Planning Perspectives 2Q 2015

Integrity in Investing:
Rough Road Investing

Paul Byron Hill, MBA MSFS MFP
Certified Financial Planner™ ©2015

PROFESSIONAL FINANCIAL
Consultative Wealth Management

During hot summer traveling, owners of all-purpose SUVs really appreciate their vehicles when they leave smooth city freeways for travel over rough country roads or climbing hilly terrain in back country.

For frigid northeastern winters here in upstate New York, a four-wheel drive sometimes means the difference between getting home safely or having an accident, such as being stuck in the snow. In planning sensible investment strategy, well-diversified and informed portfolios can offer greater peace of mind as well as better outcomes during turbulent times as market volatility returns.

When skies are azure blue and the highways are straight as an arrow, standard city sedans might cruise faster and more comfortably than sturdier sports utility vehicles. But when rubber meets a rough road, the real test starts when weather conditions unexpectedly change, and your vehicle's not up to the challenge.

That's why people who frequently travel through different terrains or during extreme weather conditions often invest in a SUV or other four-wheel drive vehicle. It can accommodate a range of situations and environments, but without sacrificing too much in convenience, economy, efficiency, and performance.

Structuring an informed investment portfolio involves similar decisions. You need an asset allocation for the portfolio of mutual funds or ETFs that can withstand a range of investment conditions while being mindful of fees and taxes that inefficiently reduce returns.

When certain sectors or stocks perform strongly for months and sometimes even years, it can be tempting to concentrate on the "winners" and keep chasing returns. But when (not if) underlying conditions deteriorate, you can end up like a motorist with a flat on a southwestern desert road or lost in the Adirondack wilderness without a spare (and no cellphone connection!).

Likewise, when financial markets perform badly (and even become outright scary), the temptation might be to hunker down, cancel the trip and motels, and stay safe at home. But when investment skies abruptly brighten and road conditions clear, you risk missing out on an enjoyable investment experience you could have had by just staying with staying on course with the original plan.

One common approach is to frequently shift strategies according to current climate conditions, hot or cold, rainy or dry, sunny or snowy. But this makes for a difficult investing situation, and can be very costly. It's the equivalent of keeping two cars in the garage when only one

is needed. You're paying double the insurance, registration, and upkeep costs as well as losing wealth from ongoing depreciation. Anyway you're not really happy about what you did after accounting for the true costs is made.

The most effective approach is to structure a unified diversified portfolio strategy, coordinated around a holistic investing philosophy. That means spreading risk in an informed way that helps your portfolio capture the returns of what markets worldwide have to offer while reducing or even avoiding numerous unrewarding risks. In any year, at least some portions of the portfolio will do well. Other portions will disappoint. You can't reliably predict. *But the point of diversification is avoiding costly investing mistakes*, such as having too much cash when markets surprise and those expected returns are lost forever.

No investment or investment strategy can completely eliminate risk, of course. Even the best-designed diversified portfolios are not immune to declines. That memorably happened back in the 2008–09 financial panic. At most, diversification only reduces risk. Risk sometimes may be transformed, but because those forms are unfamiliar, does not make risk less real.

Sensible planning strives to minimize, and preferably avoid, unrewarding investment risks. Unrewarded risks typical of investors include unduly exposing a portfolio too much to influences of specific stocks, sectors, or countries—usually the result of confusing too much lucky momentum with personal acumen as an investor.

An excellent example of unrewarded risks are day traders of technology stocks back in the late 1990s. A few were big winners, and much featured in the media. Concentrated bets can pay off big, but consistent outcomes are rare, even among hedge fund managers. Getting timing right is very hard, and active trading can be very costly. Further, studies show that most winning traders don't know when to stop. Like players at Niagara Falls casinos, eventually they give back their winnings—and often much more.

By contrast, an informed, dimensionally diversified portfolio is like having a durable, all-weather, all-road, fuel-efficient vehicle in your garage. You're not only sure of smoothing out some big bumps along the way, but will enjoy a safer driving experience in a wide variety of road conditions.

Because no one knows which markets or which sectors or countries will outperform each year, diversification improves consistency for planning for those all-important life goals. Disciplined diversification and staying with your plan helps capture more of what global markets can offer than futile attempts at tactical timing shifts.

With informed implementation added to a disciplined diversification, you can have a low-cost, tax-efficient structured solution that looks pretty good when most of those guys with slick-looking cars they bragged about are stuck at home or are sitting forlorn on a snowy New York road.

Just as expert engineers design fuel-efficient vehicles for a range of conditions, many Certified Financial Planners™ with the right education and experience can construct diversified strategies that are structured to capture more of what markets have to offer, while controlling for risks that compromise performance.

There always will be rough roads for the seasoned driver, to be sure. But by doing the right planning and choosing the right vehicle, driving over rough investing roads cannot only be more comfortable, but help you travel with more safety than you imagined possible.

Disclosure: Professional Financial Strategies, Inc. is an investment adviser registered with the Securities and Exchange Commission, and independently associated with Charles Schwab & Co., TIAA-CREF and Dimensional Fund Advisors, LLC. A current Firm Brochure and Supplements are available by calling 585.218.9080 or emailing paulhill@professionalfinancial.com.

Past performance is not a guarantee of future results. Investing involves risks such as fluctuating values and potential loss of investment principal. All expressions of opinion are subject to change without notice in reaction to shifting market conditions. This content is provided for informational purposes, and it is not to be construed as an offer, solicitation, recommendation or endorsement of any particular security, product, or service.