

# Perspectives

FOURTH QUARTER 2013

Despite U.S. markets returning to record highs recently, many investors are anxious that a major pullback is around the corner. While a pullback is always possible, a better understanding of the market's fundamental drivers can help reduce your investment fears.

## Is the Market Overvalued?

By Alan Zabloudil  
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How can you value stocks in the current market environment? We are inundated daily with information that ultimately forms our perspective of what we believe to be true. You've probably heard through casual conversation or financial media that the stock market recently reached all-time highs and that it might be wise to take some money off the table.

### Price-to-Book Ratio

Book value is a measure that represents the bottom line value of the company if it were to have been broken up and sold. This is sometimes referred to as the liquidation value and is a good measure of the company's underlying assets. We can apply the book value to current prices to establish the price-to-book ratio. The S&P 500 Index had a price-to-book ratio of 2.49 as of 9/27/2013, according to Bloomberg data. The most recent high was 2.91 times in 2007 and the all-time high of 5 times book value was achieved in 2000. Lower price-to-book ratios indicate fairly valued companies, but could also signal financial distress and should be used in coordination with other valuation techniques to make investment decisions.

### Price-to-Earnings Ratio

The most popular measure of stock valuation is the price-to-earnings ratio, better known as the P/E ratio. Just like the price-to-book ratio, P/E is a comparison tool against peers or the broader market. This is the measure most people would use when discussing stock prices with a neighbor or listening to financial media. The P/E ratio is important because it describes the level of willingness investors will pay for every \$1 of the

underlying company's earnings. If a company has a P/E of 15, that generally means that investors are willing to pay \$15 for every \$1 of current earnings. The P/E ratio is critical when comparing similar companies. You can see from the table, that the cost to invest in Apples & Caramel is lower than Candy Apples, Inc., meaning you can purchase more earnings for less money with Apples & Caramel than you would with Candy Apples, Inc.

	Candy Apples, Inc.	Apples & Caramel
Price per Share	\$26	\$26
Earnings per Share	\$4	\$5
P/E Ratio	6.5	5.2
Cost to Invest*	\$6.50	\$5.20

\*(For every \$1 of earnings)

### Dividend Discount Model

Companies that pay dividends offer another means of valuation by using predicted dividends and discounting them back to present value. This technique utilizes the time value of money theory, which means that \$1 today is worth more than \$1 tomorrow. Investors use this information

While it is true that markets need to have strong bi-directional moves to maintain a healthy balance of supply and demand, not stepping back and approaching market valuation based on fundamentals can lead you to make irrational or emotional investment decisions. Let's take a look at some traditional approaches to stock market valuation.

to determine the value of a stock today based on future consumption and is based on the principle that stocks are worth no more today than their expected benefits. Assumptions have to be made when using dividend discount models that make this model somewhat subjective because each investor's return requirement is different. However, when used in the correct context the model can provide valuable information about where there are opportunities.

### Alleviating Anxiety

These methods can be applied to the broader market when estimating market cycles by understanding the drivers of stock prices. Determining current values of stocks is a critical part of the investment decision-making process and is a mathematical approach to investing. By helping you understand the fundamental drivers of markets, your advisor can help reduce your anxiety and minimize emotional investment decisions.

# Preserving Your Legacy: The Importance of Planning the Transfer of Your Wealth

By Ryan George  
Director of Communications, 1st Global

Wealth is more than just the amount of assets on your balance sheet. Wealth represents the opportunity of a college education, home ownership or financial security that you can bestow to your loved ones or those in need. While most of life is spent accumulating and protecting wealth, effectively transferring wealth is a critical step to ensuring that your hard-earned assets are preserved. With an estimated \$41 trillion set to be transferred in the coming decade, the need for expert financial planning for those leaving wealth behind, and those receiving it, is as great as ever. The earlier you have a plan in place, the better.

Historically, the generational transfer of wealth through inheritances and gifts has accounted for up to 50 percent of total household wealth accumulated in the U.S.<sup>1</sup> From 1989 to 2007, transfer of wealth accounted for 23 percent of American household net worth, according to the U.S. Bureau of Labor Statistics. Despite these historical trends, statistics show that 70 percent of heirs “lose it all” (money, assets and family harmony) after an estate transition.<sup>1</sup> The 2012 U.S. Trust Insights on Wealth and Worth™ Survey found that “six out of 10 high net worth parents were not fully confident their children will be well-prepared to handle financial inheritance.”

Despite an evident need for cross-generational dialogue with your loved ones and your financial advisor, the majority of people, some 80 percent of Baby Boomers and 77 percent of seniors, have not spoken with a financial advisor about a plan for their inheritance, according to a 2009 BMO Retirement Institute Report.

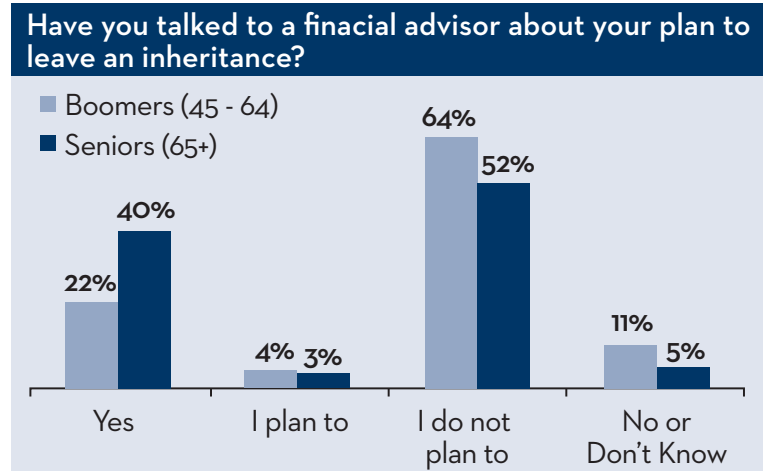
Through conversation and estate planning with your advisor and a qualified attorney, you can uncover significant factors that may impact how much you will leave behind. Key points to consider are: life expectancy and retirement age; unanticipated events and health care expenses; challenging markets, interest rates and inflation; taxes upon death; and the needs of your heirs and family members.

Your advisor and a qualified attorney can help you put in place and properly fund the following:

- Revocable Living Trust
- Charitable Trust
- Pour-over Will
- Declaration of Guardian
- HIPAA Release
- Medical Directives to Physicians (Living Will)
- General & Medical Powers of Attorney

Preparing estate documents can help reduce costs such as taxes and administration expenses, bequest specific heirlooms to appropriate heirs, charitable donations, grant executor powers and more.

While discussion of death and inheritance is likely to make you and your family members uncomfortable, communication of your intentions with your financial advisor and family can effectively create a plan for each of these factors to ensure your wealth fulfills its purpose and promise. Don't wait until it's too late to have this important conversation.



Source: BMO Retirement Institute Inheritance Survey, 2009  
Please note that due to rounding percentages may not add up to 100% (+1%)



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<sup>1</sup> Inheritance and the Distribution of Wealth or Whatever Happened to the Great Inheritance Boom? Bureau of Labor Statistics, January 2011.  
<sup>2</sup> Starting the Post-Wealth Transfer Conversation, Elite Advisors Forum – October 2010  
<sup>3</sup> Passing it on: What will future inheritances look like? BMO Retirement Institute, July 2009