Every investor’s question: ‘What’s next?’

By David Keator, Keator Group

During the last 30 years, we have seen investment “bubbles” of different variet-
ies that are nothing more than extreme investment swings based on a myriad of factors. Internet, commodity and real estate bubbles, to name just a few, have
all caused many investors anxiety. The primary drivers of these inflated values
are based upon momentum and greed. It comes from a feeling that everyone
else is making money and the investor is
missing out.

It is OK to be an optimist, but it is a
good idea to be watchful when everyone
is an optimist. Beware of crowds at the
extreme. When we see the type of exu-
berance that typically leads to inflated
values, we believe it is a good time to take
a breath and put up a safety net.

Last year, in early spring, many econo-
mists and market analysts warned bond
prices would decline and the result would
be higher interest rates. As a result, the
conventional wisdom was to shorten the
duration of a fixed income portfolio in
an attempt to create a bunker.

Because we have enjoyed unprecedented
ed and historically low yields (high-bond
prices), many heeded this call. Some saw
a bond “bubble,” and it was time to take
profits. On March 1, the five-year trea-
sury yield was 2.23 percent. Four months
later, on July 1, the five-year yield was
1.48 percent. When prices on bonds rise,
their yields typically fall. That means the
short-term investment call was premu-
ture, giving credence to market calls be-
ing more art than science.

So, what is being done with all of the
cash that is being held? Investors are
searching for a place to invest it. Short
treasury yields (one year) have fallen in
half from 0.3 basis points (one-third of 1
percent) to 0.16 basis points (one-sixth
of 1 percent) between March 2010 and
July 2011. This has caused investors to
hunt for yield and seek higher income
potential from more aggressive invest-
ments.

Theoretically, the higher the potential
yield, the greater the risk, but the appe-
tite for higher yield has been strong and
that has the potential to cause a bubble
in the high-yield market just as high de-
mand for Internet stocks caused unrealis-
tistic valuations in the late 1990s.

Buyer beware: A fixed-income invest-
ment paying a 3.5 percent yield might not
seem very good on face value, but if it is com-
pared to the relative security of treasur-
ies, then you can easily see a potential for
a disconnect.

So, back to our title: “What’s next?” The
next step for each investor is to evaluate
where your safety net is. Do you have an
investment plan? Have you figured
out your risk profile and adjusted your
investments accordingly? Do you have a
bunker?

If the market drops by 10 to 20 percent,
do you have enough cash as a liquidity
investment as a reserve so that you can
avoid selling under-valued assets to meet
emergency or even day-to-day needs?
Are you properly diversified?
It is painful to see CDs and short-term
treasuries paying less than 1 percent. If it is
part of your bunker, you have to stay
disciplined. If your investment time-
frame is short, you must be very careful
of volatility. With a longer timeframe,
you could possibly take advantage of
high-quality stocks with dividend po-
tential or short-term corporate bonds.
Remember, we are in a global economy,
so do not overlook investment opportu-
nities throughout the world.

We believe one of the safest ways to in-
vest is with a long-term horizon.

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Investing in fixed-income securities in-
volves certain risks, such as market risk
if sold prior to maturity, and credit risk,
especially if investing in high-yield bonds,
which have lower ratings and are subject
to greater volatility.

All fixed-income investments may be
worth less than original cost upon re-
demption or maturity. U.S. Treasury se-
curities are guaranteed by the full faith
and credit of the U.S. government for the
timely payment of interest and principal
if held to maturity. Investing in foreign
securities presents certain risks not asso-
ciated with domestic investments, such as
currency fluctuation, political and eco-
nomic instability, and different account-
ing standards. This may result in greater
share price volatility.

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