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MORGAN STANLEY WEALTH MANAGEMENT

U P D A T E

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To Buy or Not to Buy

Whether you're investing for the first time or buying new stocks to augment your current portfolio, there are five important questions to ask yourself:

1. What's my objective? Is your ideal stock one that pays a high dividend or that doesn't pay dividends at all, but has a high rate of growth? Is it a stock with relatively little price volatility but likely lower gains, or one with a lot of potential risk and possibly higher rewards?

How you answer those questions — and the stocks you choose — depends on your objectives. If capital preservation is your goal, for example, a lower-risk stock is probably your best bet. On the other hand, if you're young and growth is your target, a higher-risk, potentially higher-return stock may be the right one for you. Whatever your objective, defining that goal is the first step to selecting stocks for your portfolio.

2. Is my portfolio diversified? When considering which stock to purchase, determine whether you need to target your investment in certain areas to balance out your diversification.

Diversification is the single most important factor in managing the risks of a stock portfolio. You should be sure your portfolio isn't concentrated in just one industry, but spread out over at least four or five. And there are other dimensions to consider as well: cap weighting

Continued on page 2

Growth vs. Value Investing

To gain a better understanding of growth and value investing, let's take a moment to discuss the differences between the two.

Growth Investing — Growth stocks are those that have seen impressive gains in recent years and have been proven to be leaders in their sectors. Generally, growth companies are those that have held a prominent place in the market for some time; but they may also be new, emerging growth companies that are bringing in large profits at the beginning of their business life. Growth stocks tend to be higher priced, more volatile, and have higher earnings than the rest of the market.

Value Investing — Another approach to buying and selling stocks is value investing. This involves looking for companies whose stock prices may not necessarily reflect their value. The idea is that by getting in on the ground floor or after a good company has experienced a serious setback, investors have a better chance of seeing an impressive return with value stocks. However, the market price for certain stocks that show promise may actually be accurate, in which case a large return will likely not materialize.

Because growth and value investing are so different from one another, there doesn't tend to be a lot of overlap. This is actually good for the investor, however, as it allows for both approaches to be utilized at the same time. Making use of growth investing *and* value investing can be an effective way to diversify your portfolio. ✔✔✔

To Buy or Not to Buy

continued from page 1

(large-, mid-, and small-cap), style (value or growth), and geography (U.S.-based, developed foreign markets, and emerging markets). The benefit of diversification is that the up and down movements of different asset subclasses are not completely correlated, so over time, losses in one industry or subclass may be offset by gains (or lesser losses) in another.

3. What's my expected holding period? If you're looking to speculate or trade for fast gains, your expected holding period is short. In that case, you need to be sure you are timing your purchase so you're getting in near the beginning of an upswing, not at the end.

However, if you are buying for the long term, the price you pay is less critical, as long as you don't purchase a stock in the early stages of a steep decline in value.

4. What's the prevailing market trend? In the 1990s, the market was so strong that almost any stock was likely to go up in value. But in a trendless or bear (declining) market, it's a lot harder to find a winner, at least in the short and intermediate terms. That's because the majority of stocks move in the same direction as the market, no matter how fundamentally strong a stock may be.

5. At the current price, would I be paying too much? To answer this question, you'll have to consider some basic fundamentals.

First, look at the stock's price/earnings (P/E) ratio, which is its price per share divided by earnings per share. How does it compare to the stock's normal range, and how does it compare to its direct competitors? If the P/E ratio is high, maybe the stock is overpriced. If it's low, it could either be a bargain or an indication of a fundamental weakness.

In addition to the P/E ratio, you should examine the stock's past and future earnings growth rate. Then look at its price/earnings to growth ratio (PEG ratio). The PEG ratio compares the stock's P/E ratio to its five-year projected earnings growth rate. A PEG ratio of 1 to 1.5 is typically considered normal. A PEG of 2.0 or higher is often a sign that a stock is overpriced, while a PEG below 1.0 may be an indication that the stock is a good bargain.

Please call if you'd like help reviewing your stock investments. ✔✔✔

Tactical Allocation and Market Timing

Your investment strategy should include a long-term plan for dividing your portfolio among the major asset classes: stocks, bonds, and cash. The term for this is strategic asset allocation, and it entails an annual review to bring your portfolio into alignment with your strategy. Over time, some asset classes perform better or worse than others, causing your actual holdings in each class to be larger and/or smaller than your strategy calls for.

You can resolve this discrepancy by selling off some assets that grew to be more than the plan calls for and use the proceeds to buy assets that became a smaller portion than they're supposed to be. In this way, you maintain your target risk level.

But there's another way to go about managing your portfolio that takes a different approach. It's called *tactical* asset allocation and involves making changes in your portfolio to take advantage of emerging up trends in one asset class and avoiding the damage a new down trend could cause in another asset class. If you're successful, you can achieve higher returns than by sticking with your strategic allocation plan.

Notice, however, the word "if." It's extremely difficult even for professional money managers to succeed in tactical asset allocation.

As most financial advisors tell their clients, the best portfolio returns are often achieved not by timing the market, but by how much time your money is in the market. Studies show that the biggest returns come in spurts over short periods of time.

The table below illustrates the benefits of remaining in the stock market and risks of being out of it, even for relatively short periods of time. It shows returns from a portfolio entirely invested in the Standard & Poor's 500 Index for all 5,038 trading days from the first day of 1997 through the end of 2016, compared to the returns that an investor would have if he/she had been out of the market for its 5, 10, 20, and 40 best days. The differences in returns are striking.

Average Annual Total Return: 1997–2016

Invested…	
All 5,038 days	7.68%
Minus 5 best days	5.49%
Minus 10 best days	4.00%
Minus 20 best days	1.57%
Minus 40 best days	-2.42%

Source: Index Fund Advisors, 2017

Need some help with your strategic asset allocation? Please call. ✔✔✔

Watch Out for Retirement Derailers

To make sure your retirement isn't derailed, consider these tips:

1. Start saving now. Because of the power of compounding, starting to save for retirement just a few years earlier can make a huge difference at the end.

2. Save now to spend later. This is where it's critical to make a budget for current expenditures, a retirement budget, and a plan to make retirement work. That plan may involve trimming current expenditures, scaling back retirement expectations, or both.

3. Prepare a retirement plan. Unless you plan to work until the day you die, a retirement plan should be an integral part of your overall financial plan. Think seriously about where you might want to spend your money before or during retirement and then build that into your retirement plan. Obviously unexpected circumstances do arise, but if you can anticipate your children or grandchildren might need help and are willing to help them, put that into your financial plan.

4. Review the implications of taking Social Security benefits before reaching full retirement age. For people who were near retirement age when the Great Recession hit and lost their jobs, taking Social Security at age 62 probably seemed like a far better idea than trying to get a new job at that age. But it's important to understand that while the government will let you start taking benefits at age 62, it will penalize you for it: for an individual born in 1960 or later who retires at age 62 instead of full retirement age, his/her monthly benefits will be reduced by 30%.

5. Have a candid conversation with your parents or other family members who may need care. Talk about how they'll want to be cared for and the means they have to pay for such care. Urge them to consider long-term-care insurance, which can greatly ease that financial burden.

If you have already been impacted by a retirement detailer — or any other circumstance that has impacted your retirement plans, here are five ways you can get back on track:

1. Take advantage of catch-up provisions. If you are 50 or older, you can contribute more tax-deferred income to a 401(k) or IRA (catch-up contributions). In 2018, you can contribute an extra $6,000 to a 401(k) or 403(b) plan and $1,000 more to an IRA.

2. See where you can trim expenses to save more. Boosting your savings to get back on track for retirement might be easier than you think: most of us spend more than we realize on discretionary things like meals out, clothing, travel, and other personal expenditures. Take a hard look at your budget and see where you can cut back — even $100 per month can make a difference in your retirement savings.

3. Evaluate your investment choices. Review your current asset allocation. Many individuals close to retirement pulled money out of the stock market during the financial crisis; and if you haven't since reassessed your asset allocation, you're probably missing out on significant investment opportunities as the equity market rebounds. That said, you want to ensure your asset allocation is appropriate (not too heavy in equities) given your age and target retirement date.

4. Reevaluate your retirement lifestyle. Most financial advisors recommend you be able to replace at least 70% of your preretirement income during retirement. If you planned to spend 85% of your current income in retirement, you might be able to scale back and still retire comfortably.

5. Work longer. When Social Security was created in 1935, the average American 65-year-old man could expect to live to age 78 and the average American woman to 80. Today, the average American 65-year-old man can expect to live to 84.3 and the average American 65-year-old woman to 86.6 (Source: Social Security Administration, 2017). In that context, working five more years might not be such a sacrifice — and it can make a big difference in the retirement lifestyle you can afford. For a 60-year-old who has a retirement account balance of $250,000 today and contributes $2,000 a year, pushing retirement back from age 65 to age 70 would yield an additional $158,410 in total savings (not counting Social Security) — adding $300 per month to his/her retirement income.

No matter where you are on the path to retirement, or whether you've been derailed or not, please call to discuss this in more detail. ✔✔✔

U P D A T E

Bonds and Interest Rate Changes

Basically, interest rate changes affect bond prices as follows:

✔ **Interest rates and bond prices move in opposite directions.** The price of a bond will decrease in value when interest rates rise and increase in value when interest rates fall. The price of an existing bond changes to provide the same return as an equivalent, newly issued bond at prevailing interest rates. If interest rates are higher than the rate on an existing bond, it becomes less valuable because of the lower interest payments, causing the price to decrease. Since you'll receive the full principal value at maturity, holding a bond until maturity eliminates the impact of interest rate changes.

✔ **Interest rate changes have a more dramatic effect on bonds with longer maturities.** Since long-term bonds have a longer stream of interest payments that don't match current interest rates, their price must change more to compensate for those interest rate changes.

✔ **Bond price changes are less significant for bonds with higher coupon rates.** Bonds with coupon interest rates near or above current interest rates will experience the least amount of price fluctuation.

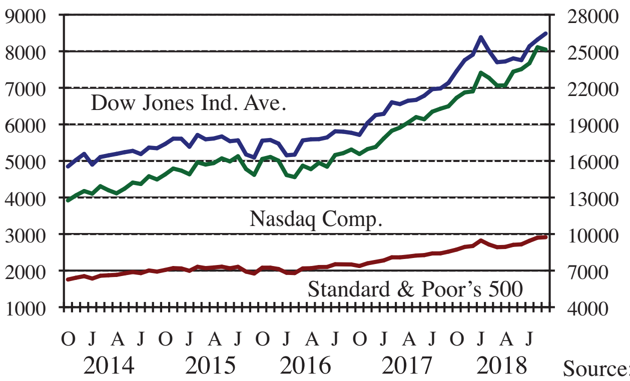
By understanding the effects of interest rate changes on bond prices, you can make more informed decisions regarding your bond portfolio. Please call if you'd like help with your bond portfolio. ✔✔✔

Market Data

	Month End			% Change	
Stocks:	**Sep 18**	**Aug 18**	**Jul 18**	**YTD**	**12 Mon.**
Dow Jones Ind.	26458.31	25964.82	25415.19	7.0%	18.1%
S&P 500	2913.98	2901.52	2816.29	9.0	15.7
Nasdaq Comp.	8046.35	8109.54	7671.79	16.6	23.9
Wilshire 5000	30189.60	30184.10	29230.11	9.1	15.5
Precious Metals:					
Gold	1187.25	1202.45	1220.95	-8.4	-7.5
Silver	14.69	14.54	15.59	-13.6	-12.4
Interest Rates:	**Sep 18**	**Aug 18**	**Jul 18**	**Dec 17**	**Sep 17**
Prime rate	5.25	5.00	5.00	4.50	4.25
Money market rate	0.47	0.45	0.49	0.33	0.27
3-month T-bill rate	2.18	2.08	2.00	1.45	1.05
20-year T-bond rate	3.13	2.91	2.92	2.66	2.57
Dow Jones Corp.	4.14	3.84	3.93	3.13	2.97
Bond Buyer Muni	4.14	4.02	4.01	3.88	4.04

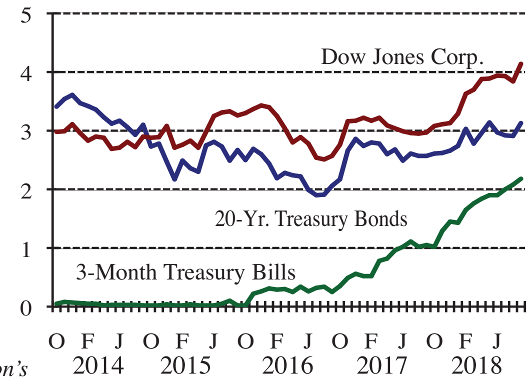
Sources: *Barron's, Wall Street Journal. An investor may not invest directly in an index.*

Stock Indices
October 2013 to September 2018



Source: *Barron's*

Interest Rates
October 2013 to September 2018



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