

INSIGHTS

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FEATURED ARTICLE

Be It Resolved

by Brad Steiman

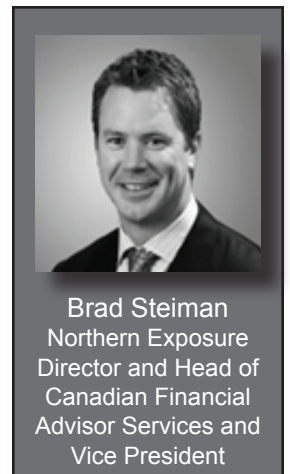
It's that time of year when many of us think about establishing one or more New Year's resolutions. This often means committing to improving one's lifestyle by losing weight, exercising more, or drinking less. Some investors could probably benefit from resolutions targeting their financial health as well. Just as many individuals endanger their well-being with bad habits, numerous investors suffer from ill-advised practices that are detrimental to their wealth. Perhaps a set of New Year's investment resolutions, along with an advisor capable of helping investors adhere to them, will lead to a more prosperous future.

Everybody wants to be healthier, and many people want to be wealthier, but it's just not that easy. Most of us are creatures of habit and discover that making permanent changes in our behavior is surprisingly difficult. We need every possible mental crutch at our disposal to help us adhere to a new regimen; hence we establish mental road signs, such as New Year's resolutions, as behavioral aids.

To make matters worse, our commitment to change is sometimes tested by examples of those who ignore prudent behavior to their apparent advantage and those who follow it to their apparent detriment. Winston Churchill lived to age 90, fortified by an ample supply of champagne and cigars, while author and jogging enthusiast Jim Fixx died of a heart attack at age 52. In the financial world, the investor who sunk every penny into Apple shares ten years ago watched her investment multiply over forty-fold while a globally diversified equity portfolio lost money.

These isolated examples may test our faith but should not encourage us to abandon a proven set of prescriptions; continuing to apply them will still improve our odds.

1. I will not confuse entertainment with advice. I will acknowledge that the financial media is in the entertainment business and their message can compromise my long-term focus and discipline, leading me to make poor investment decisions. If necessary I will turn off CNBC and turn on ESPN.
2. I will stop searching for tomorrow's star money manager, as there are no gurus. Capitalism will be my guru because with capitalism there is a positive expected return on capital, and it is there for the taking. And for me to succeed, someone else doesn't have to fail.



3. I will not invest based on a forecast—whether it is mine or anyone else’s. I will recognize that the urge to form an opinion will never go away, but I won’t act on it because no one can repeatedly predict the future. It is, by definition, uncertain.
4. I will keep a long-term perspective and appropriately consider my investment horizon (i.e., how long my portfolio is to be invested) when determining my performance horizon (i.e., the time frame I use to evaluate results).
5. I will continue to invest new capital and work my plan because it is time in the market—and not timing the market—that matters.
6. I will adhere to my plan and continue to rebalance (i.e., systematically buying more of what hasn’t done well recently) rather than “unbalance” (i.e., buying more of what’s hot).
7. I will not focus my portfolio in a few securities, or even a few asset classes, as diversification remains the closest thing to a free lunch.
8. I will ensure my portfolio is appropriate for my goals and objectives while only taking risks worth taking.
9. I will manage my emotions by learning about and acknowledging the biases and cognitive errors that influence my behavior.
10. I will keep my cost of investing reasonable.

Most of us find it hard to follow a sensible diet or a sensible investment strategy 100% of the time. If you must stray when managing your wealth or well-being, moderation is the key. Chocolate cake is OK, as long as it’s not for dinner every night. Speculating on a stock or two is all right as well, as long as you don’t do it with your investment capital.

Finally, just as successful athletes rely on coaches and trainers to help them achieve their goals, most investors can probably benefit from having a “financial coach” to remind them about their New Year’s resolutions and keep them on track toward a more prosperous future.

I wish you and your clients good health and good wealth in 2011.

January 4, 2011