goals. You may need to save more, change or eliminate some goals, or delay your retirement date.

✔ **Do you understand ways to reduce the risk in your portfolio?** While all investments are subject to risk, there are some risk-reduction strategies you should consider for your portfolio. These strategies include:

Diversify your portfolio. You should diversify among several different investment categories, including cash, bonds, and stocks, as well as within investment categories, such as owning several types of stocks.

Stay in the market through different cycles. Remaining in the market over the long term helps reduce the risk of receiving a lower return than expected, especially for more volatile investments, such as stocks.

Use dollar cost averaging to invest. Dollar cost averaging is a method of investing a certain sum of money in set amounts at regular intervals. This spreads your purchases over a period of time, keeping you from making one major purchase at high prices. Since you are investing a set amount, you purchase more shares when prices are lower and fewer shares when prices are higher. While a valuable investment strategy, dollar cost averaging does not ensure a profit or protect against losses in declining markets. Before starting a program, consider your ability to continue purchases during periods of low price levels. This strategy requires the discipline to invest consistently regardless of market prices and can help develop a habit of regular investing.

Please call if you'd like help assessing your risk tolerance. ✔✔✔

How to Know If You're Making Progress

One of the most rewarding parts of a financial plan is watching the progress you make toward your financial goals. Following are some simple steps you can take to ensure you are on track:

Review Your Goals — All of your goals should have a time frame and an attached dollar value so you'll know how much money you need to achieve that goal within a particular period of time. By reviewing your progress at regular intervals, you will be able to identify any gaps and can work to fill those gaps.

How's Your Cash Flow? — By keeping a close watch, you will be able to see if you need to increase your income or lower your expenses to put you on track to meet your goals.

Track Your Net Worth — To come up with your net worth, add up all your assets including property, investments, and cash, and subtract all your debt, including mortgages, credit cards, and personal loans. If you are not seeing progress, you need to take a step back and review your financial plan.

Peace of Mind — The most important thing a good financial plan can give you is peace of mind. If you feel confident that you have good cash flow, emergency savings, life insurance coverage, diversified investments, and a retirement plan, then the progress you are making is on track. If you are stressed and worried about your progress, this is a significant sign that you need to review and rework your financial plan. ✔✔✔

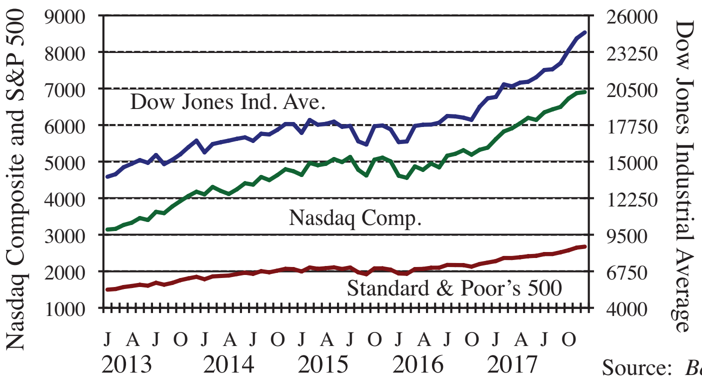
Market Data

	Month End			% Change	
Stocks:	**Dec 17**	**Nov 17**	**Oct 17**	**2017**	**2016**
Dow Jones Ind.	24719.22	24272.35	23377.24	25.1%	13.4%
S&P 500	2673.61	2647.58	2575.26	19.4	9.5
Nasdaq Comp.	6903.39	6873.97	6727.67	28.2	7.5
Wilshire 5000	27673.19	27433.82	26687.97	18.9	10.3
Precious Metals:					
Gold	1296.50	1280.20	1270.15	11.9	9.1
Silver	17.01	16.34	16.68	6.0	15.8
Interest Rates:	**Dec 17**	**Nov 17**	**Oct 17**	**Dec 16**	**Dec 15**
Prime rate	4.50	4.25	4.25	3.75	3.50
Money market rate	0.33	0.33	0.32	0.29	0.27
3-month T-bill rate	1.45	1.29	1.02	0.56	0.26
20-year T-bond rate	2.66	2.62	2.61	2.86	2.60
Dow Jones Corp.	3.13	3.11	3.08	3.17	3.43
Bond Buyer Muni	3.88	3.96	4.03	4.26	4.22

Sources: *Barron's, Wall Street Journal. An investor may not invest directly in an index.*

Stock Indices

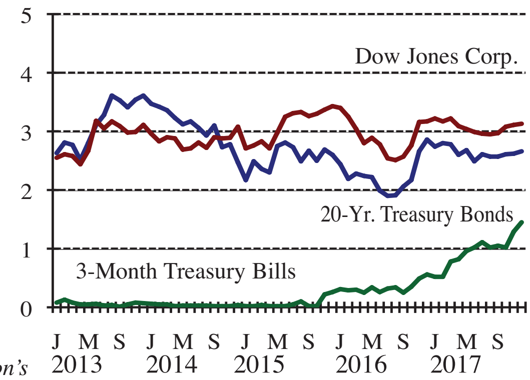
January 2013 to December 2017



Source: *Barron's*

Interest Rates

January 2013 to December 2017



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