PDM Investment Services
An Independent Registered Investment Advisor

Investor Goals

January 2018

Investor Education

Investor Education is Critical to reach your Financial Goals
Wealth gives you Freedom and Control of your Life

Setup an Auto-Investment Plan to Invest on a Regular Basis in Bull and Bear Markets
Create a Diversified Portfolio with the Proper Asset Allocation
Purchase Quality Investments
Manage your Portfolio Properly

PDM Investment Services, LLC
A Registered Investment Advisor

5131 Standish Drive, Troy, Michigan 48085
1-248-890-4696 * www.fginvestor.com * info@fginvestor.com

Index

Goals

Define your investment goals. (Retirement, College, Home)

Time Horizon

When will you need to spend the investment portfolio? The time horizon will help determine the risk level you can take.

How do you envision your ideal retirement? What is most important to you about your financial future? Why should you follow your investment plan? Common answers include freedom, security, flexibility, reduced stress, peace of mind, travel, family time,time with hobbies.

Employ a GROWTH strategy with a MODERATE risk. (Base Allocation: 75% Stocks / 25% Bonds & Cash)

How much will you need to save for retirement to maintain your standard of living? The Wealth-to-Income Ratio says you should have saved 10 times your working average annual income by the time you retire. If your average annual income is $130,000 over the next 15 years, you can retire comfortably with $1,300,000 or $4,500 per month after taxes of total income including Investment Income + Social Security + Pension. <u>Assumptions: 20% tax rate and 5% annual investment return in retirement.</u>

Risk tolerance is the amount of price volatility and investment loss you are willing to withstand before changing your behavior. Risk comes in the form of market risk, security risk, financial risk, valuation risk, economic risk, currency risk, political risk, interest rate risk, inflation risk and liquidity risk. Most investors are not trained to tell an advisor their risk tolerance. At market tops, most people will say their risk tolerance is high. At market bottoms they will say they have no tolerance for risk. The longer your time horizon, the higher the risk you can take. Volatility is only a problem if you sell. There is long-term risk in not owning equities. Consider your need to take risk to reach your goals. <u>How did you react in the past bear markets and corrections?</u>

<u>Achieving goals based on a long-term plan is more important than benchmark beating returns each year. In order to participate in bull market gains, you must also endure the risk of corrections and bear markets. Without some risk, reward will likely by small.</u>

- If you have a large pension, you may be able to take on more investment risk.
- If your job earned income is very stable into your sixties, you may be able to take on more risk.
- If the investment will be passed on to heirs, you may be able to take on their level of risk.
- If you have no debt, you may be able to take on more risk.
- The more you understand the markets, the more likely you will be comfortable with more risk.

Select a portfolio type based on your goals, risk tolerance and time horizon from the table below.

Portfolio Asset Allocation & Risk Table

Fidelity Asset Manager Funds	40% FFANX	50% FASMX	60% FSANX	70% FASGX	85% FAMRX	100% PREIX
Risk Category	INCOME	CONSERVATIVE	MODERATE CONSERVATIVE	MODERATE	MODERATE AGGRESSIVE	AGGRESSIVE
Fund % Stocks / % Bonds & Cash	40% / 60%	50% / 50%	60% / 40%	75% / 25%	80% / 20%	100% / 0%
Risk Description	Low	Low	Medium	Medium	High	High
Beta, Standard Deviation (5 / 10 year)	B=0.8 / x, SD=5 / x	B=0.9 / 1.0, SD=6 / 10	B=1.0 / x, SD=7 / x	B=1.2 / 1.3, SD=8 / 13	B=1.4 / 1.5, SD=10 / 15	B=1.0 / 1.0, SD=10 / 15
Time Horizon	0 years	0 years	5 years	10 years	15 years	20 years
Annual Return (Past 5 / 10 years)	6.4% / x	7.2% / 4.9%	8.2% / x	9.0% / 5.0%	10.4% / 5.1%	14.4% / 6.7%
Best Year Return (Past 10 years)	26%	31%	33%	36%	39%	32%
Worst Year Return (Past 10 years)	-23%	-28%	-30%	-35%	-39%	-37%

The Risk Category, Risk Description and Time Horizon are defined by PDM Investment Services. The other numbers are from Morningstar ending December 2016. Beta is volatility relative to the S&P 500 of 1.0 and Standard Deviation is return variation from the mean. Past returns are used for comparison between risk categories only. Future returns may be significantly different and are not guaranteed in the future.

Types of Risk

Market Risk
The price of a security, bond, or mutual fund may drop in reaction to tangible and intangible events and conditions. This type of risk is caused by external factors independent of a security's particular underlying circumstances. For example, political, economic and social conditions may trigger market events.

Security Risk
These risks are associated with a particular industry or a particular company within an industry. For example, oil-drilling companies depend on finding oil and then refining it, a lengthy process, before they can generate a profit. They carry a higher risk of profitability than an electric company, which generates its income from a steady stream of customers who buy electricity no matter what the economic environment is like. The company growth rate can fall due to competition or pricing pressures. Integrity risk can also be a factor. A security that uses leverage can be risky.
Companies that use future proceeds from investments may have to be reinvested at a potentially lower rate of return (i.e. interest rate). This primarily relates to fixed income securities.

Financial Risk
Excessive borrowing to finance a business's operations increases risk to profitability, because the company must meet the terms of its obligations in good times and bad. During periods of financial stress, the inability to meet loan obligations may result in a declining market value and even bankruptcy. This can affect the price of particular stocks, or even the broader stock market. Companies with low credit ratings have the highest risk.

Valuation Risk
When a stock price rises faster than its growth rate the stock becomes overvalued. Speculation and psychological pressures can cause a stock to rise and fall dramatically.

Economic Risk
Slow economic growth and a recession can cause a company's growth and profits to slow. Cyclical companies get hit harder than growth companies.

Currency Risk
Overseas investments are subject to fluctuations in the value of the dollar against the currency of the investment's originating country. This is also referred to as exchange rate risk. If an investor in the U.S. invests overseas in a company that its currency is falling relative the stronger US dollar, the investor loses the currency change.

Political Risk
A political up rise in one country can affect many countries. Examples of political risk are wars, currency devaluations and leadership changes that affect trade. A Financial Crisis, Credit Crisis or Debt Crisis can cause investors in markets around the world to react.

Interest Rate Risk
Fluctuations in interest rates may cause investment prices to fluctuate. For example, when interest rates rise, yields on longer duration bonds and high-dividend stocks become less attractive, causing their market values to decline.

Inflation Risk
When any type of inflation is present, a dollar next year will not buy as much as a dollar today, because purchasing power is eroding at the rate of inflation. A disruption in world oil supply can cause energy prices to rise which in turn cause inflation to rise.

Liquidity Risk
Liquidity is the ability to readily convert an investment into cash. For example, Treasury Bills are highly liquid, while real estate properties are not. Under periods of extreme market duress, liquidity of most investments may be significantly reduced.

Risk Tolerance Level

Risk tolerance is the amount of price volatility and investment loss you are willing to withstand before changing your behavior. Your risk tolerance will change depending on market conditions. At market bottoms people focus more on low risk tolerance. At market tops people focus more on a high-risk tolerance. After the fact, we inevitably make it appear as though the past was more certain than it actually seemed at the time. The present time will usually appear to be far riskier. Perception of risk has a profound impact on how investors manage their portfolios.

Below is a list of questions to ask yourself to determine your risk tolerance level.

	Higher Risk Tolerance
• Amount of liquid assets like bank and money market accounts.	Low amounts of cash
• Amount of non-liquid assets like stocks and mutual funds	High amounts of stocks
• Are you self-employed?	Are self-employed
• What is your annual income level?	Higher incomes
• How predictable are your income sources?	High income predictability
• How much do you save annually?	Higher savings rates
• Years until retirement	Higher number of years
• Age	Lower age
• Education	Higher education level
• Household size	Smaller household size
• Marital status	Married couple or single male
• Occupation	Professional or management
• Debt level	Have a mortgage
• Investment knowledge	Higher investment education
• What is your attitude toward stock market price fluctuations?	Concern when market falls over 25%
• Are you willing to take higher risk for potentially higher returns?	Willing to take higher risk for higher returns
• What would you do if the market is down 40% and sentiment is at 40-year lows?	Buy more stocks
• Would you raise cash, hold or buy stocks after a bear market loss of 25%?	Buy more stocks
• In a bull market rising 60%, what gains would be acceptable?	60% or more
• Do you expect your investments to perform at a higher rate than inflation?	Expect higher than inflation

Risk Analysis

In order to be a successful investor you must learn to assess risk and bear it for profits.
You cannot predict risk, only prepare for it when it comes.
The more skilled you are at assessing risk, the more risk you can manage successfully.
Perception of risk has a profound impact on how investors manage their portfolios.
The best performing strategies often incurred lower rather than higher risk.
In newsletter recommended portfolios, higher risk lead to slightly lower returns.

The Definition of Risk

- Risk of permanent capital loss over a defined period
- Risk of volatility (Beta and standard deviation)
- Risk of underperformance to a benchmark
- Risk of falling short of goal to meet income demands

Economic cycle ups and downs will always exist because of human nature, fear and greed.
Investors will overvalue the market in good times and undervalue the market in bad times, like a pendulum.
The only problem is you never know how far the pendulum will swing each way.

At market tops:
Extreme optimism, greed, risk-on, high valuations and a focus on high absolute return (1999, 2007)

At market bottoms:
Extreme pessimism, fear, risk-off, low valuations and a focus on risk-adjusted return (2002, 2009)

The goal is to capture the upside and limit the downside of the market. A manager adds value by outperforming the market with less risk.

Risk Variables

Risk comes from the market, portfolio allocation and individual securities.
Black swans with low probability cannot be predicted.
Risk is uncovered in down markets.
Macroeconomic (risk rises as the economic/credit cycle ages)
Valuation (risk rises as the PE ratio’s rises)
Psychology (asset bubbles can form from extreme optimism raising risk)
Financial risk
Currency risk
Geopolitical risk
Liquidity risk

Risk Control

Skillful risk control is the mark of the superior investor.
Assess the risks and evaluate the probability of each risk.

Risk Measurement

The risk level of a portfolio or investment can be measured using the metrics listed below.
The metrics should be compared to the S&P 500, appropriate risk benchmark and long-term averages.

- Beta – Volatility relative to the S&P 500. A beta of 1.0 would mean the investment tracked the market.
- Standard Deviation – Variability from its mean. See the bell curve distribution and outliers.
- Sharpe Ratio – Risk adjusted return. Looks at performance and risk level together relative to benchmark.
- Consistency – Portfolios that outperform their benchmark most of the years are more consistent and typically less risky.
- Drawdown – The periods with the most negative returns. Compare to your appropriate benchmark.
- Correlation – How close the investment follows the benchmark or stock market? R-squared.
- Valuation – Price-to-earnings ratio. Valuations higher than the mean indicate more present risk.
- Diversification – Typically the more diversified and more holdings in a portfolio the closer it will track the general market.
- Internal – The internal makeup of the portfolio can help determine the risk. Look for large positions in risky investments. Look at the % in cash, bonds and alternatives.