DO YOU KNOW WHERE YOUR MONEY IS?

Investing in Today's Economy

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When **saving for** retirement, investors generally are not as concerned about fluctuations in their portfolio because it is a "future" event and there is time for corrections and additional savings. **Investing after** retirement is a very different circumstance. Considering the volatility in the stock and bond markets over the past 15 years, the uncertainty of our economy, and political gridlock in Washington, it is no wonder that many people feel apprehensive about their money and retirement!

When it comes to investing in stocks and bonds, it is understandable to have concerns. Most investors are in one of two camps: traditional and tactical. This information is directed toward traditional and tactical investors.

Traditional Asset Allocation

In traditional terms, asset allocation is a process which helps determine how money should be distributed between three major asset classes: cash, fixed income (bonds), and equities (stocks). More advanced asset allocation strategies also consider the amount of money in other investments such as real estate, commodities, or collectibles.

Investment managers and financial planners will usually follow either a strategic asset allocation process or a tactical asset allocation process. You should understand the difference.

Strategic Asset Allocation

Strategic asset allocation is a traditional approach to determining how much money should be invested in which categories in order to achieve long term goals. It starts with assessing an individual's tolerance for risk as well as the time frame for investing. The amount of money to be allocated to each asset class is also determined by looking at the long-term expected returns and risk levels of each class. Each asset class is also broken down into additional categories; stocks, for example, would be broken down into large cap, small cap, U.S., international, or emerging markets, just to name a few.

Once all these factors have been reviewed, a recommendation can be made to create an allocation of investments that should match the desired long-term returns and risk tolerance.

What Does A Strategic Asset Allocation Look Like?

A strategic asset allocation recommendation might suggest that you have 70% of your portfolio in stocks, 20% in bonds, and 10% cash; another allocation might be 60% in stocks and 40% in bonds. You might see these allocations referred to as a "70/20/10" portfolio or a "60/40" portfolio. Frequently, allocations will be rebalanced on a quarterly, semi-annual, or annual basis.

Tactical Asset Allocation

Tactical asset allocation is a more active approach than strategic asset allocation. With tactical asset allocation, rather than following a static allocation and rebalancing on a periodic basis, you choose to over-weight or under-weight asset classes based on an analytical assessment of the value of the asset. The objective of tactical asset management is to preserve assets in declining markets and participate in a rising market.

With tactical asset allocation you start with a base allocation, such as 60% stocks, 30% bonds, and 10% cash, with a range of plus or minus ten or twenty percent. If calculations show that stock valuations are high, you would choose to under-weight stocks so your allocation might be 40% stocks, 30% bonds, and 30% cash. Or, if stocks seem under-valued, you may be up to 80% stocks with only 20% in bonds and cash.

Critics of tactical asset allocation consider it a form of market timing. Market timing, however, is more akin to trying to guess, using technical analysis or a "gut feeling" to determine when to get in or out of investments. Most market timing techniques have poor results.

Tactical allocation follows a defined process of "appraising" an asset class based on numerous factors such as price to earnings ratios, price to book ratios, the macro economic outlook, consumer spending, interest rates, and much, much more. This approach allows for more flexibility, but also takes more expertise, and, of course, there are no guarantees they will deliver better results.

Tactical asset allocation is difficult to do unless you have a great deal of investment expertise. A tactical asset allocation portfolio as an asset class, or combination of portfolios, may be a better choice.

Asset Allocation in Retirement May Be Different

Remember, as you near retirement, a new way of looking at asset allocation needs to emerge - an asset allocation model that focuses on ways to maximize your life-time income. Such an asset allocation model would look at the amount of investments you have that could produce guaranteed income that would be available to meet essential expenses. Then it would look at investments that produce variable income that would be available to meet non-essential expenses.

One of the obstacles in retirement when withdrawing from a portfolio is fluctuation, and the effects of the sequence of returns. For example, in two separate deferred portfolios beginning with $250,000 assuming no withdrawals and a 5% compound average return for ten years, both portfolios will end up with the same values regardless of the order of returns. However, in retirement, the withdrawal amounts and the order of returns have a huge impact on your portfolio balance.

Let's assume the money saved for retirement grows to $500,000 and you want income from this account. If we look at two portfolios with a 5% compounded average return, withdrawing $25,000 (5% of the beginning investment value) annually, the sequence of returns can lead to completely different outcomes. For example, one portfolio starts with a 5% loss; the other begins with a 5% gain. The $25,000 withdrawals can erode the principle in an account which starts with losses vs. an account which starts with gains. Even with the same average returns, except now factoring in withdrawals, the ending values can be completely different to the extent that you could be faced with running out of money or changing the withdrawal amount and affecting the lifestyle. In retirement, the way most people think about their investments changes. After all, the idea is not to have to go back to work or change retirement life style due to portfolio fluctuation.

By combining Tactical Asset Allocation and Tactical Asset Management and using managers with proven track records, you may end up with a better outcome.

One more thing to keep in mind: the earlier you start, the more time your money has to grow. If you would like to know more about Tactical Allocation Management and whether this is a good option for you, please contact me. I'd be happy to speak with you. Retirement is fast approaching, so get started today!

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"Providing Retirement and Income Solutions"

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