FACTORS IN FOCUS

May 2018

Words On Wealth

by Eric D. Nelson, CFA

There has been an explosion of choice in our society over the last few decades, and it is happening at an ever increasing rate. Management guru Peter Drucker said, "In a few hundred years, when the history of our time will be written from a long-term perspective, it is likely that the most important event historians will see is not technology, not the Internet, not e-commerce. It is an unprecedented change in the human condition. For the first time—literally—substantial and rapidly growing numbers of people have choices. For the first time, they will have to manage themselves. And society is totally unprepared for it."[1]

The finance industry has not been immune to this trend or its consequences. We have countless choices regarding *how* to invest, *what* to invest in, and *with whom* to invest. Even the choice of *why* you're investing has become more complicated—retirement, college planning, periodic income, healthcare costs, future generations, and/or charities and organizations of interest all receive regular attention.

In many respects, choice is ideal; however choice also comes with a cost. The availability and the pursuit of more can lead to less. The "you can have it all" mentality often leaves you with some of everything but not enough of what really counts. If you look at the various aspects of your life, you will probably find multiple examples.

What if, instead of trying for a little of everything, you started with your financial plan, and you decided to reject the myriad of choices and options and focus purposely and deliberately on the essential, on a "less but better" philosophy? What would that process look like? The principles have all been outlined before but let me tailor them to your wealth objectives.

"If you don't know where you are going, you'll end up someplace else."
—Yogi Berra

The most underrated of all considerations? Simply defining what you want to accomplish and aligning your wealth. Notice that I did not say "defining what *others say* you should aim for." The choice is yours and I always trust that clients know what's most important to them. Once the choice is made, you should act accordingly.

In a recent client meeting with an older retired couple and their son, the topic of nursing care came up and how to fund that cost if the need becomes a reality. Was the portfolio sufficiently liquid to withstand a series of sizable withdrawals? What if stocks were down when money was needed? Instead of answering the question, I asked and answered a different one. *Was* the primary goal of the portfolio to simply fund future nursing care should the need arise, or was it meant for something more? Something greater? The answer, I already knew, was yes.

The clients had always made it clear that their primary objective was to leave a legacy to their children. There were other, smaller goals along the way, including charitable contributions and one day the potential for additional health care costs. But the kids were the top priority so I invested 75% of their wealth in a diversified stock portfolio for growth, with 25% in a short-term bond fund to manage near-term cash flow needs, dampen stock fluctuations and possibly cover future health costs during bear markets. Stocks have far outstripped the returns on safer short-term bonds since we started almost 15 years ago, as expected, so the results have been far better than if we took a conventional approach with safety (bonds) first and only a modicum of growth (stocks) at the margin. One simple decision—your ideal destination, if clearly defined, can make a tremendous difference.

Continued…

"The trouble with the world is not that people know too little, but that they know so many things that ain't so."
—Mark Twain

To some, a 75% stock allocation for an 80+ year-old couple seems completely backwards. But while the stock allocation is significant, it is not speculative, as most are. Decades of academic and industry research teach us that stock picking and market timing, tactical allocation and interest rate forecasting all fail at maximizing lifetime wealth. They succeed only at increasing stress and anxiety, which you probably already have a fair amount of in other aspects of your life. We deliberately avoided all of these common pitfalls; it was written into the Investment Policy Statement.

We instead focused on a few primary investing decisions—global diversification, stocks over bonds, and within the stock portfolio, a moderate emphasis on smaller and more value-oriented stocks. We did what financial science has taught us should work, even if those things were relatively few, seemingly simple, and didn't always pay off. We avoided more conventional approaches that are long on sizzle but short on results.

Some of our decisions have paid off better than others and we acknowledge and accept that. As previously mentioned, stocks have shone brightly. Small cap stocks have had much higher returns than large cap stocks as well. The value premium has been noticeably absent in recent years and global diversification has been a tough pill to swallow for some time.

We didn't make these investment decisions believing that they would all work all of the time. By narrowing our focus and spurning convention for academic rigor, it made it easier to understand and track our progress, celebrating what went well and accepting what did not as part of the inherent uncertainty of investing.

"It's not the work that's hard, it's the discipline."
—Anonymous

2008 was not an easy time for these, or any, investors. Stocks fell as much as they had in any year since 1932, and set them back several years in terms of growth. We could not have seen the decline coming nor would we be able to predict when stocks would recover. We only knew, if history was any guide, that they would. What other guide would we use? The ramblings of active managers and market prognosticators with their persuasive prose but dismal track records? Amidst the noise, we stuck it out, even rebalanced from bonds to stocks and back to target. Today, 2008 and those deflated portfolio balances are a distant memory.

Across the country, another experience was unfolding. The former and recently retired editor of a well-known financial magazine hired a financial planner to design an investment plan for a one-time fee to be implemented and maintained by this savvy retiree. He knew what to do, he just needed the rough edges rounded off, he related to me by phone. When stocks started to plummet, he lost his nerve and stayed in cash. What looked like a smart move for 15 months turned into despair a few years later as rising stock prices proved as difficult to plunge into as falling ones did. By 2016, a nine-year policy of staying in cash proved wholly unprofitable and far more stressful than riding the market down and then back up.

Knowing *what to do* wasn't the hard part; it was the *discipline to do it*, to stick to a singular plan while tuning out uncertainty and countless nuggets of conflicting advice.

"Simplicity is the ultimate sophistication."
—Leonardo daVinci

Pursuing your most important goals, employing just a handful of time-tested investment principles, and maintaining the patience to stick with them during the most difficult times; what if you stripped away everything else in your financial life and focused on doing these three things? Would you miss out on opportunities or be forced to make significant sacrifices in the name of simplicity? Or is it possible you would achieve more, including more of what matters most to you?

I have run Servo since 2012 with the belief that for most people, the latter is true, and all that is needed is a trusted professional to steer them in the right direction and keep them on course. I couldn't be more proud of how this simple yet sophisticated philosophy has impacted the dozens of individuals and families who now entrust Servo with their wealth, or more excited to share it with people I will eventually meet. To me, these are more than just words on wealth.

[1] Peter Drucker, "Managing Knowledge Means Managing Oneself," *Leader to Leader Journal,* no. 16 (Spring 2000).

Past performance is not a guarantee of future results. Diversification does not eliminate the risk of loss. Index and fund returns include the reinvestment of dividends but not expenses or additional advisory fees. This article is for informational purposes, and it is not to be construed as an offer, solicitation, recommendation, or endorsement of any particular security, product, or service. Servo is a Registered Investment Advisor (RIA) with clients nationwide. Unauthorized copying, reproducing, duplicating, or transmitting of this material is prohibited. For past *Factors In Focus* newsletters, please visit Servo's website at servowealth.com. **Edited by Kathy Walker.**

Contact Eric Nelson, CFA at eric@servowealth.com with any questions, comments, thoughts, or to discuss your personal financial situation.