Investor Insights & Outlook

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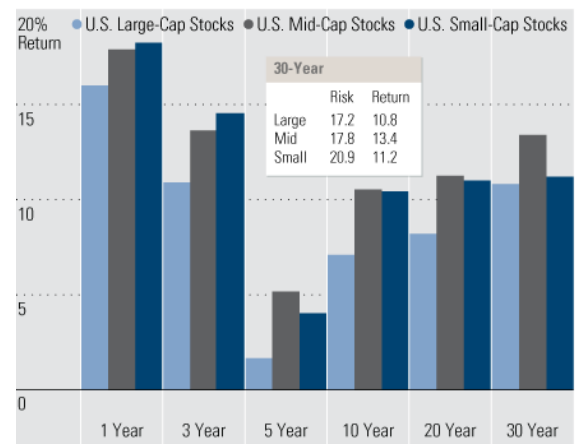
A Quick Look at Mid-Cap Stocks

Investors often hear about large- and small-cap stocks, but what about mid-caps? A quick look at large-, mid-, and small-cap stock performance over various time periods shows that investors may want to consider U.S. mid-cap stocks for their portfolio.

Mid-cap stocks offered the highest compound annual returns in four out of the six time periods analyzed, and were relatively close (in terms of return) with small stocks in two other time periods. In terms of risk, the data shows that mid-cap stocks had a 30-year annualized risk of 17.8%, which was lower than the 20.9% risk of small stocks and only slightly higher than the 17.2% risk of large stocks.

Talk to your financial advisor to see if there is potentially a place for mid-cap stocks in your portfolio allocation.

Annualized Stock Performance as of December 2012



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Diversification does not eliminate the risk of experiencing investment losses. U.S. large stocks are represented by the Standard and Poor's 500®, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general, U.S. mid-cap stocks by the S&P MidCap 400®, and U.S. small stocks by the Ibbotson® Small Company Stock Index. Returns and principal invested in stocks are not guaranteed. Furthermore, small stocks are more volatile than large stocks and are subject to significant price fluctuations, business risks, and are thinly traded. Risk and return are measured by standard deviation and compound annual return, respectively. Standard deviation measures the fluctuation of returns around the arithmetic average return of the investment. The higher the standard deviation, the greater the variability (and thus risk) of the investment returns.

Advisor Corner

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Bill Roller is experienced in financial planning and investment analysis. He focuses his consulting practice on estate, retirement, and financial planning for businesses and individuals. Bill started BR Capital Inc. in 2003 and registered it as an investment advisory firm in June, 2004. Before that he worked for a large Wall Street firm for over nine years. He served for seven years as a U.S. Army officer in Infantry and Special Forces (Green Beret) units. Bill is a Chartered Financial Analyst as well as a Certified Financial Planner. He is the past president of the Estate Planning Council of Southwest Washington. He earned a Bachelor of Science degree from the United States Military Academy at West Point in 1982, and a MBA from the Wharton School of Business in 1991. He provides the morning and afternoon market reports and financial commentary for AM 1360 KUIK. A link to Bill's articles and interviews is available at http://brcapitalinc.com. To subscribe to articles and daily market updates go to http://brcapitalinc.com/subscribe/

Three Reasons to Add ETFs to Your Portfolio

Innovative offerings in equities, fixed income and alternatives have made ETFs one of the fastest-growing investment vehicles in the financial industry. ETFs are a popular investment choice among both active and passive investors because of their flexibility to trade like a stock and diversification similar to a fund, allowing investors to use ETFs for both long-term strategic asset allocation and short-term tactical allocation. Here are three ways how ETFs may be used in a portfolio.

Better diversification: ETFs may be used to construct a diversified portfolio from the ground up because they allow for potentially low-cost diversification that may be suitable for a client's investment objectives, risk profile and time horizon. A core-satellite portfolio approach allows investors to create a core holding consisting of broad market funds, such as, for example, an S&P 500 ETF and an aggregate bond ETF, to serve as the foundation of the portfolio. Meanwhile, the smaller satellite component of the portfolio allows investor to explore other investments such as industry specific funds, potentially adding value. This core-satellite strategy allows investors to have a larger portion of their portfolio passively mirror the overall market indexes while also actively investing the smaller portion of their portfolio, which may deviate from the overall markets.

Exposure to all corners of the market: ETFs may allow investors to make short-term tactical decisions. Given their liquidity and trading flexibility, ETFs may help adjust an existing portfolio to target specific undervalued or overvalued market segments based on a market view. Another way ETFs can complement an existing portfolio is by providing access to alternative asset classes that may be inaccessible or too costly for an average investor to invest in directly.

Hedging risk: The diverse coverage and trading flexibility of ETFs may offer downside risk protection, allowing investors to reduce their exposure to certain sectors and therefore potentially minimize risk. For example, an investor may be heavily weighted in the financial sector but because of potential employer stock restriction or tax consequences, is unable to sell. In order to reduce exposure to the financial sector, one option for the investor would be to buy the equivalent inverse ETF. An inverse ETF uses various financial derivatives to offer the opposite return of the underlying index.

Understanding the risks associated with each of these portfolio strategies, as well as the costs and potential tax consequences, are important. Speak with your financial advisor to better understand how ETFs can be used in your portfolio.

Holding an exchange-traded fund does not ensure a profitable outcome and all investing involves risk, including the loss of the entire principal. Since each ETF is different, investors should read the prospectus and consider this information carefully before investing. The prospectus can be obtained from your financial professional or the ETF provider and contains complete information, including investment objectives, risks, charges and expenses. ETF risks include, but are not limited to, market risk, market trading risk, liquidity risk, imperfect benchmark correlation, leverage, and any other risk associated with the underlying securities. There is no guarantee that any fund will achieve its investment objective. In addition to ETF expenses, brokerage costs apply. Fees are charged regardless of profitability and may result in depletion of assets. Inverse ETFs are not appropriate for a long-term or buy and hold investment strategy. They are designed for short-term or intraday trading for investors seeking daily investment results and who intend to actively monitor and manage their investments as frequently as daily. Keep in mind that diversification does not eliminate the risk of investment losses. Investors should consult a financial professional before considering complex investing strategies involving derivatives.

Monthly Market Commentary

The U.S. stock market dropped by 2.9% in August, heavily weighed down by news out of Syria. Though Syria produces no oil to speak of, there are fears that other Middle Eastern oil producers would be drawn into the conflict, and oil prices would soar.

Federal Reserve news: There are a lot of worries in anticipation of the Fed's September meeting, when tapering seems imminent. An increasing number of Fed governors seem to believe that there has been enough bond buying. Still, some governors continue to believe that the economy is in a fragile state and are more reluctant to make any changes without clear evidence of an accelerating economy. A small tapering might represent an acceptable compromise, unless the near-term economic indicators fall apart.

GDP: The second-quarter GDP estimate was revised sharply to show 2.5% growth, compared with the previous estimate of just 1.7%. Most categories were unchanged, except for the much-anticipated change in net exports, which accounted for almost the entire 0.8% revision in the GDP.

Employment: The economy added 169,000 jobs in August, with most of the growth coming from the retail trade and health-care sectors. However, the June and July numbers were revised downward by a combined total of 74,000 jobs. Based on the new numbers, only 148,000 new jobs were created on average during the past three months. The unemployment rate dropped to 7.3% from 7.4% in July.

Housing: Pending home sales fell 1.3% between June and July, while the year-over-year tally was up 6.7%, its lowest showing in 2013. Unfortunately, pending sales are tracking lower than existing-home sales data, which means that existing-home sales are likely to show slower growth rates in the months ahead. The data also seem to indicate that the big jump in July existing homes was a result of a rush to close mortgages faster (to beat rate increases), and not actual gains in the housing market. Home prices have risen sharply over the last 15 months; however, rising interest rates and declining affordability may keep a lid on prices, at least in the near future. Affordability has slipped from an index of 210 to 166, and that was before rates really started to increase this spring. Overall, the housing market appears to be slowing its growth rate.

Consumer spending: Consumption, which represents 70% of the U.S. economy, has been on a slow drift down during the past year. Given the limited growth in July actual data and lackluster shopping-center data so far in August, Morningstar economists estimate that consumption data will be hard-pressed to grow much faster than 1.5% in the third quarter overall, compared with increases of 2.3% in the first quarter and 1.8% in the second quarter. Given that consumption is the largest component of GDP, the data would seem to indicate a slowing in the overall GDP growth rate in the third quarter.

International: The European economy appeared to move out of recessionary territory in the second quarter as the 17-country eurozone experienced growth for the first time after an 18-month-long double-dip recession. The 2013 second-quarter annualized GDP growth rate of 1.1% was the first positive one since fall 2011. Germany, France, and the United Kingdom were the backbone of the recovery with annualized growth rates of 2.8%, 2.0%, and 2.4%, respectively. Employment data didn't show nearly as much improvement as GDP did, especially in France, but overall, the improved data should make Europe less of a headwind to world growth.

Morningstar economists are still optimistic about the long-term outlook for the U.S. economy, because of the potential of the housing, oil, aerospace, and auto industries. Manufacturing and the banking system also remain strong, and inflation appears under tight control. However, there is no denying that fiscal austerity and higher interest rates are taking at least a short-term toll.

Five Lessons from the Three-Year Market Rally

…now a four-year market rally, but the lessons are still relevant. 1) The turning point is not always obvious. In hindsight, it seems like it should have been dead obvious that stocks were cheap four years ago. But, because of their inability to clearly identify market bottoms, investors may be better off sticking with a strategic asset-allocation plan. 2) Don't let past performance control your portfolio. To the extent that you can, let your strategic asset-allocation framework be a key driver of where you deploy new cash. 3) To help maximize participation, make a little room for the risky stuff. Even though higher-quality stocks tend to hold up better during downturns, the opposite tends to be true during recoveries. Investors may want to maintain exposure to both types of companies: high-quality, wide-moat dividend payers and economically sensitive small- and mid-caps. 4) But there are also chicken ways to play. You don't need to pile on the risk to generate robust gains in absolute terms. Investors who have shorter time horizons or are simply more comfortable with lower-risk stocks can reasonably allocate more toward such stocks without completely ceding their upside potential. 5) There will be bumps (and buying opportunities) along the way. The movement hasn't always been upward since the market bottomed. If your portfolio is light on stocks at the outset of a rally, periodic sell-offs may provide opportunities even at a later time.

Diversification and asset allocation do not eliminate the risk of investment losses. Stocks are not guaranteed and have been more volatile than other asset classes. Small stocks are more volatile than large stocks, are subject to significant price fluctuations and business risks, and are thinly traded. This should not be considered financial planning advice. Please consult a financial professional for advice specific to your individual circumstances.

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