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An IPS is like a GPS for Your Investment Portfolio

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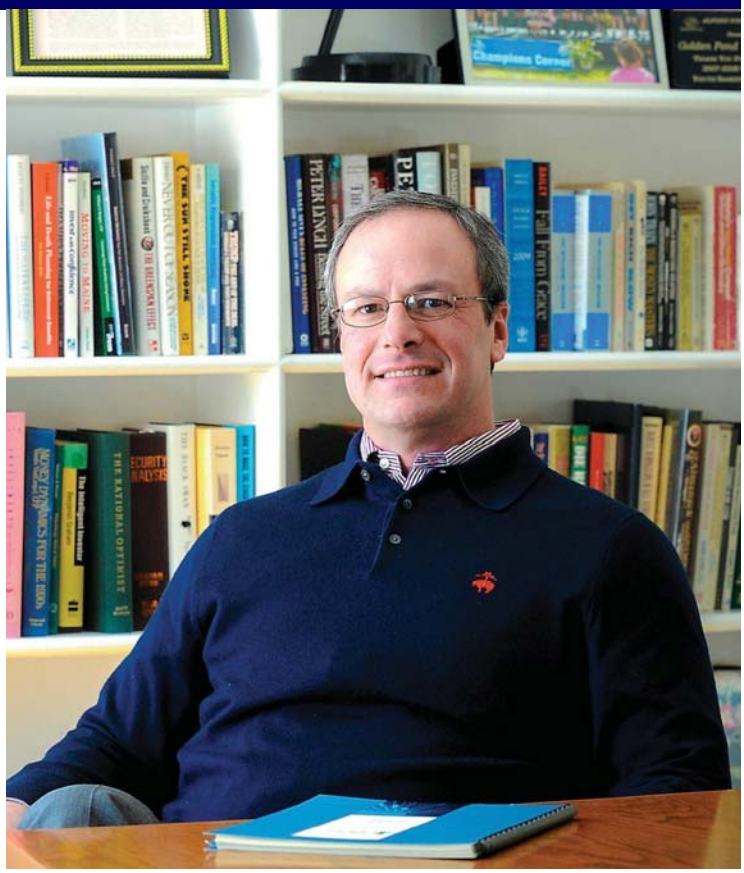

If you drove a car to Boston prior to the invention of the GPS (Global Positioning System) you can probably recount horror stories of missing turns, getting off the wrong exits, heading down one-way streets the wrong way, trying to reach a building that you could look up and see but just couldn't find the right road to get there (I once even ran out of gas in downtown Boston after driving around aimlessly confused by the conflicting directions I received from disinterested pedestrians on the side of the road.) The GPS has made travel for those of us with no sense of direction so much more efficient and less stressful.

A written Investment Policy Statement (IPS) can act much like a GPS for your investment portfolio, providing you and your financial adviser with guidance and limits with a goal of providing a sustainable and growing income stream throughout your retirement journey. The IPS is a simple yet powerful document that spells out an acceptable allocation range to target in stocks, bonds, and cash. The IPS also provides flexibility to allow the investment advisers to tilt the allocation towards and away from stocks and bonds to adjust to current and future market conditions. In most cases, our IPS for retirees allows for a range of 50% to 70% in stocks and 30% to 50% in bonds. The IPS places further limitations on the allocation inside the stock and bond sleeves - requiring the core of each to be invested in stock and bond asset classes which have historically had the least amount of downside risk. The IPS can also establish long-term annualized return targets for your portfolio and indicate what benchmarks the portfolio and each investment in it will be measured against.

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The IPS also states investments which are prohibited: options and futures contracts, short sales, non-marketable securities, initial public offerings, and margin. Finally, it can specify the frequency with which each investment is reviewed, and the portfolio rebalanced to target allocations.

Using the car/GPS analogy, these written guidelines establish the rules of the road; discouraging the temptation to take too much risk by "breaking the speed limit" and going all in on stocks and prohibiting "off-road riding" into areas of risky and exotic investments which can tempt any investor looking for a shortcut to long-term success.

A written spending policy which governs the amount you can withdraw from your portfolio can also be incorporated into your IPS. A typical spending policy will limit the annual withdrawals to 3%-5% of the previous year-end value. To provide for less fluctuation in withdrawals it can be calculated based on the average ending balance of the 3 previous calendar years.

Taking the time and effort to establish a simple IPS for your retirement portfolio can provide you with a GPS which ignores the inevitable short-term bumps in the road to keep the focus on the ultimate long-term destination of retirement income security.

Once established, your IPS should be reviewed every few years, but just as importantly, it should be reread out loud during times when greed and fear attempt to block your GPS signal. (be sure to pull off to the side of the road when you read it!) During bull markets… like the one we experienced from the end of the Great Recession to the beginning of the Covid Pandemic, most investors will be tempted to ignore their IPS and drive way beyond their posted speed limit by delaying a reallocation from stocks to bonds. The IPS can be that friendly yet stern state trooper who pulls you over to warn of curvy and bumpy roads ahead filled with bears just waking from hibernation.