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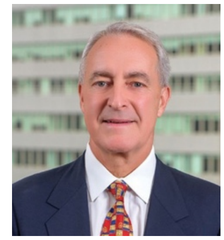
Thoughts for Investors



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Winter Newsletter to Clients

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"The beginning is the most important part of the work"

– Plato

What Do You Want?

Unbelievably, we are halfway through the first decade of the twenty-first century. Where did the time go? Perhaps this has caused you to think about what you didn't finish in 2004 and more importantly what you want to accomplish in 2005. Perhaps somewhere on that list is to pay close(r) attention to your financial picture. You may be asking: Did I save enough? How do I know? How much will I need? Will I run out of money during retirement? What if business is not so good this year? Should I be making changes to my investments now? Everyone is talking about dividend stocks. Should I have some? What about bonds? Hedge funds?

As you might imagine, answering these questions in a forum such as this newsletter would be difficult. Each reader is unique in terms of age, goals, amount of assets and tolerance of risk. Therefore, rather than answer those questions, I will ask yet another – what do you want? This is the single most important question that any financial advisor can ask. If your advisor is not asking this question (or if you are not giving them the time to ask) then you may not be able to answer the other questions. Answering the question "what do you want?" will help create a path to your optimum investment plan.

What do I want? What do I need? Some will argue that these are essentially the same question. I maintain that as long as the financial markets fluctuate, they are not the same question. The difference is whether (at this point in time) you should be creating capital or preserving capital. This is where a financial plan helps. In its simplest form, a financial plan serves three purposes. First, it asks what you want. Next, it asks what you need. Finally, it suggests a path you can travel to get there. It does not transport you to your destination nor can it tell you how rough the path may become. You will find that out as you travel.

"Traveler, there are no roads. Roads are made by walking."

– Spanish Proverb

Some investors are fortunate enough to have quite a bit of capital. For them, what they want and what they need can be the same. Including inflation and negative surprises, their plan can be built mainly with preservation in mind. Other investors are not as fortunate. There may be a wide chasm between what they want and what they reasonably need. For them, creating capital is going to be the cornerstone of their plan – by necessity. The vast majority of investors, however, lie somewhere in between. In many respects their challenge is the most extreme because there is no financial advisor or financial software that can suggest an easy, clear cut path. That is why a good financial advisor continually asks the question, "What do you want?" A good advisor can determine if the best path is creation, preservation or a combination. Furthermore, they will also act as a compass, directing investors back on course when the hype of the latest financial product leads them astray.

Many paths ascend Mount Fuji, but from the top everyone sees the same moon."

– Japanese Proverb

After reflecting on what they want, many investors search for what I call the SUV Investment. The SUV Investment is based on the very successful concept of the SUV (sport utility vehicle), which is a single vehicle that purportedly both rides and looks like a luxury car yet hauls stuff like a truck. Investors crave a single investment that both "makes money and doesn't lose it." Yet an SUV doesn't really ride or look as nice as a luxury car nor can it haul like a real truck. To do the job right, you need both a car and a truck. The same goes for investing. There is no single investment that has the potential to make money without also the potential to lose money. You need both stocks to "make money" and bonds to "not lose it". A short look at the last 20 years in the stock market will explain how the SUV Investment came into being and why it's so popular.

For the current generation of investors the past bull market was a truly wonderful time. Almost steadily from its low in 1982 to the high in 2000 (and notwithstanding the crash of 1987 and a few other bumps in the road) investors could "make money" in all kinds of stocks and even bonds. It was one success after another and losses were rare. And, as pointed out in an earlier newsletter, if one kept increasing the amount they invested, a portfolio could grow exponentially. In retrospect, the top of the market came when investors became hooked on "indexing", the "cruise control" of investing. Today, putting your savings on "cruise control" and then falling asleep behind the wheel, i.e. indexing and then not paying attention to your investments, no longer seems like a foolproof method of driving. The road has always had twists, turns, traffic and rough pavement. When the bear market and its obstacles arrived, all the good feelings and much in the way of paper (and real) profits were gone. Investor's interest switched from making money to not losing any. Currently, there is over $5 trillion dollars in money market funds, short term CDs, and savings accounts. One-half percent returns on money market looked very appealing. Investing in stocks slowed to a crawl as investors looked for an SUV investment. Enter the hedge funds. With their drumbeat of "we can make money and not lose any", hedge funds have become extremely popular. (However, recent Wall Street Journal articles suggest that they may no longer be capable of doing both). Some investors were even convinced by their advisors that the problem was not their driving skills but rather their car. Many simply switched investment vehicles at the bottom of the market and are now truly convinced that the car was the problem. With the strongest part of the inevitable rebound now over, investors don't know if the stock market's next move is up or down. So when in doubt on which way to go, most people follow the herd (into real estate, high dividend stocks or hedge funds.) So what should a weary investor do? Again, before I can answer that question I have to ask, "What do you want?" Do you need to create capital or preserve it? 2005 is a great year to answer that question and do a plan.

"You get whatever accomplishment you are willing to declare"

– Georgia O'Keefe

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Hear the Other Side

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If you would like to discuss the topic of this newsletter, or our team's approach to investing, please feel free to contact us by email at al.boris@alexbrown.com.

Thoughts for Investors is a quarterly newsletter written for clients since 1997 by this author. The purpose is two-fold. First, it is meant to help explain the investment philosophy that guides the author's approach to portfolio management. Second, it is meant to remind readers of important behavioral skills that the author believes are necessary to help them become successful investors. The author welcomes comments and criticisms, especially if they can be shared for the betterment of all investors. Quotation is permitted with full attribution.

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