FOURTH QUARTER
DECEMBER 31, 2018

DEIGHAN
WEALTH ADVISORS

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25 Years
Deighan Wealth Advisors
1994-2019

MARKET COMMENTARY

Opportunity cost is a key economic concept. It represents the value, or cost, associated with making one choice relative to another. To illustrate, let's consider Herman, a young college student. Herman has a big exam tomorrow. In fact, his entire course grade hinges upon this one exam. Herman will only pass the exam if he studies tonight. However, his friends want him to go to the movies. Let's assume that if Herman were to go to the movies, then he wouldn't be able to study at all.

> As investors, we must always be conscious of opportunity cost.

In the above scenario, each choice is mutually exclusive; Herman cannot both go to the movies and study. Therefore, each choice could be summarized as follows:

- If Herman were to stay at home and study, then his return would be a passing grade on his exam. The cost associated with this return would be forgoing the opportunity to spend time with his friends and enjoy a movie.
- If Herman were to go to the movies with his friends, then his return would be the pleasure and friendship he would derive from doing so. The cost associated with this return would be forgoing the opportunity to study and therefore failing his exam.

Note that the presence of an opportunity cost reduces the return received. In Herman's case, if he didn't have an exam tomorrow, then he could enjoy a movie with his friends free and clear. However, because the opportunity cost (failing his exam) is so great, this cost reduces, and arguably overcomes, the return associated with going to the movies.

> The goal of asset allocation is to maximize return while minimizing risk, relative to other opportunities.

When presented with an opportunity cost, a rational actor will subtract the cost from any return received and analyze the net return. Assuming that Herman is rational, he would deduce that the cost of failing his class is greater than the benefit of going to the movies (or, in other words, the benefit of passing his class is greater than the cost of missing a night with his friends). He would, therefore, choose to study all night.

Because life is a series of competing choices, we make these same types of deductions all the time, usually without realizing it. Opportunity cost is a powerful concept that drives much of our personal decision making. As investors, we must always be conscious of opportunity cost. That's because portfolios are finite. A decision to put dollars into one investment is simultaneously a decision to NOT invest dollars in a competing investment.

Research has shown that asset allocation is the biggest contributor to variability of portfolio returns over time. Therefore, arguably the most important decision an investor can make is the decision to properly allocate between stocks, bonds, cash, and other investments, like commodities or real estate. The decision to put dollars into stocks, for example, means forgoing the opportunity to put dollars into bonds, and vice versa. The goal of asset allocation is to maximize return while minimizing risk, relative to other opportunities.

Of the three major asset classes, the one with the highest long-term return potential is stocks. Cash has the lowest return potential, and bonds are somewhere in between. Therefore, a decision to invest in bonds or to leave cash uninvested is a decision to forgo stocks – forgo the highest potential return. What does this mean? Bonds and cash have high opportunity costs.

You might say, "But stocks are the riskiest of these asset types." In a traditional sense, you'd be right; stocks have the potential to decline in value more so than bonds or cash. That said, we need to look at this dynamic more closely. An investment in a single stock can be highly risky, because common stockholders are last in line when it comes time to get paid. If a company goes bankrupt, its common stockholders are the ones

most likely to experience a total loss, which is why any individual stock has the potential to go to zero.

But a diversified stock portfolio minimizes this risk or eliminates it altogether. If an investor is diversified across enough company stocks, then the odds of all of these companies going bankrupt is extremely small, and the impact of any one bankruptcy on the overall portfolio is also small. This means that, while a diversified stock portfolio can be volatile, it is also likely to recover from any downswings and earn a positive return over time. There is little risk of permanent capital impairment, so long as an investor doesn't sell during downswings and lock in losses.

At the end of the day, it depends on how you define "risk." If risk is simply defined as price volatility, then yes – stocks are risky. But what if we were to define risk differently? What if we were to relate risk back to an investor's goals? Investors care most about the end goals that their portfolios can achieve. An investor thinks about things like their standard of living in retirement or their ability to put their children through college. These goals are all predicated on returns.

So, rather than define risk as price volatility, let's define it as the risk of failing to meet your goals. More specifically, let's define risk as the risk of failing to grow your wealth above and beyond the rate of inflation and your investment costs. If we define risk in this way, then stocks are decidedly less risky than bonds or cash, because stocks offer the highest long-term potential returns and the highest likelihood of obtaining goals. Let's use the following example to illustrate our point:

- Stocks, as measured by the S&P 500 Index, have returned 9.95% per year on average over the past 30 years.
- Bonds, as measured by the Barclays Aggregate Bond Index, have returned 6.09% per year on average over the past 30 years.
- Inflation, as measured by the U.S. Consumer Price Index, has averaged 2.64% per year over the past 30 years.
- Assume that these aforementioned rates hold into the future.
- Jack and Jill are two investors, both of whom just retired at age 65 and both of whom want to "live their best lives" in retirement. They each have $1 million, and they each want to draw $50,000 per year from their portfolios, adjusted for inflation. Assume they each pay investment management fees of 1.00% per year, assessed at the end of each year.
- Jack insists on a bond-only portfolio, because he doesn't want as much portfolio volatility. As a result, he averages a return of 6.09% per year. Because he is withdrawing more from his portfolio than the portfolio is earning, Jack's portfolio is worth just $554,154 after 20 years. He runs out of money after 27 years.
- Jane, on the other hand, is willing to put up with more portfolio volatility, and she agrees to a mix of 60% stocks and 40% bonds. As a result, she averages a return of 8.41% per year. Because the portfolio is earning more than Jane is withdrawing, Jane's portfolio is worth $1,450,822 after 20 years. Jane never runs out of money, and her portfolio keeps growing over time.

> "When markets make such sudden moves, it can cause fear and uncertainty among investors."

Let's consider the above in terms of Jack's opportunity cost. After 20 years, because he chose to forgo stocks in his portfolio, Jack is $896,668 less wealthy than Jane. After 27 years, Jack is insolvent, whereas Jane has $1,567,396 in her portfolio. This assumes that both Jack and Jane withdraw the same amounts from their portfolios each year, having essentially the same quality of life for 27 years (minus any stress Jack would have because he's worried about running out of money).

Remember, too, that both Jack and Jill had the ultimate goal to "live their best lives." What if unexpected expenses were to arise in the future? Jill would be able to pay for them, whereas any increase in spending would cut the life-expectancy of Jack's portfolio even shorter. Talk about worry! In fact, Jill could withdraw $54,413 per year, adjusted for inflation, and still have $1 million in the bank after 30 years. In order to run out of money after 27 years, like Jack, Jill would have to withdraw $65,155 per year, adjusted for inflation. Ultimately, Jill can afford a higher standard of living and will have a higher quality of life, simply because she invested in stocks. She will also have the ability to make bequests to family members or charities, whereas Jack will not.

Put another way: To shun stocks in favor of bonds or cash is to reduce long-term portfolio returns. An investor might do this because they are concerned about the possibility of price volatility, which often turns out to be temporary. Instead, that same investor should be more concerned about the certainty that inflation and expenditures will always be there, and the only way to keep up with them is to earn a sufficient return – and to put up with price volatility.

It's no coincidence that we've chosen to discuss this topic now. Stocks in the third quarter were more volatile than we've seen in many years. The S&P 500 Index dropped nearly 20% from peak to trough, wiping out gains from earlier in the year, and the S&P 500 Volatility Index (VIX), a measure of stock market volatility, rose as high as 36.07 in December after averaging just 14.87 over the past five years. When markets make such sudden moves, it can cause fear and uncertainty among investors. It can cause investors to question why they've invested in stocks in the first place.

But for all of the drama in the stock market – and the news – over the past quarter, it's important to keep the recent drop in perspective. The S&P 500 Index, on a total return basis, was down just 4.39% in 2018 after nine years of positive returns. In seven of the past ten years, the S&P 500 Index returned 11.96% or greater. Over the past ten years, the S&P 500 Index grew by 242.75% on a total return basis, or 13.10% per year. Think, for a moment, about this annualized return within the context of the Jack and Jill example above, where stocks were assumed to return 9.95% per year.

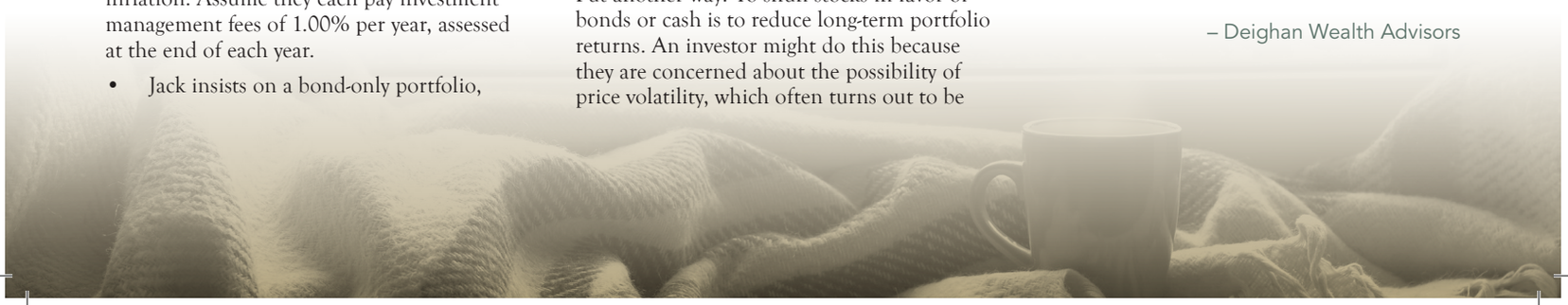
Volatility is as much a part of investing as breathing is a part of living. But, without volatility, there can be no return. Even bonds experience price volatility, and, in the current rising interest rate environment, bonds are more price sensitive than normal.

Therefore, if the current market is causing you concern, our best advice is to ignore the noise as much as possible. Find something to distract you. Find something that you enjoy doing. Just don't sell your stocks! And, as always, please call us whenever needed. Sometimes, simply talking can help.

Our plan is to keep on the current heading and do our best to keep the ship steady amongst the choppy waves. Markets have been relatively resilient since Christmas, which signals some support, but we expect more rough sailing over the coming quarter, as the market continues to wrestle with Federal Reserve policy and tariff uncertainty.

Until next time, may you and yours have a very Happy New Year!

– Deighan Wealth Advisors



PLANNING CORNER

New Year's Resolutions for Working Parents

It is that time of year again. Time for fresh starts, clear thinking, and new opportunities! Resolutions abound for all, but in celebration of the themes fresh, young, and new, we decided to share a "to do" list of resolutions that we think are important for working parents with young children. This demographic is often too busy to think about, let alone attend to basic financial planning and details, but if they are able to check off the following items early in life, then their families will be far better protected throughout their young years and will be light years ahead of most middle aged folks when they eventually choose to work with a financial planning professional.

Our resolution for early 2019 is to author short blog articles that discuss each of the following subjects during the first half of the year. In the meantime, there is enough information right here to help the enterprising young couple get started building a solid financial future.

> "Time for fresh starts, clear thinking, and new opportunities!"

1. Have Wills that as a minimum:

a. Name guardians for your children (there is no perfect solution, but your children will need steadiness versus chaos on top of grief should something untimely happen to both of you.)

b. Ensure that there is a trust for your kids with a financially reliable trustee appointed, and that it contains "pass through" language so your children can receive valuable tax benefits from "stretch" IRAs. The attorney who drafts your Wills will know exactly what this means.

2. Prepare for unexpected incapacity:

a. Have reciprocal durable Powers of Attorney (POAs) between spouses with a back-up person appointed in case both spouses are affected.

b. Have Advanced Directives in place (Healthcare POAs/Living Wills).

3. Have sufficient term life insurance to help the surviving parent keep the ship aright. Should the unthinkable happen to both parents, make sure the contingent beneficiary is a trust for the kids. Buy inexpensive term insurance and invest the difference in the recommendations that follow.

4. Have proper property and casualty insurance coverage. Make sure you have adequate homeowner's coverage for your real estate holdings, and all of your vehicles. You should also have umbrella coverage that properly connects to your homeowners, and vehicle coverage to protect against the unlikely disastrous event that could clean out your savings. Don't overlook your motorcycles and other fun vehicles. They should connect to your umbrella coverage as well.

5. Plan for Cash Flow Emergencies. Have cash reserves in the amount of six months of spending if there is one primary earner and three months if there are two primary earners. Keep this in a separate account for REAL disasters like losing a job. Short-term CDs are ideal for this type of account. They can be "laddered" to mature at different dates in the near future and will help you resist dipping in for budget extras. Credit cards do not suffice as cash reserves.

6. Pay off your student loans. Student loans can be a terrible ball and chain for young adults especially those with families. Interest rates are often high and the terms can be tough, but pay them off as soon as possible. If your loans are large, sit down with a financial planner and work out a plan of attack. Although it is true that up to $2,500 of loan interest can be deducted, the deduction phases out as income climbs. Also, with the new standard deduction of $24,000 for married couples, far fewer young married couples will be itemizing deductions. There are also some special programs that can help, but they are too few. In most cases, living as modestly as possible while focusing on paying the loans off is the best route to free yourselves from this terrible drag on your future success.

SOUNDBYTES

Jean Deighan was featured in the September issue of *Maine Magazine's 50 Mainers Balancing Heritage and Progress.* Congratulations, Jean! We were also pleased to see one of our Seasons of Maine and Deighan holiday card artists, **Jill Hoy**, featured in the same article.

Jenifer Butler was among several panelists at the University of Maine's Finance Career Day on October 15th, speaking with college students about financial industry careers.

Our entire team attended a reception featuring Deighan holiday card artwork and poetry at the Bangor Public Library. Artist **Kristborg Whitney** is also featured at BPL, and her fabulous work and the Deighan holiday art can be seen at BPL until the end of January 2019.

On December 6th, **Jenifer Butler, Jean Deighan** and **Lucie Estabrook** traveled to Portland to attend the Olympia Snowe Women's Leadership Institute Annual Leaders Luncheon.

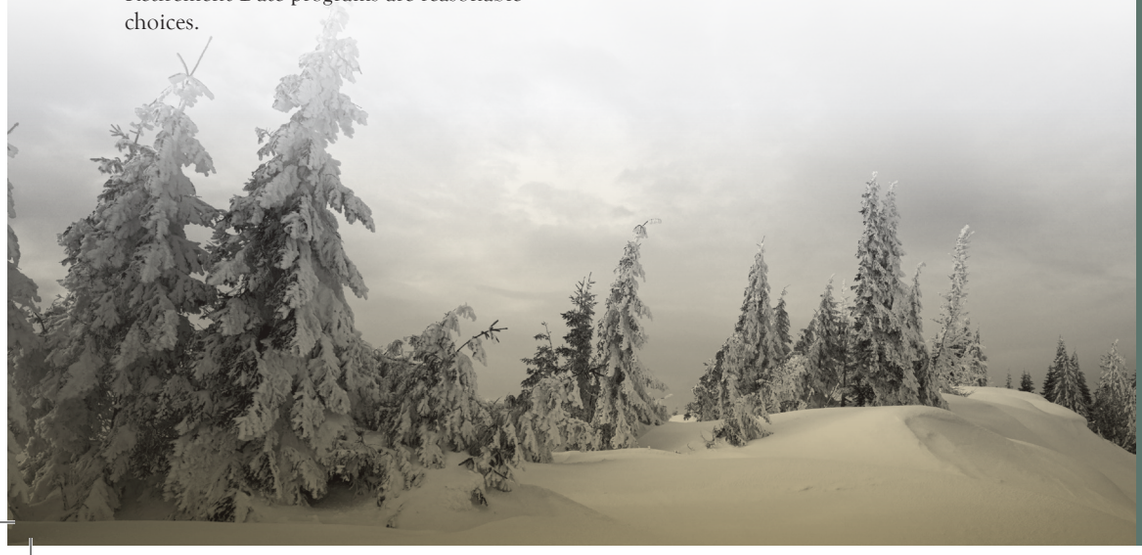
7. Plan early for your retirement. Defer as much income toward the future as possible while living a reasonable life. This will accomplish two goals. First, funds will be tucked away to grow for your future. Give these funds an endearing name for these are your "Freedom Funds" and will afford you the gift of choice in the future with respect to when and how you will retire. The second goal of salary deferral is avoiding lifestyle bloat. Lifestyle bloat is like consuming extra calories every year and then wondering why you are thirty pounds overweight as you approach midlife. Staying financially trim and flexible is as important as keeping your body in shape. Following are some specific recommendations:

- If you work for a company, defer as much as you can into your employer retirement plan. For 2018, the maximum contribution for wage-earners under age 50 is $19,000. Starting small is fine. You will be surprised to see that for every $10 you defer, it will be a smaller amount coming out of your paycheck, for example, maybe only $7 or $8 dollars. Why? Because the funds are coming out pretax! When you get a raise; don't spend it, defer it, and your deferral amount will naturally grow.
- If you are self-employed be religious about annual IRA, individual 401(k), SEP, or SIMPLE plan contributions. Consider having a modest automatic withdrawal after consulting with your tax preparer regarding the amount. The greatest enemy of saving is not getting around to it.
- Pay attention to the investment education offered by your employer or plan vendor and strive for a diversified portfolio appropriate for your time horizon and risk tolerance.
- You will do well to avoid high cost funds but paying up for some active management is sensible too, especially in certain asset classes like international emerging markets. Just keep an eye on costs.
- If you are too busy to take the time to deal with your investments, often the Target Retirement Date programs are reasonable choices.
- Be sure you have designated beneficiaries for your retirement assets. Moreover, be sure to update your beneficiaries when major life changes occur, especially difficult ones like divorce.

> "If you work for a company, defer as much as you can into your employer retirement plan."

8. Plan for College Costs: Be sure to have 529 Educational Plans for your children in an amount that at least takes advantage of all state matching grants. However, do not focus so much on your children's education that you ignore your retirement. You, and/or your children, can borrow for college but not for retirement. We recommend making regular 529 Plan contributions (preferably automatic checking withdrawals) of at least $600 annually. If you are using the Maine NextGen Plan, this contribution level allows you to receive the $300+ annual grant funding from the State of Maine for your children. Even a modest 529 account can make a huge difference in terms of closing gaps to obtain higher education. We recommend Maine residents choose the NextGen Direct series and choose an age related investment choice. Blackrock or iShares are both fine, the important thing is to get the age related shares.

We hope you have found this list helpful. There is intention to the order of the recommendations. If it is possible, do a little bit of each thing listed even if the amounts involved seem small at first. From many years of experience, we know that tiny acorns do grow into big oaks! Again, we will be publishing short, readable articles expanding on each subject listed in the coming months. In the meantime, should you have any questions about these subjects please feel free to call. Happy New Year!



DEIGHAN
WEALTH ADVISORS

TELEPHONE 207-990-1117

www.deighan.com

DEIGHAN WEALTH ADVISORS
455 HARLOW STREET
BANGOR, ME 04401

JEAN M. DEIGHAN, JD, CFP®
CHIEF EXECUTIVE OFFICER
jeandeighan@deighan.com

JENIFER L. BUTLER, CFA, CFP®
PRESIDENT
CHIEF INVESTMENT OFFICER
jeniferbutler@deighan.com

LUCIE E. ESTABROOK, CTFA
VICE PRESIDENT
CHIEF OPERATING OFFICER
lucieestabrook@deighan.com

JENNIFER L. EASTMAN, JD
jennifereastman@deighan.com

TYLER D. HOXIE
PORTFOLIO ADMINISTRATOR
ASSOCIATE ANALYST
tylerhoxie@deighan.com

KAREN S. MITCHELL, CAP
OFFICE MANAGER
karenmitchell@deighan.com

PHOTO CREDIT:SHANE LEONARD

WE WELCOME JENNIFER EASTMAN!

We heralded in the New Year welcoming Jennifer Eastman to the Deighan Wealth Advisors Team! As you may recall from our October announcement, Jen has been a member of the Bangor professional community since 2003, concentrating in the areas of retirement planning, estate planning, and fiduciary law. She has advised clients on all aspects of estate and generational planning including transfers of family businesses and legacy real estate holdings. Her past experience directly augments the skills of our other firm professionals allowing us to more fully address this important aspect of wealth management especially in the areas of elder care planning.

An Arizona native, Jen came to the east coast to attend law school and moved north to Bangor after graduating from the College of William and Mary School of Law. She and her husband Marc have three active children, two cats, and a Great Dane. They love supporting their children in their academic and athletic endeavors.

We thought it might be fun to ask Jennifer a few questions, some serious and some not-so-serious, to help you get to know her better.

Since "Community" is one of our core values, tell us about your sense of community and your service.

I was raised with the value of contributing to community, through family, church, school, and profession. The College of William & Mary Law School presented the concept of "citizen lawyers," a philosophy established by George Wythe and Thomas Jefferson, that we have a responsibility to use our training to be good citizens and civic leaders, as well as excellent lawyers, which was deeply inspiring to me. Coming to Bangor after law school, I was encouraged by how easy it is to become engaged in this community, and the warm welcome I received only increased my enthusiasm to get involved. Over the years I have served on a number of nonprofit boards. As a family, we participate in fundraisers and volunteer opportunities for sports, Scouts, the Humane Society, and other local events and causes. It is imperative to me as a parent that I pass this sense of responsibility to community on to my children.

It has been rewarding to match my personal values and passions with community service. I currently serve on the board of Penobscot Community Health Care and recently joined the board of the American Folk Festival. I am proud that one of the top federally qualified health care centers in the country is located right here in Bangor, Maine, and I am passionate about the importance of health care for all to establish firm foundations for children and families to thrive. Music is a central component in our home, and we have been ardent attendees and supporters of the Folk Festival since inception. Not only does the festival broaden our cultural experience, we love that it brings crowds to Bangor to experience our great community.

You grew up in Arizona, and came to Maine fifteen years ago. Tell us a bit about what you like best about being a Mainer.

Gosh, where do I begin? I think two primary motives brought us to Maine: four seasons, and the opportunity to raise our family in a small town, rich in cultural and consumer resources.

I quickly embraced that sense of Yankee practicality and frugality we find in Maine. People don't put on airs here. If something needs to get done, you do it. You pitch in for neighbors, friends, community. That Maine culture of thriftiness, resourcefulness,

and "re-usefulness" is unique to our region, I think. Mainers value hard work and effort, a growing rarity in our instant gratification world. We certainly need these values to get us through long winters!

Of course, Maine's natural resources are unmatched. We have come to love all of Maine, and travel around the State whenever we have the opportunity. The drive to Limestone (where my son is a high school senior at The Maine School of Science and Mathematics), is always a pleasure, not a haul. Our favorite beach is Roque Bluffs State Park. Acadia is a fun, spur of the moment, afternoon for a hike. It is not lost on our children that we live in the prettiest state in the country, and we are grateful for their appreciation of the environment.

What are you most excited about in joining Deighan Wealth Advisors?

The opportunity to expand my knowledge and draw upon my experience to help clients with financial and retirement planning is exciting to me. It's never too late to learn new things and new ways of approaching familiar issues. But even more, I am excited to be in an environment where client service is at the forefront of everything we do, and to explore new ways that I can help our clients live their best lives.

What is your favorite Maine hike and what is your favorite ice cream flavor?

The Jordan Pond loop is a favorite in our house. We usually hike it several times a year. My daughters check on the loons and watch for beavers no matter the season. Climbing the new Abol Trail at Katahdin will remain my ultimate hiking experience, though.

Pink Peppermint Stick has been my favorite ice cream flavor since childhood!

What is it that attracted you to Wealth Management, and specifically what attracted you to this firm?

As an estate planning and probate attorney, I know that legal documents are only part of a smooth transition in retirement and at death. The best planning is more holistic, incorporating a client's financial wants and needs into the legal work that reflects long term care and legacy goals. Wealth management is an opportunity for me to assist clients in the full spectrum of life planning, and to help ensure that financial, retirement, and estate planning goals properly align. I have been fortunate to work with the wonderful people of this firm, and their wonderful clients, for some time. I have admired the high level of personal client service DWA provides and am excited and honored to be a part of this firm and carry on the legacy Jean has built.

Thank you, Jen. We're excited to have you on board and know that our clients and colleagues will enjoy working with you as well.