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Lessons Learned From the Market Downturns of 2000-02 and 2007-09

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> "If you have an I.Q. of 150, sell 30 points. (To be a successful investor) you need to be intelligent. You don't have to be a genius."
>
> Warren Buffett, annual shareholders meeting, Omaha, NE, May, 2009

Good sources of information for what works: Burton Malkiel, *A Random Walk Down Wall Street;* John Bogle, *The Little Book of Common Sense Investing;* Jeremy Siegel, *Stocks for the Long Run;* William Bernstein, *The Intelligent Asset Allocator,* Alexander Green, *The Gone Fishin' Portfolio*

1. Begin with Asset Allocation. Asset allocation is the single most important and most basic investment strategy.

Major Asset Allocation Categories

Cash and Cash Equivalents—checking accounts, savings accounts, certificates of deposit, money market funds, U.S. T-Bills
Fixed income—U.S. Savings Bonds, Treasury bills and bonds, corporate bonds, municipal bonds, bond mutual funds, fixed annuities
Equities (stocks)—common stocks, stock mutual funds, some annuities, direct business ownership, partnerships
Real estate—commercial real estate, limited partnerships, real estate investment **i**nvestment trusts, real estate mutual funds
Commodities/Precious metals—there are many ETFs now available that enable investors to invest in almost any type of commodity

Note: *Ninety-five per cent of us do ninety-five per cent of our investing in these five categories.*

We diversify for **JUST ONE REASON:** *because* . . . .

Basic Diversification Principles

(1) There is no single, right diversification strategy. You need to decide what is right for you, perhaps with the help of your financial advisor.

(2) Most investors should use at least three of the diversification categories—stocks, fixed income and cash.

Example:	Equities (stocks)	60%
	Bonds and Fixed income	30%
	Cash	10%

(3) ***Most investors*** should have somewhere between 40% and 75% of their portfolios in stocks and stock mutual funds ***most of the time.***

(4) The major potential mistake is to have ***everything*** invested in stocks or stock mutual funds or to have ***nothing*** invested in such investments.

(5) Portfolios should be rebalanced at least annually to bring them back to your desired asset allocation targets.

2. Asset Protection. After Asset Allocation, develop a plan to insure that you don't lose what you already have.

Possible strategies: Set stop loss points (the strategy I use most often)
You may set stop loss points based on a given amount of loss (15%, 20%, etc.) or you can use a moving average point on a chart
Buy puts on indexes or individual stocks
Buy reverse funds that are designed to move in the opposite direction from the market

Asset protection– that you DO IT is far more important than HOW you do it!
Especially important you do this for money you will need in five years or less

3. Asset Liquidity—Have time horizons for your investments. Be sure you have liquid investments to cover your short term investment needs

Short-term goals (money needed in less than two years)

To pay for a European vacation next summer, a daughter's college tuition next September or to meet emergency needs (loss of job, illness, accident)

Low risk investments: money market funds, certificates of deposit, savings accounts, U.S.Treasury Bills, short-term bond funds

Intermediate-term goals (money needed in two to five years)

To buy a house, to start a business or to meet retirement needs in next five years

Moderate risk investments: Short or intermediate term corporate bonds or bond funds, Treasury bonds, moderate risk mutual funds

Long-term goals (longer than five years)

To save for college tuition, to plan for retirement or to prepare for estate management and transfer

Higher risk investments More volatile stocks, commodities, funds and ETFs

Rule of thumb:

Take the number of years before you will need a given amount of money
Multiply that number by 10. That will tell you the % of the money that should be invested in stocks and other higher risk investments

Example: You will need the money in two years. No more than 20% (2years x 10) should be in stocks and higher risk investments. 80% should be in liquid, low-risk investments.

If you won't need the money for 7 years, then up to 70%
can be in higher risk, higher volatility investments.

Consider using funds that manage the time frame for you

Fidelity Freedom 2015, 2020, 2025, 2030, etc.
Vanguard Target 2020, 2025, 2030, 2035, etc.
T. Rowe Price Retirement 2025, 2030, 2040, etc.

NOTE: If you had the above three strategies—asset allocation, asset protection and asset liquidity-- in place at the beginning of 2008, you are much better off today than most of your fellow investors.

4. Have a basic, or foundation, portfolio based on disciplined, regular, systematic investing and a long-term investment perspective.

think of it as **"automatic pilot investing"**
regular investments in **employer retirement account** every payday
regular monthly or quarterly investments in mutual funds
use **index funds, exchange traded funds,** large blue-chip investments

The portion of your investments that should be in your foundation portfolio depends on your interests, competence, time to devote to investing, risk tolerance, etc.

5. Actively manage some portion of your portfolio

Actively manage to the extent of your ability, interests and risk tolerance
Do your homework and undertake solid research
Experiment with new ideas and strategies – investment seminars, clubs, etc.

AVOID: Using timing strategies except for your higher risk investments
Using active management strategies for large portions of your portfolio until you have tried and tested them

Consider new investment alternatives beyond the traditional asset allocation categories

Consider the opportunities offered through exchange-traded funds

6. Concentrate on what you can control rather than what you cannot

Maximize your tax-deferred investing – IRA, Roth, 401K, 403B, 529, etc.
Watch your costs— (a) mutual fund loads, (b) annual expense ratios, (c) fund tax and turnover costs, (d) use a discount broker/or internet broker

7. To Summarize

1. Have an asset allocation plan
2. Have asset protection strategies
3. Have time horizons
4. Invest regularly and systematically
5. Experiment and actively manage a portion of your portfolio
6. Control what you can control

8. Buy low, sell high! If you can pull this one off, forget all the other points!