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Why Defense Wins Games (And Asset Management Returns)

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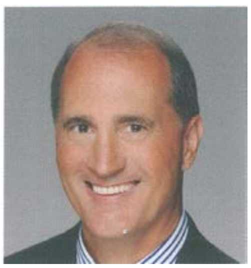

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If you are "offense only" in your asset management style, you eventually will deal with a crash. Much like a car with no brakes, staying fully invested all the time means you will ultimately have to deal with a declining asset that may also have withdrawals being taken from it. Time lost in the market is opportunity lost.

A core principle in retirement planning is risk management for your investment assets. When you are working and accumulating funds for retirement, your tolerance for risk may be higher thanks to that paycheck hitting your account every couple weeks. Once that stops and the reality that your accumulated funds are basically all you hav to pay your bills for the next twenty - or thirty - years sinks in, then you may become more sensitive to market volatility.

As financial advisors, we are trained to recommend classically diversified investment portfolios and stay the course over market ups and downs. That strategy served us well in the '90s, but when we hit the 2000 to 2010 time frame, it lost its viability as a strategy for most people. We had two major stock market declines along with a steady reduction in interest rates, which in past years, was a cushion we could rely on during a weak stock market.

For example, during the decline in 2008, the "buy-and-hope" approach was not what investors wanted to hear. Most investors have been taught - as have most financial advisors - to buy, diversify, and hold for the long term. They've been trained to have portfolios that are full-on offense, all-in, all of the time. They've been influenced and persuaded by materials produced by the largest asset management companies in the world to never was a cushion ever sell. But why?

Those of us who have been through multiple market crashes in our careers have a chip on our shoulders. We're apprehensive about an industry that has shoved modern portfolio theory (MPT) down our throats and told us that big firms have all the knowledge, so just drink the Kool-Aid and stay invested. Those of us who practice tactical, proactive portfolio management and the buy-and-hold MPT crowd do have one thing in common: a long-term investing perspect ive. Many successful investing strategies are not focused on the long term, but I believe that the majority of us who manage our clients' hard-earned retirement assets are doing so with a long-term time frame in mind.

As planners and fiduciaries, we first must know our clients. One industry standard is to develop a "risk profile," which tells us how a client approaches investing. Do they deal poorly with risk, or are they "game-on," liking the ups and inevitable downs that the market will most assuredly provide? Basically, we want to define what kind of investor model best fits the client.

Advisors should also provide a comprehensive financial analysis and planning approach to any recommendations they make. Knowing both what a client wants and needs provides parameters for determining how to construct the most appropriate strategy to help them achieve their goals with the highest probability ofsuccess. Many years ago, I practiced martial arts. One major influence in the community back then was Bruce Lee, who disrupted the traditional martial arts world with unorthodox style combinations. He said to use what works from each discipline, rather than restrict yourself to a single style with limitations: "Be ... like water." We can apply that concept to asset management, as different market conditions require different tactics. Markets came back to life from mid-2009 to around late 2014. They stagnated from 2015 to late 2016 and then ran again until January of 2018; and, as of this writing, they are now in a "consolidation" phase. You may be lulled into thinking that you made money for about 14 months; so, that is how it will always be, right?

When the market is in a long-term uptrend, we want our portfolios to be more aggressively buying pullbacks and corrections, treating them like clearance sales. This is where the similarities between proactive advisors and their buy-and-hold brethren end. One simple way to identify when to exhibit caution and when to avoid stocks completely is by observing trends. You want to own asset classes while they are going up, and conversely, avoid asset classes that are going down. I bet now you are asking, "What do I do with the money when it goes down?" Right? Good question. Here's the process we follow:

First, make a list of what you will own at any given time. Have a way to monitor those asset classes so that you aren't just sitting at a computer screen waiting to hit a button. Follow the plan. So, in our case, we want assets that aren't all in the same category. From this perspective, we are still selecting from the traditional classes, such as U.S. stocks, foreign stocks, commodities, bonds, real estate, etc. We also add a "safe" component , which is where funds go when we cannot find an asset class that is working. Now you have a game plan.

There are times when you need to put the offense on the bench and send the defense onto the field; your primary goal should be capital preservation.

Defense wins championships (and helps clients meet retirement income needs!)

As the great Bear Bryant once said, "Offense sells tickets, but defense wins championships." One of the biggest advantages a proactive advisory firm brings to the table is the ability and willingness to adjust our viewpoint according to what the market is telling us. Any tenured money manager knows that when you fight the trend, you lose ... and the market doesn't care about what you've done before. All we should care about is what we're going to do tomorrow, next week, and next month.

The bottom line is, whether it's supplemental income or vacations with kids and grandkids, most folks need to spend their money at some point. To help you safely navigate a successful retirement, consider taking a long-term, proactive approach to investing your hard-earned dollars. Our job is to help you focus on the horizon, not on your feet, teaching you to measure the distance between retirement and 100 years of age with an odometer, not a ruler. There are many cliches, but preserving your money during stressful market conditions and getting into the markets when they give us an opportunity to appreciate is a strategy that can give *you* a more probable chance of hitting those goals for income and legacy into the future.

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