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Investment Planning

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The “act of investing”, according to Princeton University’s wordnet involves the “laying out of money or capital with an expectation of profit.”

In our January 2009 article (Back to the Basics INSIDE Cherry Creek Volume 13 Issue 3, January, 2009) we suggested that you get “Back to the Basics” by updating your personal financial plan. We encouraged you to validate and prioritize your goals, inventory assets and liabilities, redefine your tolerance for risk, establish a 2009 budget and match your cash flow to your budget. An integral piece of a personal financial plan is Investment Planning.

Ideally, during your formative years, you studied economics and the principles of investing. With this foundation, you should be able to successfully design, implement, and manage your own investment plan. At best, this statement is an interesting theory. High school and college graduates in America know little about personal finance, let alone investment planning and investing. Those individuals that do manage their own investment portfolios, with rare exception, according to a Google search of “average investor performance,” over time, don’t do that well. The “rare exceptions” that successfully manage their own portfolios are extremely computer literate; they have investment training and experience, and the single commodity most Americans do not have – time. Faced with busy schedules, a general lack of investment training and knowledge, and a myriad of investment choices, most Americans turn to the financial services community for advice and assistance, i.e. a financial advisor.

Most financial advisors, in developing your investment plan, take you through a process. They establish your goals, assets and liabilities, time horizon, and tolerance for risk. Out of this “process” come investment recommendations. And you invest. When you invest you subconsciously develop “expectations.” As time passes, you start to actualize your subconscious expectations. Your “expectations” become conscious goals supplanting your investment goals and risk tolerance. You expect to make a profit. You expect that your financial advisor will regularly consult with you.

You expect to receive periodic, understandable reports. You expect that when the eventual market correction shows up, that somehow your financial advisor will get you “out of the market.” When your expectations are not realized, you become disappointed. Your disappointment turns to anger and frustration. And you start looking for a new financial advisor.

Our experience tells us that within five to seven years after hiring a financial advisor, and adopting and implementing a new investment plan, most individuals start looking for a new financial advisor. Concurrent with your anger and frustration that your expectations have not been met, your financial advisor has either washed out of the business or moved to another firm. Regardless, no one communicates with you. You can’t understand your statements. You’re in the middle of a market correction and no one got you “out of the market.” You hire a new financial advisor, and you “recreate the wheel.” Many of you have been through this process many times. Somehow, you can’t find the nirvana you seek.

To add “insult to injury” with stocks having lost 40 percent of their value in 2008, many investors have lost (at least on paper) all of their earnings/growth accumulated over the last ten years. Those of you that “got out” took a real loss. If you went from the stock market to the bond market, you “lost twice.” You found out that the credit crisis caused the value of your bonds to fall 20 percent. You experienced the “double whammy” of investing. Back to back losses in stocks and bonds. Most of you that “got out” altogether have your investment money sitting in bank savings/money market accounts earning two percent – or less. You are paralyzed with fear, asking, “When do I get back in?”

Those of you who are “savers” (as opposed to “investors”), meaning that you need your money to be “guaranteed,” have your money in bank savings/money market accounts and certificates of deposit. The brutal fact is that after income taxes and inflation, you are losing money. This fact falls on deaf ears because your money is “safe”.

And perish the thought that you succumbed to the siren song of the “one trick pony” insurance agent who tempts you with bonus index annuities or a variable annuity with “guaranteed” income. In our experience, investors who purchase these “guaranteed” insurance products do so out of fear. Nearly all investors who own contemporary insurance products, purchased in fear, rue the day they went in this direction. After a couple of years you come to realize that the investment performance promised is not there, and you have committed to significant back-end surrender charges that may last 20 years or longer. Again, anger and frustration.

At Woodward Wealth Management our investment planning process breaks the yo-yo cycle of anger and frustration by:

Establishing a lifetime belief system that embraces Modern Portfolio Theory and a Core/Niche Investment Methodology.

Negotiating a balance between tolerance for risk, expectations, and emotions.

Superimposing disciplined, full-time professional, active management on your investment plan.

Taking advantage of tax-advantaged investment mechanisms.

Adopting a clear, understandable periodic reporting system which incorporates a Weekly Market Commentary, monthly and quarterly account and performance reporting, quarterly telephone conversations with a firm principal, quarterly client education workshops, and an annual review meeting with a firm principal.

Modern Portfolio Theory (MPT). Professor Harry Markowitz pioneered this theory in his paper, "Portfolio Selection", published in 1952 by the Journal of Finance. MPT, according to Investopedia, is a theory that shows risk-averse investors how to construct investment portfolios to optimize or maximize expected return based on a given level of market risk, emphasizing that risk is an inherent part of higher reward. According to the theory, it is possible to construct an "efficient frontier" of optimal portfolios offering the maximum possible expected return for a given level of risk. MPT becomes a "belief system;" a "linchpin;" a central cohesive source of support and stability. This linchpin helps you manage periods of excess and instability with a confidence that you have reason and purpose associated with your investment plan.

Core/Niche Investment Methodology. This methodology, developed by the Woodward Wealth Management Group, Inc., combines a core, professionally managed, actively traded portfolio of stocks and bonds, surrounded and protected by a number of "niche" investments, e.g. large and small cap real estate, life insurance, annuities, energy, and other opportunistic investments. The dividends produced by the niche investments are reinvested (dollar cost averaged) back into the core portfolio.

This investment methodology currently contains a projected annual total return of 12 to 15 percent. The niche investments are currently producing a six to eight percent annual cash flow, which is "protecting" the core portfolio of stocks and bonds (which during 2008 experienced a paper loss of approximately 20 percent). The exact dollar allocation of funds between the core and niche investments is customized for each client.

Negotiating a balance between tolerance for risk, expectations, and emotions. We help you identify and learn how to strike a balance between risk, expectations, and emotions. You will still experience emotional swings between "greed," and "fear," as it is impossible to escape instantaneous media coverage of the economy and markets. The goal is for you to develop an ability to manage the psychology of investing.

Superimposing disciplined, full-time, active professional management on the investment portfolio. In our experience, the most common reason for failing to achieve investment goals and attain acceptable investment performance over time is lack of discipline. Lack of discipline is overcome by the retention of full-time professional investment management. In our complex environment today, you can't get away with

just a mutual fund manager, an independent money manager or two, or a financial cleaning house or bank that provides “free” financial advice. You need to have a professional relationship with a firm that has the capability to serve as the glue, which binds your personal financial plan in a framework that supports progress.

Tax Advantaged Investing. Tax advantaged investment mechanisms have the ability to significantly leverage your investment return over time. Years ago, our colleague, A. Raymond Benton, CFP®, coined the phrase, “Pay no tax before its time.” For many of us, our income taxes will trend upwards in the not-too-distant future. As such, income tax deferral will become increasingly important. Qualified retirement plans, deferred compensation plans, life insurance, and annuities are the typical tax advantaged investment mechanisms. Municipal bonds, municipal bond mutual funds, certificates of deposit, real estate, college savings plans, and U.S. Savings Bonds are also properly classified as tax advantaged. One must exercise care and diligence with tax deferred mechanisms, lest they morph into future income and estate tax time bombs (a phrase also coined by Ray Benton) that figuratively explode (with adverse tax consequences) in the laps of future generations

Communication and Reporting. You must, in any investment plan, be able to “see” where you have been, where you are, and where you are going. The financial services industry does a lousy job with consumer reporting. The evolution of onerous federal regulation and requirements is part of the problem. Many consumers and financial commentators believe that the green eye shade types in the backrooms of large financial firms do not want their reporting to be “too clear” lest the consumer actually understands what is going on – especially when it comes to performance, fees, and expenses. Do your best to demand clear, concise reporting. The lack of ongoing bilateral communication between you and your financial advisor will destroy any investment plan. Ensure that you and your financial advisor clearly establish a communication methodology in which you develop the ability to talk “with” each other, not “at” each other.

Investment planning is a “big boy and big girl game.” No individual, firm, or system can accurately predict the economic future, accurately predict future investment performance, or guarantee results. What you can do is significantly increase the statistical probability of investment success by developing an investment plan based on a belief system.

Al Woodward is a CERTIFIED FINANCIAL PLANNER® professional and Chairman of the Board of Woodward Wealth Management, Inc. a Registered Investment Advisor specializing in fee-based investment, retirement, estate and asset protection planning. Trustee and trust services are offered by Woodward subsidiaries. (303) 355-0556. info@woodwardwealth.com. www.woodwardwealth.com.