

# Dialogues » WEALTH STRATEGIES FOR DISCUSSION



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At Smith Barney, wealth management is defined by understanding you better—gaining deeper insight into your and your family's needs, goals and values. By looking at your whole financial picture, we can help you develop sound investment strategies. Let's continue working together to optimize your portfolio potential.

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## Looking Beyond Short-Term Volatility

Whether you get your news from the papers, television or the Internet, you know how quickly the financial markets can change. Some days are euphoric (a key economic report may bolster consumer confidence or a company reports better-than-expected earnings for the quarter, igniting market indexes). Other days, however, aren't as sunny—and some of them may be downright unnerving. So what are some of the possibilities when an inevitable downturn occurs in the market?

An important piece of advice to keep in mind during a market slide is one you've no doubt heard before: Do not overreact. Even though your instincts may be telling you to try to protect your investments by switching to a more conservative approach or to liquidate your positions in hopes of buying them back at lower prices when the worst is over (an approach known as "timing" the market), it's important to keep your emotions in check—and your eyes on the long-term horizon. History tells us that over the long run the stock market can be quite resilient. From wars to natural disasters to economic meltdowns, the market has seen it all—and over time has shown remarkable capacity to bounce back.

While it's not always easy to maintain long-term perspective, overreacting to events as they unfold may compound the damage—and you may end up selling at the bottom or missing part or all of a subsequent market recovery. To help protect against short-term volatility and the anxiety it may create, together, we can help develop a diversified investment plan that reflects your long-term goals and tolerance for risk. By reviewing the investment plan on a periodic basis, we can try to alter it as needs change. At Smith Barney, our primary focus is ensuring that your wealth continues to work hard for you day in and day out. ■

Past performance is no guarantee of future results. Diversification does not ensure against loss.  
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# Seven Strategies for Investing

## During Volatile Markets

» The markets don't always behave the way we'd like them to: Geopolitical turmoil, natural disasters, interest rates and world events can have a profound effect on market movements. If recent market volatility has you concerned about the economy, you are not alone; this is a confusing time for many investors. Some have decided to stay the course, while others are sitting on the sidelines waiting for the market to rebound. However, since no one can predict how the markets will perform, it's important to develop an investment strategy that can help you stay on the right track to meeting your long-term financial goals. Here are some strategies that you can implement that may help to manage risk during these uncertain times.

**Work with a Financial Advisor.** There are a lot of do-it-yourself investment resources available to investors today. However, none of those resources can replace the experienced, personal service we can provide. We can offer an understanding of your complete financial picture, not just your investments. Additionally, in periods of market volatility when you need the most support, we can provide:

- » Access to important decision-making research and information;
- » Ongoing monitoring of your investment portfolio, while anticipating your changing needs; and
- » A comprehensive market-volatility plan.

**Have a plan.** Developing a financial plan is one of the best ways to meet your long-term goals. Your plan should also include an action plan to address market volatility, which should be developed well in advance of a turbulent market. Having a market-volatility plan will help you to set realistic goals and appropriately manage your return expectations.

**Invest regularly.** It may not seem intuitive, but investing regularly—even during market downturns—can help to reduce your overall costs. Dollar cost averaging is one of the best ways to invest regularly, since you're investing a fixed amount on a fixed schedule, regardless of how the markets perform. Investing regularly can also have intrinsic benefits: It encourages discipline and may also ease the anxiety of daily market fluctuations.

**Diversify.** If you've ever heard the saying, "Don't put all your eggs in one basket," then you already have a basic understanding of diversification. Diversifying your portfolio can reduce risk and volatility if the assets have little or no correlation to each other.

Investing in mutual funds is one way to achieve portfolio diversification, since mutual funds are typically a diversified investment. There are also several other ways to diversify and potentially reduce portfolio volatility:

- » Within an asset category, such as purchasing different types of mutual funds;
- » Among asset categories, such as purchasing stocks and bonds; and
- » Outside the United States, since some markets move opposite to the U.S. stock market.

**Put volatility to work for you.** Do you think of the glass as half empty or half full? Your perspective can affect the investment decisions you make during market

downturns. Investors who view market volatility negatively can make irrational decisions. A down market can be an opportunity for you to build your portfolio and take advantage of lower unit costs.

**Stay invested.** You are probably anxious during times when the value of your investments has decreased. As a result, you may be tempted to move out of the market, sit on the sidelines and wait for the market to rebound. However, since no one knows how the markets will move, how do you know you're leaving at the right time? Also, how will you know when it is the right time to get off the sidelines and start investing again?

If you have worked with a Financial Advisor, your investment strategy was developed to help you meet your long-term goals. Timing the market could potentially jeopardize your financial plan—and your future goals.

**Be patient.** There will always be uncertainty in the markets; market volatility is a natural part of the investment cycle. Although it may take some time, markets do rebound.

In the meantime, call us to help you develop an action plan for market volatility and continue to focus on your long-term investment goals rather than short-term market moves. ■

Asset allocation and diversification strategies do not guarantee a profit or protect against loss.

A periodic investment plan such as dollar cost averaging does not assure a profit or protect against a loss.

International stocks are subject to certain risks of overseas investing including currency fluctuations and changes in political and economic conditions, which could result in significant market fluctuations. These risks are magnified in emerging markets.

**Mutual fund investments are subject to market risk, including the possible loss of principal. They are sold by prospectus only. The prospectus contains the investment objectives, risks, fees, charges and expenses, and other information regarding the mutual fund and variable annuity contract and its underlying investments, which should be carefully considered before investing. Prospectuses are available through your Financial Advisor or at [www.smithbarney.com](http://www.smithbarney.com). Read the prospectus carefully before you invest or send money.**

# Understanding Our Behavioral Blind Spots

## Making the Difficult Choices

» Investment decisions are among the most important life choices a person can make. They may determine where your children will be able to go to college, when you'll be able to retire, or what kind of lifestyle you'll enjoy after you retire.

Unfortunately, these are also some of the most difficult choices a person can make. In order to make sound decisions, we need to be aware of our own psychological blind spots. These can lead us to make persistently poor financial choices—errors that over time can do significant damage to our portfolios.

### CHAINS OF THOUGHT

Traditional financial theory assumes all investment decisions are made rationally, based on the best available information. In theory, the result is an efficient market—one in which prices accurately reflect fundamentals, such as earnings and interest rates.

However, it's not always easy to reconcile financial theory with financial reality. Investors often appear determined to ignore the fundamentals, both in bidding stock prices up and slamming them back down again.

"In many important ways, real financial markets do not resemble the ones we would imagine if we only read finance textbooks," notes Richard Thaler, a professor at the University of Chicago and a leading behavioral finance researcher.

It's not that investors are totally irrational, Thaler and other researchers argue, but rather that their thinking can be influenced by mental biases. These quirks can lead them to make choices that appear intuitively correct, but produce poor performance:

» **Overconfidence.** Investors generally assume they know more than they actually do. They also tend to remember previous investment decisions in ways that exaggerate their own foresight. This can lead to overly aggressive trading and a reluctance to admit—and correct—mistakes.

“Some studies have shown that the more investors know about the investment process, the less likely they are to be misled by behavioral biases.”

» **Mental Accounting.** Financial experts often advise investors to take their entire portfolio into account when making investment decisions. Yet, many investors unconsciously divide their wealth into separate pots. If they have a big gain, for example, they may think of it as essentially “free” money and take greater risks with it than they would with their “own” money.

» **Anchoring.** Logically, investors should always base their decisions on current prices and expectations. Instead, they often become fixed on past events, such as the price they paid for a particular stock. Investors will often refuse to sell at a price lower than that—even when it makes more sense to accept their loss and invest their remaining money elsewhere.

» **Framing.** How people view a decision often depends on how their choices are presented. For example, in one study researchers asked participants how much they would be willing to pay to avoid a one-in-a-thousand chance of being killed.

The average answer was \$1,000.

Participants were then asked how much they would demand to accept the same risk. This time, the answers ranged as high as \$200,000. From an economic point of view, the two questions were identical, but subjects saw them very differently.

» **Loss Aversion.** In a completely rational market, the risk of loss and the possibility of gain should carry equal weight. However, on average investors place twice as much importance on avoiding a loss as they do on making a gain. In other words, to accept a 50% chance of losing \$100, most people will demand at least a 50% chance of earning \$200.

### THE VALUE OF ADVICE

Are investors doomed to repeat these mistakes? Maybe not. Some studies have shown that the more investors know about the investment process, the less likely they are to be misled by behavioral biases.

This is one reason we encourage investors to develop prudent, long-term investment strategies that take into account their goals and tolerance for risk. While this doesn't guarantee investment success, it can at least reduce the risk of being led astray by behavioral blind spots. That's something even the smartest investor might want to keep in mind. ■

# Did You Know? A Little Lesson On A Big Topic—Asset Allocation

» Asset allocation is the process of distributing funds among various investment instruments or asset classes for the purpose of managing risk. Done properly, asset allocation enhances the likelihood of achieving desired investment returns with the least amount of risk. It accomplishes this by reducing the exposure to losses caused by a decline in the value of one or more of a portfolio's components.

Distributing funds among several asset classes that have dissimilar expected return and risk characteristics increases the probability that a portfolio's components will complement one another, thereby improving overall risk-adjusted returns. Diversification does not ensure against loss. There may be additional risks associated with international investing involving foreign economic, political, monetary and/or legal factors. International investing may not be for everyone. These risks may be magnified in emerging markets.

As the world of investing has grown larger and more complex, so too have the number of asset classes and investment styles. But complexity has its price as the expansion of investment choices has given rise to a host of labels to describe various asset and style options. Here are some common categories as defined by Smith Barney's Portfolio Management Group. ■

<p><b>Growth Style</b></p> <p>Growth stocks tend to have prices that are high relative to earnings, dividends or book value. Earnings growth projections tend to be higher than the market average.</p>		<p><b>Value Style</b></p> <p>Value stocks tend to have prices that are low relative to earnings, dividends or assets. Earnings growth tends to be relatively modest and often is influenced by short-term economic fluctuations.</p>	
<p><b>International Markets</b></p> <p>International markets tend to be those of more mature, industrialized countries of Europe, as well as Japan, Australia and New Zealand.</p>	<p><b>Emerging Markets</b></p> <p>Emerging markets comprise the developing economies of South-east Asia, Latin America, Africa and Eastern Europe.</p>	<p><b>Fixed Income</b></p> <p>Fixed Income includes the universe of securities that pay a regular stream of interest income such as corporate bonds, Treasuries, mortgage securities and foreign bonds, as well as hybrid securities such as convertible bonds.</p>	
<p><b>Large Cap</b></p> <p>Market capitalization is calculated by multiplying the number of outstanding company shares by the stock price. Large-cap stocks have a market capitalization of \$5 billion or more.</p>	<p><b>Mid Cap</b></p> <p>Mid-cap stocks are those with a market capitalization of more than \$1 billion but less than \$5 billion.</p>	<p><b>Small Capitalization</b></p> <p>The small-cap market securities consist of stocks with a market capitalization of less than \$1 billion.</p>	<p><b>Micro Capitalization</b></p> <p>Micro-cap stocks are those small-cap stocks that have an approximate market capitalization between \$50 million and \$300 million. Market-cap below this threshold is often called Nano-Cap.</p>

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