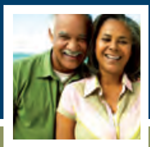

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THE AMERICAN INVESTOR

A SOPHISTICATED APPROACH TO BUILDING WEALTH

Reynolds and Associates
12345 Anywhere Street
San Diego, CA 92127
858-592-6262

Mark Reynolds
CPA, Director

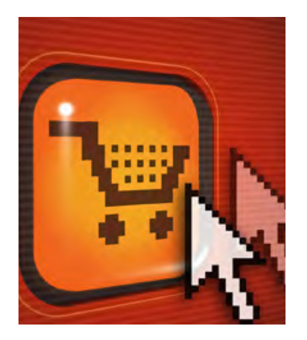
BIG PICTURE

How Much Investment Risk Can You Take?

Investors should consider two different aspects of risk tolerance when determining an appropriate level of portfolio risk: their personal financial circumstances and psychological tendencies.

E-Commerce Update

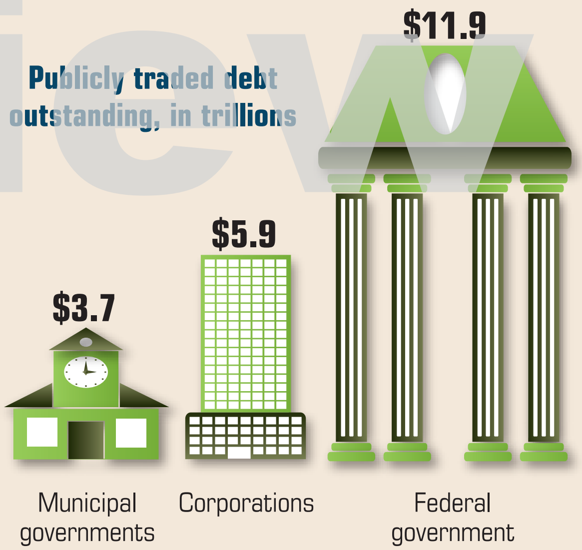
Online U.S. retail sales are projected to rise from $262 billion in 2013 to $370 billion by 2017, with sales growth exceeding that of "brick and mortar" retail stores.



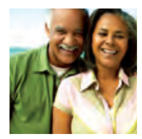
Source: *The Wall Street Journal*, June 16, 2013

Big-Time Borrowers

The value of the total U.S. bond market surpassed $21.7 trillion in 2013.



Source: Federal Reserve, 2013 (Q1 data)



Troubled Detroit Draws Attention to Muni Bonds

Weighing the Risks and Potential Rewards

In July 2013, Detroit officials filed the largest public-sector bankruptcy in U.S. history, requesting to restructure $18 billion in debt.[1] The filing followed a June announcement that the city would stop making payments on about $2 billion in debt, and a proposal to treat some general-obligation (G.O.) bonds as unsecured debt, offering creditors only about ten cents on the dollar.[2–3]

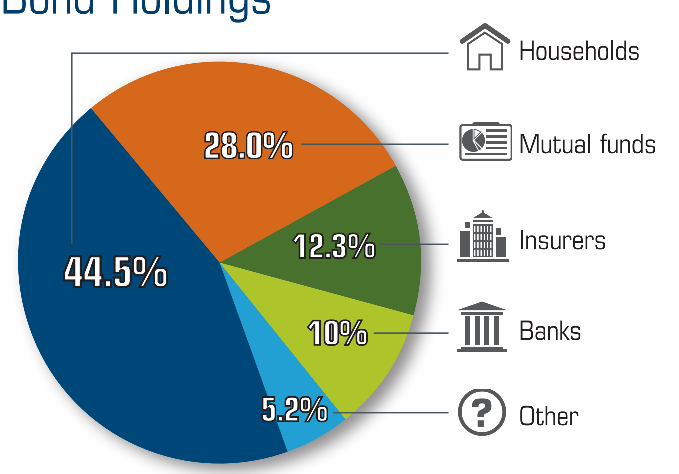
Detroit's economic problems and the resulting budget shortfalls are so serious that the beleaguered city can no longer meet its debt and pension obligations. Though not entirely unexpected, the news out of Detroit unsettled the municipal bond market and raised concerns about the precedents it could set for other struggling cities.[4]

However, Detroit represents a small part (0.05%) of the $3.7 trillion muni market.[5–6] Because municipal bond income is generally exempt from federal taxes, carefully selected muni investments could still be a key component in the diversified portfolios of investors who are relatively conservative and/or earn high incomes.

Revisiting Credit Risk

Muni bonds have generally been considered higher-quality assets because governments have the power to raise taxes and fees to pay the principal and interest. Detroit officials have argued that they shouldn't prioritize payments to investors over other creditors, including city employees and retirees, because taxes have reached the state-mandated limit.

Investors' Share of Municipal Bond Holdings



Source: National Association of Insurance Commissioners, 2013

Investors have long assumed that G.O. bonds have seniority over other obligations, so if Detroit's position prevails, it may change the risk perception of some types of municipal bonds and increase borrowing costs for many cities and counties.[7]

Detroit's woes aside, the municipal bond market has experienced few defaults and is still highly rated. According to Moody's, the five-year default rate is about 0.03%, and 93% of municipal bond issuers are rated single A or higher.[8–9]

Fund Exposure

Mutual fund companies generally had little exposure to uninsured Detroit bonds ($2.5 billion or just 0.003% of their muni bond holdings). The city's struggles were well known and many fund managers had time to adjust their portfolios.[10] In fact, owning bonds in mutual funds could make it easier to attain geographic and credit diversification. Diversification is a method used to help manage investment risk; it does not guarantee against investment loss.

Credit jitters may create opportunities for buy-and-hold investors, especially if the tax-adjusted yields of highly rated muni bonds compare favorably to taxable investment-grade corporate securities, which have higher default rates.[11] Of course, investments seeking to achieve higher yields tend to involve a higher degree of risk.

The return and principal value of bonds and mutual fund shares fluctuate with changes in market conditions. Mutual fund shares, when sold, and bonds redeemed prior to maturity may be worth more or less than their original cost. Bond funds are subject to the same inflation, interest-rate, and credit risks associated with their underlying bonds. As interest rates rise, bond prices typically fall, which can adversely affect a bond fund's performance.

Interest rates could rise as the economy improves, so you might want to keep in mind that bond funds with shorter durations are typically less sensitive to interest-rate movements.

Mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

1–2) CNNMoney, July 18, 2013
3–5, 8) CNNMoney, August 19, 2013
6–7) *InvestmentNews*, July 19, 2013
9) *Barron's*, May 7, 2013
10) Associated Press, August 3, 2013
11) *The Wall Street Journal*, August 28, 2013

How Much Investment Risk Can You Take?

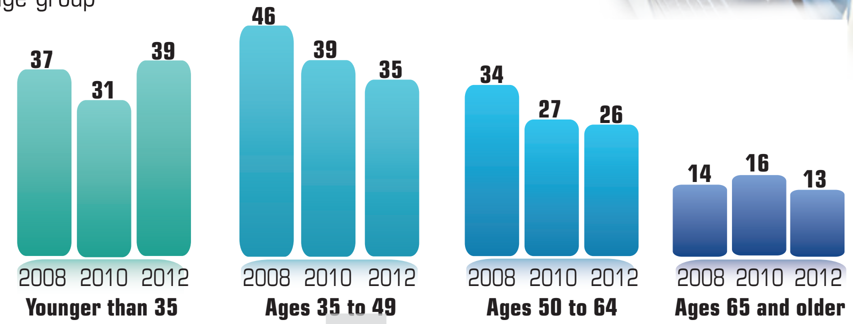
Consider Both Sides of Your Risk-Tolerance Story

It took several years for the risk tolerance of young U.S. investors to return to levels reported before the 2008 financial crisis. In 2012, 39% of mutual fund–owning households younger than 35 said they were willing to take above-average or substantial financial risk in order to achieve potentially higher investment returns, up from a low of 31% in 2010 and slightly higher than the 37% level seen in 2008 (see chart).[1]

Risk tolerance varies widely from person to person. Moreover, an investor's attitude toward and willingness to assume risk can change over time, with experience, and with age. Investments seeking to achieve higher returns often involve a higher degree of risk.

Age and the Appetite for Risk

Percentage of mutual fund–owning households willing to assume above-average or substantial investment risk, by age group



Source: Investment Company Institute, 2012

Fundamentals First

Assessing risk usually starts with your time horizon — the length of time before you will need to tap your investment assets. The more time you have to keep the money invested, the more likely it is that your portfolio can withstand the volatility associated with riskier investments. An aggressive risk tolerance may be appropriate if you're investing for retirement that is many years away. However, when investing for a teenager's upcoming college education, a conservative risk tolerance may be more appropriate.

In addition to the time horizon, your age, health, job security, earnings potential, net worth, and financial goals are factors that can influence your tolerance for risk.

Why Feelings Count

The second aspect of risk tolerance is harder to measure because it has to do with your personality and behavioral tendencies. Some people seem to be born risk-takers, whereas others might try to avoid risky moves whenever possible. Complicating the matter is the fact that investors who occasionally describe themselves as conservative or aggressive may act differently when tested by real events.[2]

Investment experience and knowledge can also come into play. Some people may be more fearful of market forces, whereas investors who have experienced the cyclical and ever-changing nature of the economy and investment performance may be more comfortable with short-term market swings.

It's important to consider how you might feel and respond if your portfolio were to decline in value. Aligning the risk level of your investments with your overall tolerance for risk may help you avoid overreacting to unsettling news or other temporary events. Abandoning a sound investment strategy in the heat of the moment could be detrimental to your portfolio's long-term performance.

A Pragmatic Approach

You might also want to consider whether you really need to assume investment risk. For example, older retirees who have sufficient income and assets to cover expenses for the rest of their lives may not need to expose their life savings to considerable risk. On the other hand, workers who are risk-averse may need to invest their retirement savings more aggressively to accumulate sufficient assets for retirement and offset another risk: that inflation could erode the purchasing power of their assets over the long term.

The return and principal value of mutual funds fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost.

Mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

1) Investment Company Institute, 2012
2) *Financial Advisor*, July 26, 2013

Overcoming Cloud Confusion

Cutting-Edge Tech Tools Could Help Small Firms Thrive

According to a recent survey, only 28% of small-business owners completely understand the concept of "cloud" computing, while 27% admit they don't understand it well or at all.[1–2]

For business purposes, the "cloud" refers to the delivery of on-demand computing resources over the Internet. Instead of buying, installing, and maintaining hardware, software, and servers, companies may be able to utilize a service provider's cloud technology tools more simply and at a lower cost.

Small-business owners with limited technology budgets may find that handling at least some of their computer processes in the cloud could save them time and money. However, the costs, benefits, potential risks, and contractual obligations should be weighed carefully before committing to cloud services.

Cloud-Based Options

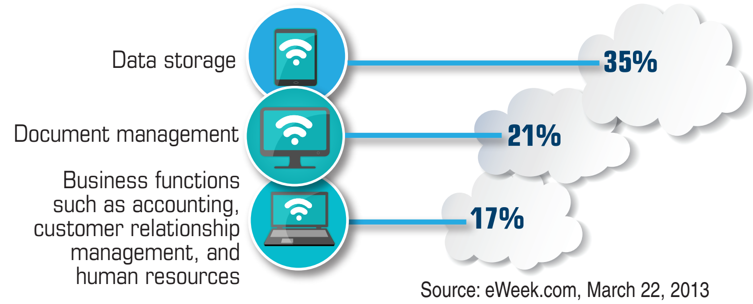
Three types of cloud-based services are available to businesses. **Software as a Service (Saas)** is when a business rents or borrows online software. **Platform as a Service (PaaS)** allows companies to build and deliver custom applications for their own commercial purposes. Lastly, **Infrastructure as a Service (IaaS)** involves the utilization of servers, networking, storage, data centers, and other computing capabilities on a pay-per-use basis.

Pros and Cons

- Using cloud services allows businesses to scale IT infrastructure up or down quickly to help meet business demands and facilitate growth.

Working in the Cloud

Share of small-business owners using cloud computing services for:



Source: eWeek.com, March 22, 2013

- Cloud applications can make it easier and less expensive for small businesses to keep their technological capabilities up-to-date and take advantage of cutting-edge features.
- Owners and employees can access company files using any device from any location with an Internet connection.
- For disaster planning and business continuation purposes, companies can choose to back up some or all of their data operations in the cloud instead of paying for off-site hardware and storage.

Of course, there are also a few pitfalls to consider. Users must have access to a speedy and reliable Internet connection. As of yet, universal standards for cloud computing have not been established, and some businesses may have intellectual property and/or data security concerns.[3]

1) eWeek.com, March 22, 2013
2–3) PCMag.com, June 4, 2013, and March 13, 2013

The beginning of the year is a good time to review your portfolio and set new financial goals. We can help you select a mix of investments that pursue the highest potential return for your risk profile.

Mark Reynolds