



Investing Has Changed...perhaps forever: Time to change the game

“Do not think for one minute, however, that you are powerless in this investing game.”

Love, religion, politics, and money. This list represents four territories where opinions are expressed with passion, and where decision difficulties abound. We live in a world of calculating outcome probabilities. When it comes to deciding among the financial choices necessary to navigate a comfortable future the problem is forecasted that, as noted by Daniel Gilbert the Harvard psychologist, we just do not do the probability thing very well (Gilbert, 2005). Indeed, Dr. Gilbert observed we have difficulty in predicting outcomes and lack the general ability to calculate probability. Other studies are like professors Tversky and Kahneman, who theorized in 1983 that judgments about a potential outcome of events are accompanied by a range of experiences and knowledge unique to each person (Tversky & Kahneman, 1983). This means that separately two people may express completely different judgments about the probability of producing an expected result under the same circumstances. This has resonance to some behavioral financial research today (see Crosby, 2020). In any event, it appears that the complication we seem to encounter is emotions drive the train when it comes to money and financial decision making.

Are the academics correct? Of course, there is no investment without risk; it is simply a matter of degree. There are times to accept more risk, and times not to. If our expectation is a 10% return in a 2% world, then we could be prone to taking too much risk; conversely, if the expectation is 10% in an 8% world, then it is conceivable that not enough risk is being taken. Key to success is to deliberate more about the emotional risk behavior we mere mortals have had along the way. While the truth may be that the concept of money is deeply, emotionally intertwined in our behavior, that does not mean we are unable to estimate outcomes. Just consider all the daily decisions we make doing just that.

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Have you watched a football, basketball, soccer game, or tennis match? With little mental work you know the rules of the game, who are the officials and what they do, you easily know tons of information on the players, and all the time limits. All throughout the games you are calculating who will win (sometimes we get it correct, too). You are on the two-lane highway, behind a slow-moving pickup, you want to pass. You collect the data (traffic both ways, speed to overtake, room to complete, weather/daylight conditions) then calculate the probability of a safe outcome! You do it all the time, even sitting at a four-way stop! Same thing if you are shopping, planning a vacation, finding schools for the kids, or a million other prudent, calculated decisions you make daily. Investing is no more complicated! You have the ability and IT IS YOUR MONEY.

Remember you are the fuel that makes our economy and our investment markets run. You are the OWNER. You hire the manager, the team, all of the support staff, and you are the paying customer. Your rules are the only ones that really count. You have the power. So, the question becomes “How?”

Established prudently, your strategy is built with your **time** horizon, **risk** tolerance, **and goals** in mind. These are THE most important, fundamental bits of data you will ALWAYS NEED; and they do change with life events or circumstances. (Pandemics notwithstanding!). There is a fundamental reality which clears the deck about having the knowledge and ability to make investment decisions. At the core there are only **four main allocation categories** to invest in anyway. Those are stocks, bonds, cash, and “hard” assets like gold or real estate. Any other labels are just derivatives of these, and each has a time to own and time to avoid. Let’s take a quick tour on the primary types, then dive into methods.

Stocks and Stock Markets.

The only game in town? Maybe, but not necessarily. Importantly, we are after growth AND safety, so managing risk is paramount. As an investor, a plethora of troubling headlines could

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make you question yourself, your life choices, and even your overall approach to the financial markets. Just remember market volatility goes hand in hand with investing. Volatility is one measure of risk and is where higher returns or greater protection can be generated, whether the moves are up or down. When the economy is good, growth can be found in stocks. Some companies do better, however, when things are “tanking” like the pharmaceutical industry right now, trying to find a vaccine. The markets make big bets on these companies, anticipating the winners raking in the money when we start getting the “shots”. Be careful of “event” driven investing as a long-term plan...the traders will burn you. Rest assured that stocks become much less attractive when unemployment and inflation rises or is sustained. Then it is time to consider the trend has changed and you should too. “Do not confuse motion and progress. A rocking horse keeps moving but does not make any progress” (Montapert, 1970).

Like every sport we can think of, each has its own playing “field” and level of participation from Pop Warner football, little league baseball to professional levels. Stock markets, similarly, have various “fields” where trading between buyers and sellers is done and, each has their own entry rules. For instance, the New York Stock Exchange membership is a minimum of \$4 million in shareholder held stock and has about 2,800 companies, Principally, trading happens on NYC exchange turf known as the “floor” (albeit pretty much everything is electronic these days). NASDAQ (National Association of Security Dealers Automated Quotation) is an electronic transaction system and has over 3,300 companies. Yes, you can buy the shares in each just like any stock but **note that while each is headquartered in the USA, they have become strategically combined with foreign owners. Globally there are about 16 exchanges and the message here is that stocks, bonds, and commodities of all kinds have the capacity of being traded worldwide every day.**

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Bond Market.

From an early age, we are induced to put money in a safe place, a piggy bank. You had a high degree of comfort with this concept because you were able to go to your bank, shake the contents and hear the jingle. Thus, you could reinforce the idea that your money was always there for you. Later, someone, a parent or other relative, suggested you put the savings you had squirreled away in a real “bank” that pays you to keep it there. The problem today is the interest you might get is DISINTERESTING to say the least. So, the idea of “bonds” surfaces as an income/conservative alternative.

When you own bonds, you are loaning money to the entity issuing the bond. The expectation is that your loan will be paid back in full at some future date (maturity) and along the way you will receive regular interest payments (coupon). Bonds are the mechanism used by governments and corporations to finance thousands of different projects, including highways, national parks, schools, bridges, new plants, and any other projects which require borrowing against future revenues. Irrespective of the type of bond you select, you are counting on three outcomes:

1. The interest rate received will beat inflation and taxes.
2. You will receive interest (coupon) payments as agreed.
3. You will enjoy the return of your entire principal at a specified date in the future (at the end of the bond’s “term”).

The basic reason to use bonds in a portfolio has historically been to reduce risk. Why? Bonds and stocks tend to have little correlation in terms of current value. Stocks often give higher returns because you are willing to take more risk. Bonds have permanence and definition in that they have a limited lifetime and a stated interest rate.

Point of Order: There is a push and pull between reaching for more return and moving to less risk. Some of that is revealed when interest rates zoom up, likely when

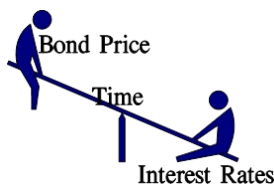
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inflation rears its head and prices rise causing business to sell less. Businesses decline in these occasions...so stocks fall. Investors pump the brakes, invest in bonds and pause stocks.

About principal risk. As long as you hold your bonds until maturity, the day you get your principal back, your deposit does not fluctuate in value to you. However, should you need your money before the bond matures you may or may not be able to get all your money back. If you plan not to hold your bonds for the whole period, you can expose yourself to something called “principal risk”. Since bonds are traded in the financial markets, interest rates and bond values have an inverse relationship. That is, when interest rates go up, bond current market values go down. You get the picture...you can trade bonds like other assets, but the odds today are not so great at holding them, and the interest rate is virtually zip. Look at the illustration below and decide if this is a good time to put your money into bonds or not!



Credit risk. Will Rogers put it succinctly when he remarked, “It is not the return on my investment that I am concerned about; it is the return of my investment”. Every few years or so, the bond market is shaken by a crisis in one sector or another that reminds us that even bonds come with risk.

Magic of Money Moves

What the balance of this whitepaper is meant to do is to persuade you to own the investment rule book and to contain your emotional behavior with money...your money.

We live in a time that demands “do-it-yourself” be revised. Complexity and rapid change are now part of the landscape limiting the possibility of safely investing on your own. Face the fact that investing will predominately force you to use a “broker”/investment advisor/money

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manager to accomplish what you desire most about becoming secure financially. They hold the keys to transactions, whether they cater to those who trade their own accounts (online) or advisors who work directly with clients (full service). Most likely you have used or are about to use a financial industry person, product, or process to aid in your quest. This is the price of participation and requires only that you provide the money. That is an unfortunate requirement in the sense that YOUR active involvement, comprehension, and knowledge is essential. Financial professionals are required to act in your best interest, but if you do not make the effort to validate the investment approaches and decisions, your best interest may not be sufficiently clear to the advisor/manager.

In the final analysis, we all want pretty much the same thing...**we want a better rate of return on our investments AND we do not want to lose money.** These factors or “wishes” peg the four-letter word we worry about most...RISK. Add time to these wishes and we have the critical ingredients affecting your investing outcomes. Understand the wishes (desires really) are fluid and change with life experiences or events. There are times we can withstand a bit more risk, while at other times not so much. Along with time, your desires can either be a throttle pedal or a noose to expected outcomes. Importantly, these two desired factors require you thoughtful, deliberate, and persistent attention, communicated plainly to your advisor.

Positioning to attain what we all want is not as complex as we make it. The complicated part is you deciding, with honest guidance, **how much risk at various points in time you can tolerate.** That belief, then, needs to be considered **relative to the amount of risk you should be taking** based on current economic and investment market conditions. This comparison is easily derived in conversations with a trusted advisor. The second piece to address is the **time frame** you can allow the proposed or planned investment to work for you. Key here is to match the investment to a specific objective. Examples: You are creating a retirement “nest egg” hoping that event occurs in seven years. Or you just sold your business and want to take the proceeds to open a new enterprise in three years after your “non-compete” expires.

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Or, perhaps, you have college bound kids when the time frame is five years to begin paying tuition and living expenses or them. Each of these contains a relationship to the amount of growth (risk) you should think about.

The Growth Role: The good part is you have many opportunities to assemble a portfolio to achieve your goal/objective. Yes, stocks are a part of that role importantly because with equities you accept that you are taking more risk, and you deserve to be paid for that. This does not mean loading all your money into stocks, however. Varying what you put into your investment account is always prudent and you should consider this a priority. A primary method of achieving this is to work with your advisor to set up a “managed account” using a professional money management team usually associated as a “platform” for that purpose. So how does that work and what are the benefits of these teams?

The objective difference, for instance, between picking a mutual fund versus a separately managed account is the fund is like choosing a school bus to reach your destination versus engaging a limousine. The bus takes you its route, stopping where it has been designated and lets you on or off at its time or location. A limousine follows your directions exclusively. So, if you need to change directions, stops, destinations...it is within your power. In this analogy, the limo is your management team. It is an “all in” fee arrangement (generally like mutual fund fees, in which we sometimes have to dig deep to find) so no need to be concerned about trading costs. Further, the **management team is not limited to a narrow investment type and can structure a truly diversified portfolio for you.** Moreover, the team has access to every imaginable asset class and does the necessary ongoing research and due diligence for you. The team deployed is instructed to accommodate your risk level and structure your portfolio accordingly. The point is that **you are the valued asset** in this relationship and when you do better, the management team does too.

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Management is available for even modest accounts sizes. You will begin with a personal profile indicating your risk tolerance, and receive a comprehensive proposal showing how the account will be allocated, importantly including how it has fared over the past. ***A best practice is to find a team (platform) that not only adapts your portfolio to your required risk level, but has some capacity to make minor adjustments within risk “bands” of approximately five or six different asset classes (e.g. US and International stocks, bonds, cash, real assets).*** Really, you, your route, time, and destination set the speed of movement moderated by the “limo driver” for you. Think of diversifying as adding parts that respond to different market conditions in a quest for higher returns with less risk. The diversification and variability become very important in maintaining your risk profile while taking advantage of opportunities when available. Note that access to your account is direct and moving as needed from one portfolio to another risk profile is efficient. These managed accounts are often included in your 401(k)-retirement account, so check this out with your human resources folks.

The Downside Watch Role: Investment protection is not that much of a stretch.

Essentially think of four “rules” for your investment accounts:

1. Protect your principal (too hard to get in the first place).
2. Strive for reasonable rate of return (no need to swing for the fences).
3. Understand clearly what and why you are invested in (whatever that choice is).
4. Choose a trusted advisor to watch over your assets (that is the only reason to pay them...make them earn it).

The common facts are that you really do know when things in the economy are going well, or not so much. Things that change the trends (economic & markets) are what you are seeking to stay in touch with. When unemployment rises, prices on goods rise (inflation), external stuff like political turmoil, social dislocation, or pandemics begin to show up you need to pull up your periscope and check to see if investment markets are reacting. Sure, adjusting the amount of risk

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by changing your portfolio mix is also, generally, a good start when stress builds. If you are in a professionally managed account much of the correspondence is there for you to read, deciding whether storms are brewing or not. ALWAYS consider that moving to a conservative posture helps protect your principal which is rule #1.

Historically, one would have shifted some assets into savings accounts or even government bonds to help protect principal in times of increased uncertainty. However, when there are fewer attractive alternatives to choose from, and there is *so much uncertainty* either personally or in investment markets like we have today, seeking more innovative means of protection is advisable. This gets back to the “desired perfect” concept of “higher rate of return and no principal loss” mentioned earlier.

You already have some idea of how to add protection to your assets, and even your life, right? Where can you look to achieve both desires today? What do you use commonly to reduce the risk of loss? Right, insurance! You are thinking “oh sure, right...here it comes!”, yet big changes have happened in that industry too. So, what is the objective of an insurance provider? Their challenge is to collect your premiums and never have to pay a claim! The law of large numbers is the game. Traditionally insurance companies could match investments to potential insurance claims through a robust, managed bond account or other investments. They could share a bit of the “prosperity” by lowering your annual premiums or paying dividends (neither very attractive), then along comes interest rates falling through the floor like we have seen in recent years. Insurance companies are nothing but abundantly smart and have introduced contracts that are directed at the “perpetual motion machine formula” of having reasonable growth with some degree of protection.

This is one complex area and you really need a financial professional to help. But if you are just trying to fill the gap in your portfolio that bonds traditionally played, then the insurance industry is worth the time to research. What you are looking for are insurance offerings that

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include stated objectives to give you some opportunity to grow your assets in rising equity markets while providing some downside protection when markets are not doing well.

The conditions to look for in this kind of alternative are simple generally. You put your money into the contract for several years, say three to six years depending on what gap you are trying to fill. The insurance company contracts with you to provide a potential upside (growth or appreciation) percentage on your deposit when markets permit, and lets you choose how much downside protection you want to have when markets are not performing well. **Note the few but growing number of highly rated companies are all different, so do your research!** Be sure to check for any internal fees, remembering that the contractual aspects limiting up and downside results need to be considered. Remember too that some contracts have an early withdrawal fee (fairly common). Note, while some might be available in a separately managed fee type account, which is pretty rare, having a 1% or more annual fee, this arrangement has the singular advantage of no early withdrawal fees so you can take all your money out at any time.

Remember! The point of this discussion is to put this kind of alternative on your research radar, addressing the desire to have the opportunity for growth and protection in a reasonable holding time span. Here are couple of examples by well-known insurance companies to get your search started:

<https://www.brighthousefinancial.com/products/annuities/shield-annuities/#/> ;

<https://equitable.com/investment/market-volatility/video> .

Note again, that much more research should be given to this kind of approach. The investment and insurance industries are constantly creating new solutions, and, who knows, maybe future interest rates on savings and bond accounts will become meaningful again.

Mental Measure: A primary shift in your thinking corresponds with the above methods.

Irrespective of all the “talking heads” and financial pundits who have for reasons of their own said “you are a long-term investor”, **you must employ a new process.** That is one of

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adaptability. Markets of all kinds move inside of trends. Think about the “camel humps” the S&P 500 went through in 1995-2000, again in 2002-2007, and 2009 to just about now.

From a trending point of view, when the overall market “passenger train” leaves the station it follows the rails, adjusts speeds, periodically stops for a **multitude of reasons**. You get to choose when to get on or off! True for investment markets too. **While you might be investing for the long haul, there is no compelling reason to think you cannot change trains, or even get off altogether to get to the destination of choice.** Your challenge is to blend growth and safety based on your consideration of risk for the current time in your life, the economy, the markets, and, yes even in the political landscape. Always check the trends and feel completely comfortable when you decide whether to alter your risk profile, get on, stay on, or just get off the ride. The markets always give you another opportunity.

No matter how you decide to adopt either of the method discussed here, the major point is that your financial goals are directly in your hands and you either take a chance or you take charge. Your expectations can become realities by choosing to be active in your investment rule book and putting a trusted, experienced advisor to work that really does “have your back.”



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