First State TRUST COMPANY
WOMEN & WEALTH

A PRIMER ON INVESTMENTS

For many, managing their investment portfolios can be an intimidating task. Let's face it, that is why First State Trust partners with world class investment managers to help you navigate the investment waters and stay the course. While the daily decisions of which assets to invest in and when to sell are often best handled by the professionals, it helps to understand the basics so that it's not so intimidating and you can understand why your portfolio is set up the way it is.

Your investment portfolio will be made up of varying investments such as stocks, bonds, mutual funds, ETF's and cash. There are others such as derivatives, alternatives and physical assets such as real estate but we will focus on the most common. Stocks, bonds and cash are the three most basic segments or "asset classes" of your portfolio. This is because most other investments are based off of these three. A mutual fund for example is just a prepackaged and managed portfolio of stocks, bonds and cash or all of them. Each of them have differing characteristics and reasons why you invest in them.

A stock, also called "equity" is an ownership interest in the company. Like any owner, you do well when the company does well and you do poorly when the company does poorly.   The risk is that it is possible to lose some or all of your money invested in a stock. At the same time, stocks generally can perform better and offer the most upside potential versus bonds and cash. Stocks are typically invested for appreciation potential and total return.

A bond, also called fixed income, is actually a loan made by the investor to the company, government or municipality. The holder is a creditor of the issuer. A primary reason to invest in a bond is for the income that is earned from the interest. When held to maturity, the holder gets back the full face amount of the bond. The risk in bonds are generally less than that of stocks in that they tend to fluctuate in price less than stocks and as a creditor of the issuer, the holder is owed their money back before equity holders. Bonds are typically invested for current income.

Cash is the most basic and generally the safest investment. Investments in cash is generally made by purchasing money market funds, US Treasury Bills or bank deposit programs.They work similarly to your bank savings accounts. Simple interest is earned on the amount invested. Because it is the safest form of investment, the rate of return or the interest earned is very low. Cash is typically invested as a short term investment and to preserve its value of $1. The primary risk to cash is the eroding effects of inflation.

As mentioned before, some include the asset classes of alternatives and physical assets into the mix too. Alternative assets are certain hedge funds, private equity and other funds that are designed to perform a bit differently than regular stocks and bonds but generally do fall into either the equity or bond category. Physical assets such as your house (real estate), jewelry and artwork can be included too but since they are not easily tradeable, they are considered "special assets". Again, for this article, we are focusing on the three primary asset classes of stocks, bonds and cash.

All three; stocks, bonds and cash can be invested in individually, as well as in a mutual fund, ETF (exchange traded fund), or SMA (separately managed account). Mutual funds and ETF's are just a prepackaged portfolio of stocks, bonds or cash or all three. All holders of the funds own the assets proportionately. An SMA is like a mutual fund or ETF in that it is a prepackaged portfolio but each individual asset is owned by you and can be traded separately. Your portfolio can be invested in any combination of the assets or types. This next step is called "asset allocation". Asset allocation is simply the combination of asset classes that makes up your portfolio. Because the three main asset classes have different risk and return characteristics associated with them, one can adjust the amount of risk and expected return in a portfolio by adjusting how much is invested in each asset class.

For example, a portfolio that is all stocks is riskier than a portfolio that is all bonds but the expected return of the all stock portfolio is much greater than that of the all bond portfolio. A "balanced" portfolio is one that has almost proportionate exposure to both stocks and bonds. First State Trust Company utilizes five primary portfolio asset allocations to help guide how portfolios are managed.

1. CAPITAL PRESERVATION:

The Capital Preservation investment objective is designed for short term time horizons and or very low risk tolerances. High income generation may also be a significant goal while appreciation potential is minimal to none. The allocation to lower volatility cash and fixed income is thus high while minimal to higher volatility equities.

Allocation Range: Cash 0-100%, Fixed Income 80-100%, Equities 0-20%
Typical time horizon: 0-2 years

2. INCOME FOCUS:

The Income Focus investment objective is designed for shorter term time horizons and lower to average risk tolerances. Its primary goal is current income generation while appreciation potential is secondary. The allocation to lower volatility fixed income is greater than that of higher volatility equities.

Allocation Range: Cash 5-10%, Fixed Income 60-80%, Equities 20-40%
Typical Time Horizon: 3-5 years

3. GROWTH AND INCOME:

The Growth and Income investment objective is designed for shorter to mid term time horizons and average risk tolerances. This objective places equal emphasis on current income generation and appreciation potential. The allocation to lower volatility fixed income is about equal to higher volatility equities.

Allocation Range: Cash 0-10%, Fixed Income 40-60%, Equities 40-60%
Typical time horizon: 5-10 years

4. GROWTH FOCUS:

The Growth Focus investment objective is designed for mid to longer term time horizons and average to above average risk tolerances. This objective places greater emphasis on appreciation potential and less on current income generation. The allocation to higher volatility equities is greater than that of lower volatility fixed income.

Allocation Range: Cash 0-10%, Fixed Income 20%-40%, Equities 60-80%
Typical time horizon: 7-10+ years

5. CAPITAL APPRECIATION:

The Capital Appreciation investment objective is designed for long term time horizons and or above average risk tolerances. This objective places primary emphasis on growth potential with little to no emphasis on current income. The allocation to higher volatility equities is high while minimal to lower volatatility fixed income.

Allocation Range: Cash 0-10%, Fixed Income 0-20%, Equities 80-100%
Typical time horizon: 10+ years.

The Trust statement will typically show you the portfolio’s asset allocation on the Account Summary page and often a pie chart to help illustrate. Many statements will further break down asset classes to show more information such as corporate bonds vs government bonds and municipal bonds as well as domestic equity vs. foreign equity but now you get the picture.

As mentioned First State Trust partners with world class investment managers to manage the portfolios on a day to day basis and decide which assets to purchase and when. No matter which investment manager it is however, the portfolio will be made up of the asset classes discussed and in proportion to the goals and objectives of the trust. We hope that this primer on investments has helped to better understand the basics of investments. Both FSTC and your Investment Advisor can help explain more and are happy to do so.

Please don’t hesitate to contact your Trust Officer with any questions or call First State Trust Company at (800)554-1364.