# Investment Directions

Fall 2007

COMPASS ADVISORS

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CHART ✦ NAVIGATE ✦ ARRIVE

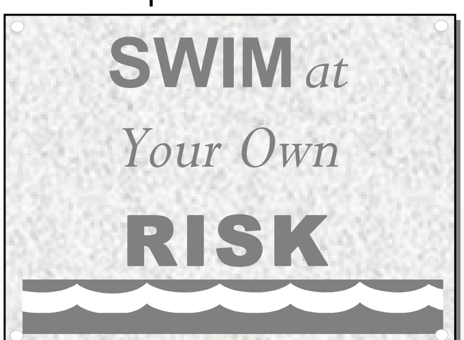
## Life with a Lifeguard

A few years ago Tyler, our son who is now 19, was certified as a lifeguard. When we spend time on or around the water we often tell our younger children they will be safe because Tyler is with us. It is comforting to have a lifeguard there who is a strong swimmer and ready at any moment to jump in and help a sibling in trouble.

In July that changed. Tyler traded his swim suit for a business suit and his flip flops for wing tips. He left us for two years to serve as a Mormon missionary in Concepcion, Chile. We are pleased he chose to go but it left us without our family lifeguard and we miss him. Now when we go to the water I notice the difference.

## What's the Difference?

As a Dad I came to rely on having a lifeguard with me as a valuable resource. Investing can be like that too. You can choose to do it with an advisor or without. The difference may be partly intangible, partly tangible, or both. The intangible difference could be the peace of mind you may feel having an advisor to talk to. A tangible difference may show up in the decisions you make when investments move unexpectedly. Either way you may find having an advisor to help you makes life different and better.




## Swimming with a Guard on Duty

I believe facts and experience may support the proposition that an investment advisor can be valuable.


Consider the following two statistics for the twenty years ending in 2004:

***1- The average equity fund with dividends reinvested returned 10.7%.[1]***

***2- The average equity fund investor earned just 3.7%.[2]***

Why do investors earn so much less than the funds they invest in? Timing.

It is tempting to think you can just get out for the bad part, when the price is dropping, then get back in when prices start rising again. The trouble with that strategy is the execution. It is hard to know in advance which days will be good and which will be bad.

Just last year the Dow Jones Industrial Average gained 19.05%[3] in 251 trading days. If you could invest in that index, and you cannot, and if you missed just the best ten trading days, you would have earned 3.92%.[4] Apparently many fund investors over the past 20 years have missed many of the good days.

You get to choose: swim at your own risk, or swim with a guard on duty. When the stakes are high and calamity is unthinkable, I recommend swimming with a guard on duty.

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[1] Lipper, as quoted by Nick Murray in "The Limits of Statistical Evidence," Financial Advisor Aug 2007.

[2] Dalbar, as quoted by Nick Murray, IBID. Past performance does not guarantee future performance.

[3] The DJIA is an unmanaged index of 30 industrial U.S. stocks, you cannot invest directly in an index.

[4] Performance according to CSI, Inc. Best days in 2006: 6/29, 7/19, 6/15, 4/18, 7/24, 2/14, 5/5, 1/3, 8/15, 7/28. Total gain = 15.13%

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## Computer Viruses to Watch for this Fall

**Arnold Schwarzenegger virus:** terminates and stays resident. It'll be back.

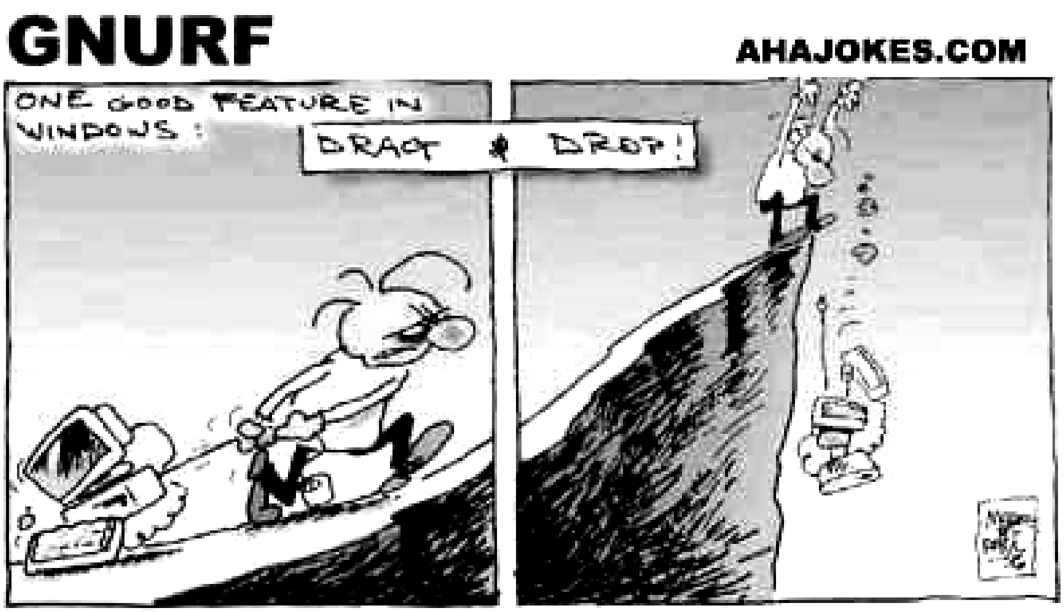
**Federal bureaucrat virus:** divides your hard disk into hundreds of little units, each of which does practically nothing but claims to be the most important part of the computer.

**New World Order virus:** probably harmless, but it makes a lot of people really mad just thinking about it.

**Paul Revere virus:** warns you of impending hard disk attack---once if by LAN, twice if by C:.

**PBS virus:** your PC stops every few minutes to ask for money.

**Warren Commission virus:** won't allow you to open your files for 75 years.



## The Reality of Retiring

# Red Zone

## Planning for Success

The retirement red zone is the ten years straddling your retirement date: five years before and five years after you stop working for wages. We call it the red zone because problems during those years could have negative consequences that last throughout your retirement. Fortunately there are steps you can take to prepare if you look ahead and plan for success.

On this page we will discuss three concerns which you may have to address just before or shortly after you retire.

### Concern #1: Experiencing an Untimely Market Downturn.

This fits in the category of bad luck. Despite our best planning, investments may dip in our red zone and we may have to adapt.

Many people who retired near the year 2000 when the market tanked had to recognize the problem and react. Some went back to work, some cut back expenses, but almost everyone had to change their original plan.

A comfortable retirement requires an understanding of confusing math concepts. For example: you have to make up more than you lose to get back to even. Say you had $100,000 and lost 50% in one year. The next year you would start with $50,000 -- a 50% gain that year would only get you back to $75,000. If you were drawing income during that time you would be in an even deeper hole. How do you plan for a pothole like that in your retirement roadway?

First you set up a well balanced plan before you enter the red zone and hope it will soften the bump. Next you recognize how serious the downturn can be and react quickly.

### Concern #2 Allowing Emotions to Drive Investment Decisions.

Retiring is a big deal and sometimes our emotions get tangled up with our logic. This is not good. It is possible, for example, to fall in love with a stock, maybe it is because we used to work there, or because it did well for us in the past. If we get so wedded to it we cannot let go, we push logic into the back seat and let emotion drive our decisions. We may find ourselves veering away from our long-term goals.

Emotional investing is not just about individual stocks; it can color our decisions regarding sectors and strategies too. A better approach is to adopt a purposeful investment plan tailored to you then monitor and adjust it over time. Emotions will come; you just need to be aware of them and not allow them to divert you from your true objectives.

### Concern #3: Choosing Unsustainable Complexity.

I once had a client who loved dividend paying stocks. He bought them from whoever pitched a story he liked, had the certificates delivered to him and didn't tell his family what he was doing. He lived a long life, bought lots of stocks from lots of brokers and then started to have trouble keeping track of the details. Checks were lost or feared lost, certificates were often not where he thought he had put them and nobody could help. He passed away some years ago, I am not confident his son ever found all the investments.

When you choose an investment strategy in the retirement red zone I recommend two grand keys: 1- keep it simple, and 2- make it sustainable.

Keeping it simple – having income paid directly to your bank is good. Checks don't get lost, you have a paper trail if there is a problem and all you have to do is spend the money. The older I get the more I value simplicity. A good retirement income plan is a low maintenance plan.

> *"It ain't what a man knows that gets him in trouble but what he thinks he knows but just ain't so."*
>
> *Will Rogers*

Making it sustainable – increasing income is good. Someday we may be paying $10 for a loaf of bread… and we may be paying it for a long time. For a couple age 65 today there is a 50% chance one of the two will live to age 92.[1] Your plan should provide a consistent and increasing income for your family.

The retirement red zone is a critical decision time. You don't have to make all the decisions alone but no one else will make them for you. Anticipating challenges and a little advance planning can help.

[1] U.S. Annuity 2000 mortality table, Society of Actuaries

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## The Redundancy Principle:

**"Introducing redundancy is a well known engineering principle normally applied to make systems more secure. Systems with built-in redundancy should continue to function satisfactorily even in unforeseen situations: such systems are said to be *robust*."**

*Understanding Intelligence P. 311, By Rolf Pfeifer, Christian Scheier Published 2001, MIT Press*


The redundancy principle can apply in investing as well as engineering. The goal of redundancy is to build a fall-back plan into your investment strategy just in case your primary assumptions turn out to be wrong.

For income investors who expect interest rates to be stable or to go down, redundancy may call for an investment that would do well when interest rates rise. For growth investors who believe large, well-known companies will do well in the months ahead, it may involve participating in some smaller companies. Consider the following example:

### Anticipating the roller coaster

We hear reports almost every day of interest rates rising or falling. Often these changes impact our investments on several levels. Rising interest rates may cause fixed-interest bonds, especially longer-term bonds to drop in value. On the other hand rising rates may signal a rise in inflation and may cause Inflation-sensitive investments to rise. Falling interest rates may do just the opposite.
A redundant investment strategy for an income investor might provide income from short-term as well as longer-term bonds and may also derive income from inflation sensitive investments like real estate investment trusts.

For a growth investor, redundancy may suggest a mix of interest-rate sensitive companies, such as those leveraged with debt, and inflation sensitive investments like companies with land, oil or timber holdings which may do well when inflation goes up.

These same principles can be applied to anticipating strong or weak economic growth, rising or falling taxes and the value of the dollar. Redundancy is the foundation of most asset allocation strategies.

### Gravity Still Applies

Asset allocation is not expected to repeal the law of gravity; if the stock market falls, a portfolio which invests mostly in stocks will likely fall some too. The goal of asset allocation is not to assure against loss but to blunt the biggest peaks and valleys a bit. A well designed asset allocation strategy may generate returns within expected limits and help you avoid big surprises.

Redundancy is about expecting the unexpected. It is a measured approach which applies prudence and discipline to investment choices. Here at Compass Advisors we believe in redundancy and in striving to build robust investment portfolios for our clients.