WEALTH MANAGEMENT

CORE Wealth Management

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"HELPING YOU MAKE SMART CHOICES ABOUT YOUR MONEY"

THE GREATEST HITS OF INVESTING

Article by Brad Steiman

Greatest hits aren't new, by definition; therefore, this article merely aims to chronicle and arrange them in a storytelling sequence, where one connects to the next, rather than in order of importance or priority. Trends change and fads come and go, but investing is like music in that true classics stand the test of time and remain relevant long after they were initially composed.

1) Conventional Thinking

Consider the questions people ask their financial advisor. "What stock should I buy?" They are looking to discover the next Apple. Another frequent request is, "Where do you think the market is going?" They want to know if now is a good time to be invested in the market, or if they should bail out of stocks instead. They are also looking to find the hot money manager or want the identity of the next Peter Lynch.

All these questions share something in common—people want a forecast! Therefore, conventional thinking seems to be that, in order to have a successful investment experience, the financial advisor must be able to look into his or her crystal ball and predict the future.

2) Market Forces

There is a completely different approach that all investors should at least be aware of, and it wasn't developed by the big banks and brokerage firms on Wall Street. It originated and evolved in the halls of academia and is based on a mountain of evidence showing that free markets work because the price system is a powerful mechanism for communicating information. As F.A. Hayek pointed out in his Nobel laureate lecture, "we are only beginning to understand how subtle and efficient is the communication mechanism we call the market. It garners, comprehends and disseminates widely dispersed information better and faster than any system man has deliberately designed."

What does this mean in the realm of fiercely competitive capital markets? Simply, that prices are fair. Competition among profit-seeking investors causes prices to change very quickly in response to new information, and neither the buyer nor the seller of a publicly traded security has a systematic advantage. Therefore, the current price is our *best estimate* of fair value.

3) Just My Opinion

Despite the strength of market forces, many investors may never lose the urge to form an opinion about the future, or to ask their advisor for one. If the compulsion to act on an opinion is too difficult for investors to resist, they might ask themselves if it is conceivable that they are the only one with the information upon which their opinion is based. If the answer is no and the information is widely known, then why wouldn't it already be reflected in prices? For example, the claim that "everyone knows interest rates are going up" should be met with the fundamental premise that if the statement were literally true, rates would have already gone up! The logic behind how markets work is a formidable response to any forecast of the future.

4) Simple Arithmetic

Not only is this logic formidable, but the evidence supporting it is also compelling. If free markets fail, it would be easy for investors to systematically beat the market, but in reality, man versus the market isn't a fair fight and most of us should accept market forces rather than resist them. There is a large literature devoted to analyzing the results of professional money managers. It dates back over four decades to the original study of its kind conducted by Michael Jensen in 1968. As you'd expect, some managers are able to beat the market on a risk-adjusted basis, but no more than you would expect by chance.

Furthermore, it must be the case that, in aggregate, investors earn market returns *before* fees. This doesn't just hold

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over the long run, but at every instant due to the adding up constraint. The market reflects the collective holdings of all investors, so the value-weighted average investment experience must be the market return *minus* fees and expenses. This is not just a theory; it is a universal unconditioned truth relying solely on simple arithmetic.

5) A Dry Lake

This arithmetic leads many investors to think that, since money managers aren't like children from Lake Wobegon (who are all above average), a winning investment strategy attempts to identify above-average managers and avoid all the others. But can you systematically identify *in advance* managers who will outperform the market after adjusting for the risks they took? Although it is hard to imagine there aren't skillful managers, the challenge facing investors is that true skill is hard to distinguish from pure luck.

Identifying managers who have outperformed in the past is just as easy as looking up the scores from last night's sporting events, but there is very little persistence in the performance of managers and no documented way of determining who will outperform in the future. Most regulators require sales communications to contain the disclaimer that PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS with good reason. Regrettably, this warning sign is treated like a posted speed limit and dismissed with flippant regularity.

This doesn't mean professional money managers are stupid! The market is hard to beat because there *are* so many smart managers—and not in spite of it. If you take the world's greatest bass fisherman to a dry lake, he won't catch any fish. He's still the world's greatest bass fisherman, but that's beside the point if there isn't anything to catch.

6) Everyone Can Win

It is not necessary for someone to have a lousy investment experience for you to have a successful one. Everyone can win because with capitalism there is always a positive expected return on capital. The expected return is there for the taking, and as a provider of capital, you are entitled to earn it. That doesn't mean it's guaranteed to be positive, but only that it is always *expected* to be positive.

Realized returns are uncertain because the market can only price what is knowable. The unknowable is by definition *new* information. If it is considered bad news, or if risk aversion increases and investors require higher expected returns, then prices will drop. This is the market mechanism working to bring prices to equilibrium where, based on the *new* information, the expected return on capital remains positive and commensurate with the level of risk aversion in the market. The opposite would be true if the new information is considered good news or if risk aversion declines. This is how well-functioning capital markets maintain a strong and pervasive relationship between risk and expected return. There is no free lunch.

Greatest Hits of Investing

1) Conventional Thinking
2) Market Forces
3) Just My Opinion
4) Simple Arithmetic
5) A Dry Lake
6) Everyone Can Win
7) Effective Diversification
8) More Than a Map
9) Behaving Badly
10) Simple but Not Easy

7) Effective Diversification

However, not all risks generate higher expected returns. Markets only compensate investors for risks that are "systematic" and cannot be eliminated. For example, the Green Bay Packers won't pay Aaron Rodgers more money to play football *without* a helmet. It is a risk that can easily be avoided if he puts on his helmet and buckles up the chin strap! Similarly, investors shouldn't expect an additional reward for taking the risk of concentrating their portfolio in a few securities, industries, or countries because the increased risk of doing so is easily eliminated through effective diversification.

To diversify effectively, investors allocate capital across multiple asset classes around the globe to suit their unique circumstances, financial goals, and risk preferences. Ineffective diversification, on the other hand, includes concentrating a portfolio in a few securities, diversifying by broker, or dividing up assets among money managers in an uncoordinated way that does not eliminate risks they shouldn't expect compensation for bearing.

8) More Than a Map

Travelling the road to a successful investment experience requires more than just a map. Building a portfolio that puts these ideas to work is one thing, but staying on route is something else altogether.

Keeping your hands on the wheel and your eyes on the final destination requires the emotional discipline to execute faithfully in the face of conflicting messages from the media and the investment industry.

Investors are bombarded with information designed to lead them off course and toward more conventional means that involve excessive trading, higher costs, and frequent detours.

A constant reminder that the media is in the entertainment industry and their objective is not to give sound advice but to attract an audience may help tune out the noise.

9) Behaving Badly

Investors ought to periodically review their plan and stick to it if the approach is still the right one. But adhering to a prudent investment strategy often becomes elusive in a world of continually streaming news and complex investment products. These forces can overwhelm human emotion and lead many investors astray.

In a nutshell, investors may not be rational, but they are normal—meaning they are often their own worst enemy.

10) Simple but Not Easy

A prudent investment approach following these fundamentals is like a steady diet of healthy food—simple, effective, boring, and difficult to maintain. It is well documented that good food, exercise, avoiding too much alcohol, and sufficient sleep will improve the odds of being healthier. It is also well documented that accepting that markets work, avoiding stock picking and market timing, effectively diversifying a portfolio, and paying attention to costs will improve the odds of being wealthier. It sounds simple, but it isn't easy.

No Reasonable Reason Not To Save

If you aren't saving for retirement (or aren't saving very much), you probably have a number of reasons. Yet, if you look closely at your non-saving rationale, you may find that it doesn't hold up very well. Preparing financially for your future is so important that there really are no good reasons not to save for retirement. Here are a few common reasons and why they aren't reasonable.

I'm not saving because investment losses will wipe out my efforts.

The stock market *is* volatile. Yet, it provides an opportunity to produce the highest long-term returns. As a long-term investor, you probably have time to make up any short-term losses. To help cushion any declines in the value of your stock holdings, consider diversifying* your portfolio. Making regular contributions to an investment lets you benefit from dollar-cost averaging.** Since you invest the same amount on a regular basis, your contribution will buy more investment shares when prices are lower.

I don't need to save because I'm going to work during my retirement years.

No one can predict the future. Illness, disability, caring for a loved one, or a layoff could prevent you from working as long as you want. If one of those situations occurs and you haven't saved, your financial security would be at risk. Even if you plan on working during your later years, you should still save as much as possible for retirement, just in case.

Social Security will provide the bulk of my retirement income.

Social Security's future is uncertain and it's always possible that changes may be made to the program. In 2013, the estimated average monthly benefit of all retired workers is $1,261 — $15,132 a year.*** It's likely you'll need a lot more than that to maintain your current lifestyle. Consider Social Security just one potential source of income.

I'll save once I pay for my other financial needs and goals.

When retirement is a long way off, it may be hard to put money toward it if there are bills to pay and shorter term goals to achieve. You may have every intention of saving for retirement once you pay off the mortgage and help your kids with their college expenses. But by the time you're ready to save for retirement, you may not have enough time to accumulate the money you'll need to fund your desired lifestyle. By waiting, you will have missed out on years of contributions and potential compounded growth. A better strategy is to prioritize your financial goals and design a plan to meet them. But keep in mind that you'll probably need a lot more to fund a comfortable retirement than you will for other items on your list.

** Diversification does not ensure a profit or protect against losses in a declining market.*

*** Dollar-cost averaging will not guarantee a profit or protect you from loss in declining markets. For this investment method to be effective, an investor has to continue buying regardless of fluctuating prices. You should consider your ability to continue buying through periods of low prices.*

**** Fact Sheet, Social Security Administration, 2013 Social Security Changes*

Government Regulations Describe Minimum Benefits That Must Be Included in Most Health Plans

A major part of the Affordable Care Act (ACA) is the requirement that nongrandfathered health insurance plans offer an essential health benefits package that provides a comprehensive set of services. In February, the U.S. Department of Health and Human Services issued final regulations defining the services that must be included in most health plans, beginning in 2014.

What are essential health benefits?

Essential benefits appear in 10 broad categories: ambulatory patient services; emergency services; hospitalization; maternity and newborn care; mental health and substance use disorder services, including behavioral health treatment; prescription drugs; rehabilitative and habilitative services and devices; laboratory services; preventive and wellness services and chronic disease management; and pediatric services, including oral and vision care. The final rule also clarifies that insurers cannot charge patients a co-pay for a colonoscopy if a polyp is found and removed. Previously, consumers may not have paid for the screening, but would receive a charge for removing a polyp during the procedure.

Also starting in 2014, all types of health insurance plans will include an annual limit on out-of-pocket cost sharing for individuals and families. While the limits haven't been set for 2014, a comparable limit for self-only coverage in 2013 is $6,250.

In addition, beginning in 2014, nongrandfathered plans must come within certain categories based on "actuarial value," or the average share of total plan benefits covered by the plan. For example, if a plan has an actuarial value of 70%, a consumer can expect to be responsible for 30% of the costs of all covered plan benefits. The categories will be defined by four "metal levels." Bronze plans will cover 60% of health-care costs; silver plans, 70%; gold plans, 80%; and platinum plans, 90%. The metal levels are intended to help consumers compare plans with similar levels of coverage.

Does it apply to all health plans?

These rules apply to nongrandfathered individual and small group health plans, as well as plans offered through state-based health Exchanges. Grandfathered plans, to which these requirements do not apply, include health plans created on or before March 23, 2010. However, some ACA provisions apply to all plans (i.e., grandfathered plans), including the prohibition from applying lifetime dollar limits to key health benefits, the requirement that plans can't be cancelled except in cases where the applicant provided intentionally false information, and the extension of dependent coverage to adult children until age 26.

An IRA For Your Spouse?

Saving enough money for retirement can be challenging for a spouse who isn't employed full-time. Leaving the work force to care for children or other family members usually means losing access to an employer's retirement plan. Even part-time employees generally aren't eligible for employer-sponsored retirement benefits.

So how can someone in this situation save for retirement?

Setting up a spousal individual retirement account (IRA) may be a good option.

In 2013, up to $5,500 may be contributed to an IRA for a spouse who doesn't have earned income, as long as the couple together has earnings of at least that amount. The contribution limit rises to $6,500 for a person age 50 or older. (Amounts are periodically adjusted for inflation.) Contributions to a traditional IRA are potentially tax deductible, but income limits may apply.

Annual contributions to a traditional IRA may be made until the year the spouse reaches age 70½. (No contribution is allowed for that year or any later year.) Although age restrictions don't apply to annual Roth IRA contributions, they are subject to income limits.

The Decisions Of Summer

What are your plans for the Summer? Do they include fishing, boating, swimming, site-seeing, vacationing, attending concerts or fairs, or just enjoying the Summer breeze in your favorite lawn chair? Whatever you select, you will probably pick the ones you think will be the most enjoyable or beneficial.

In part of the spare time you might have this Summer, you might want to reflect upon your financial situation. Has anything changed in your life that might also affect your investment portfolio allocation, are beneficiaries still correct as you want them on your life insurance, retirement plans, etc., does your Will or other legal documents need to be revised, or have you considered your long-term care needs and how to meet them? These are just a few items that you might want to consider. You should contact your Investment Advisor Representative with any concerns that you might have for some possible guidance.

Like most of the enjoyable times in our lives, Summertime will pass way too quickly, so enjoy every minute of it with your family and friends, and let us assist you with any of your concerns.

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors' returns within their tolerance for risk. Here is what sets us apart:

- Fee-only investment management
- A disciplined investment strategy
- Access to institutional no-load passive asset class funds
- An academic Nobel Prize-winning investment approach
- Continued access to academic research
- A tax-efficient focus with valuable tax- and estate-planning ideas
- Risk tolerance assessment
- Periodic portfolio rebalancing
- Regular communications and state-of-the-art reporting
- No front-end loads, no back-end loads, no surrender fees, not locked in
- MOST IMPORTANT … A TRUSTED ADVISOR RELATIONSHIP

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