The Siller & Cohen Report

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THREE KEYS TO MORE SUCCESSFUL INVESTING

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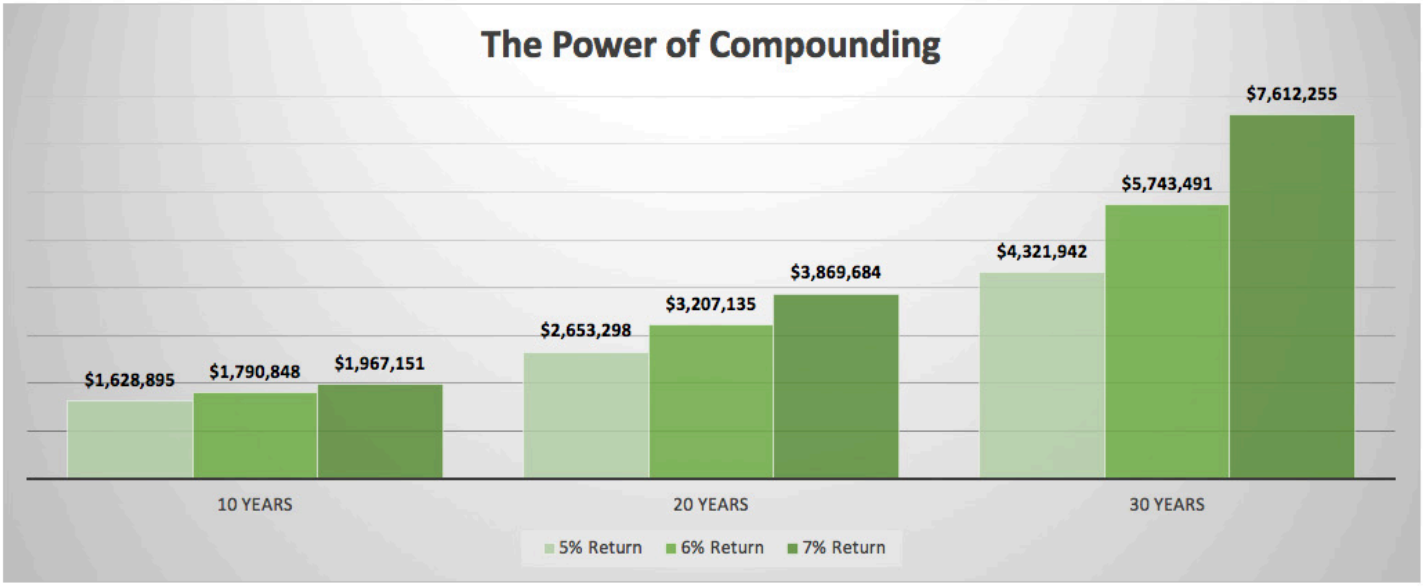
Three Keys to More Successful Investing

Though there can be no guarantee that any investment strategy will be successful and all investing involves risk, including the possible loss of principal, here are three basic principles that may help you invest more successfully.

Long-term compounding can help your nest egg grow

It's the "rolling snowball" effect. Put simply, compounding pays you earnings on your reinvested earnings. The longer you leave your money at work for you, the more exciting the numbers get. The chart below demonstrates the effect of compounding on a $1,000,000 investment over various time periods with various rates of return.



	10 Years	20 Years	30 Years
5% Return	$1,628,895	$2,653,298	$4,321,942
6% Return	$1,790,848	$3,207,135	$5,743,491
7% Return	$1,967,151	$3,869,684	$7,612,255

Of course, the rates of return listed above are hypothetical only, and do not represent any actual investment. Furthermore, this example assumes that no taxes are paid along the way, so all money stays invested. That would be the case in a tax-deferred individual retirement account or qualified retirement plan. The compounded earnings of deferred tax dollars are the main reason it is generally wise to fund all tax-advantaged retirement accounts and plans available to you.

While you should review your portfolio on a regular basis and adjust your asset allocation (defined below) over time, the point is that invested money offers the potential of a significant return over time. With time on your side, you don't have to go for investment "home runs" in order to be successful.

Spread your wealth through asset allocation

Asset allocation is the process by which you spread your dollars over several categories of investments, usually referred to as asset classes. The three most common asset classes are stocks, bonds, and cash or cash alternatives such as money market funds. Another asset class, known as "alternative investments" (the definition of which is beyond the scope of this article), can add significant diversification benefits to a portfolio. You'll also see the term "asset classes" used to refer to subcategories, such as aggressive growth stocks, long-term growth stocks, international stocks, government bonds (U.S., state, and local), high-quality corporate bonds, low-quality corporate bonds, and tax-free municipal bonds. A basic asset allocation would likely include at least stocks, bonds (or mutual funds of stocks and bonds), and cash or cash alternatives.

There are two main reasons why asset allocation is important. First, the mix of asset classes you own is a large factor — studies show the biggest factor by far — in determining your overall investment portfolio performance. In other words, the basic decision about how to divide your money between stocks, bonds, cash, and alternative investments can be more important than your subsequent choice of specific investments.

Second, by dividing your investment dollars among asset classes that do not respond to the same market forces in the same way at the same time, you can help minimize the effects of market volatility while optimizing your chances of return in the long term. Ideally, if your investments in one class are performing poorly, assets in another class may be doing better. Any gains in the latter can help offset the losses in the former and help minimize their overall impact on your portfolio.

In choosing an asset allocation, you'll need to consider how quickly you might need to convert an investment into cash without loss of principal (your initial investment). Generally speaking, the sooner you'll need your money, the wiser it is to keep it in investments whose prices remain relatively stable. You want to avoid a situation, for example, where you need to use money quickly that is tied up in an investment whose price is currently down.

Therefore, your investment choices should take into account how soon you're planning to use your money. If you'll need the money within the next one to three years, you may want to consider keeping it in a money market fund or other cash alternative whose aim is to protect your initial investment. Your rate of return may be lower than that possible with more volatile investments such as stocks, but you'll breathe easier knowing that the principal you invested is relatively safe and quickly available, without concern over market conditions on a given day. Conversely, if you have a long time horizon — for example, if you're investing for a retirement that's many years away — you may be able to invest a greater percentage of your assets in something that might have more dramatic price changes but that might also have greater potential for long-term growth.

Category	Asset Class	Risk Spectrum
Fixed Income	Cash	Less Risk
	TIPS	
	Intermediate Fixed Income	
	Long Fixed Income	
	High Yield	
Equities	REIT/Real Estate	
	Large Cap Equity	
	Smid Cap Equity	
	International Equity	
	Emerging Market Equity	More Risk
Alternatives	Absolute Return	Less Risk
	Alpha Opportunistic	More Risk

Be Mindful of The Sequence of Returns

Consider the example below. Three clients, Mrs. Jones, Mr. Smith, and Mr. Brown all invest $1,000,000 on the same day, and hold their investments for 25 years. Each investor earns a 7% average annual rate of return. However, they all get to that 7% average in different ways, Mrs. Jones has strong returns early and poor returns late, Mr. Smith has poor returns early and strong returns late, and Mr. Brown simply earns 7% each year.

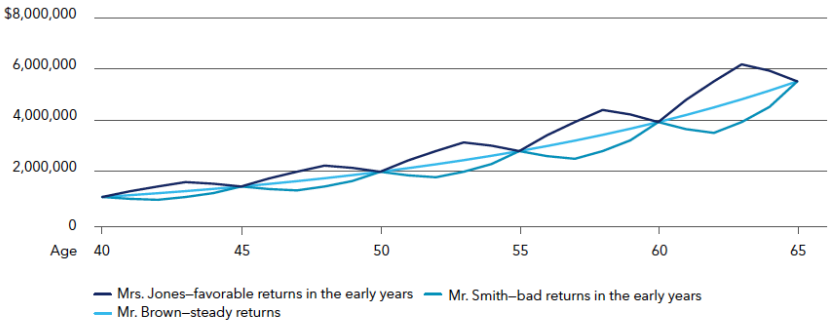
Of the three, which portfolio would you choose? From the example, it doesn't seem to matter, as all three investors end up at the same place at the end of 25 years.

Impact during savings

The sequence of returns has no impact on the final portfolio value when you are saving.

- Three investors made the same initial hypothetical investment of $1,000,000 at age 40 with no additions or withdrawals.
- All had an average annual return of 7% over 25 years. However, each experienced a different sequence of returns.
- **At age 65, all had the same portfolio value, although they had experienced different valuations along the way.**

Three unique return scenarios



Source: BlackRock. This graphic looks at the effect the sequence of returns can have on your portfolio value over a long period of time. Other factors that may affect the longevity of assets include the investment mix, taxes and expenses related to investing. This is a hypothetical illustration. This illustration assumes a hypothetical initial portfolio balance of $1,000,000 with no additions or withdrawals and the hypothetical sequence of returns noted in the table. These figures are for illustrative purposes only and do not represent any particular investment, nor do they reflect any investment fees, expenses or taxes.

Three unique return scenarios

% Yearly total returns			
Age	Mrs. Jones	Mr. Smith	Mr. Brown
41	22	-7	7
42	15	-4	7
43	12	12	7
44	-4	15	7
45	-7	22	7
46	22	-7	7
47	15	-4	7
48	12	12	7
49	-4	15	7
50	-7	22	7
51	22	-7	7
52	15	-4	7
53	12	12	7
54	-4	15	7
55	-7	22	7
56	22	-7	7
57	15	-4	7
58	12	12	7
59	-4	15	7
60	-7	22	7
61	22	-7	7
62	15	-4	7
63	12	12	7
64	-4	15	7
65	-7	22	7
Avg. return	**7%**	**7%**	**7%**
Ending value	**$5,434,372**	**$5,434,372**	**$5,434,372**

Each five-year sequence is repeated five times and has an average annual return of 7%.

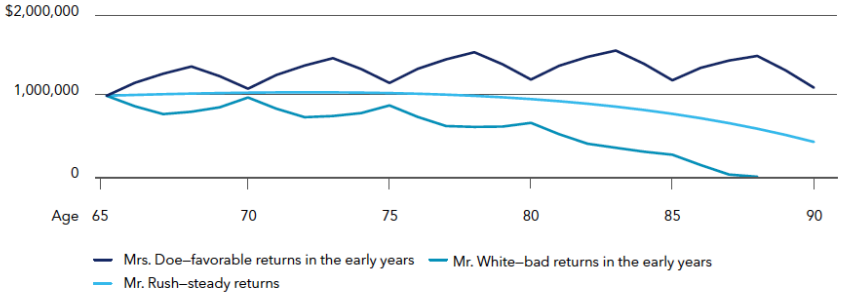
However, now consider three retirees, Mrs. Doe, Mr. White, and Mr. Rush, who are relying on their portfolio for income. Again, they each start with $1,000,000 on the same day and invest over 25 years. Just like the previous example, they each earn 7% on average over that time period, in fact, their returns exactly mimic the previous example (each investor earns the exact same annual returns in the exact same order as the corresponding investor in the previous example). The only difference here is that these investors are drawing $60,000 per year out of the portfolio, adjusted annually for inflation.

Impact during withdrawal

The sequence of returns can have a critical impact on portfolio value when you are withdrawing due to the compounding effect on the annual account balances and annual withdrawals.

- Three investors made the same initial hypothetical investment of $1,000,000 upon retirement at age 65.
- All had an average annual return of 7% over 25 years, which followed the same sequences as during the savings phase.
- All made withdrawals of $60,000, adjusted annually for inflation.
- **At age 90, all had different portfolio values due to annual withdrawal.**

Three unique return scenarios



Source: BlackRock. This graphic looks at the effect the sequence of returns can have on your portfolio value over a long period of time. Other factors that may affect the longevity of assets include the investment mix, taxes, expenses related to investing and the number of years of retirement funding (life expectancy). This is a hypothetical illustration. This illustration assumes a hypothetical initial portfolio balance of $1,000,000, annual withdrawals of $60,000 adjusted annually by 3% for inflation and the hypothetical sequence of returns noted in the table. These figures are for illustrative purposes only and do not represent any particular investment, nor do they reflect any investment fees, expenses or taxes. When you are withdrawing money from a portfolio, your results can be affected by the sequence of returns even when average return remains the same, due to the compounding effect on the annual account balances and annual withdrawals.

Three unique return scenarios

% Yearly total returns*			
Age	Mrs. Doe	Mr. White	Mr. Rush
66	22	-7	7
67	15	-4	7
68	12	12	7
69	-4	15	7
70	-7	22	7
71	22	-7	7
72	15	-4	7
73	12	12	7
74	-4	15	7
75	-7	22	7
76	22	-7	7
77	15	-4	7
78	12	12	7
79	-4	15	7
80	-7	22	7
81	22	-7	7
82	15	-4	7
83	12	12	7
84	-4	15	7
85	-7	22	7
86	22	-7	7
87	15	-4	7
88	12	12	7
89	-4	–	7
90	-7	–	7
Ending value	**$1,099,831**	**$0**	**$430,323**

* These sequences of returns are identical to those on page one. Mr. White depleted his account at age 88. Had his portfolio not run out, he would have experienced returns of 15% and 22% at ages 89 and 90, respectively, thereby continuing the same sequence of returns.

This time, the sequence of returns has a tremendous affect on portfolio performance, and ultimately, these investors ability to maintain their lifestyles in retirement. Because Mr. White has such poor returns in early years, the principal of his account begins to erode, meaning he receives less benefit from the strong returns in later years. Consequently, he runs out of money before his 90th birthday. Mr. White would be forced to either substantially alter his lifestyle or return to work.

Consider this example, if you start with a $100,000 investment and the investment loses 50% of its value in year 1, what return would you need in year 2 to get back to where you started?

Counterintuitively, the answer is 100%, not 50% (after year 1, your principal balance is $50,000, which would require a $50,000 gain or 100% return to get back to $100,000).

All of this underscores the importance of controlling risk in volatile markets. No one can control markets to be sure that the early years of a client's retirement are strong ones (like Mrs. Doe's), and no one can guarantee returns as consistent as Mr. Rush's. However, we can design well balanced portfolios that minimize volatility and give you the best mathematical chance of achieving your objectives.

Whose portfolio do you have, Mrs. Doe's, Mr. White's, or Mr. Rush's? If you're not sure, our office can help you analyze your current holdings and determine how strong your current risk management is.

Summary

The rules of thumb above are some of the main principles we find important to a successful investment strategy. Of course, successful investing isn't as simple as following three rules. Prudent investing involves careful planning, consideration, and coordination with the rest of your family's financial picture. It also requires thorough and consistent review leading to adjustments as necessary. It can be hard work, but paying attention to small details in your portfolio can be extremely impactful to you and your family over time. Please reach out to our office with any questions, we would be happy to help you design and monitor an investment plan that works for you.

What's New At Siller & Cohen: 4th Quarter 2019

Speaking Events

- Randy Siller and John Froberg presented to a prominent New York law firm. Their presentation focused on prudent personal financial planning. Specifically, they discussed financial independence modeling and strategy, investment and portfolio management, estate design, and the coordination of these topics.

Staff Updates

- We are proud to announce that John Froberg has earned the CFP® designation, issued by the CFP Board of Standards.
- We would like to congratulate Fran Narkaj on passing his Series 7 exam.