BELL TOWER
ADVISORS

12/05/11: Timeless Investing Principles

I read an astonishing statistic in today's USA Today. The cover story in the Money section states that "more than half of all workers approaching retirement age, 56%, have less than $25,000 in savings", according to a survey by the Employee Benefit Research Institute. Ouch, that is a sobering statement. I am sure that nobody on this list has that meager amount, however, reading this made me think that this is a good time to review some basic investing principles that can help, given the incredible volatility we have been enduring in the markets (with no real end in sight). As we approach the end of the year, it is an excellent time to review how your portfolio is structured in relation to these principles.

Here are five principles, or rules, that should be a part of your ongoing investment process:

1. Minimize taxes. In this era of lower equity returns, tax efficiency is more important than ever. Tax loss harvesting and using taxable and tax-advantaged accounts to their best advantage are ways to ensure efficiency. If you've experienced long term, unrealized losses in a taxable investment account, you might consider locking in those losses by selling them, and using them to offset current or future gains. (Just beware of the 30-day wash rule.) Since our current capital gains tax rate, 15%, is unlikely to be this low after 2012, these locked-in losses could become valuable from a tax perspective in the future. Please check with your tax accountant before proceeding with any tax loss harvesting plans.
2. Control costs. Based on what I see almost every day, there are still so many funds and investment products with outrageously high expenses. With the large choices we have available in the investment product universe today, it is just no longer necessary to invest in high cost funds or products. Given the meager returns we experienced in the last decade, shaving an extra 0.50% or even 1.00% off your expenses could add significantly to your returns. Beware of hidden fees/commissions being charged by your custodian or broker as well. If you are unsure of your overall cost profile, we would be happy to review your account transactions and custodial fees and give you an idea of whether the fees you are paying are reasonable.
3. Diversify. As financial markets have become more complex and volatile, maintaining a diversified approach to investing is more critical than ever. Investors should have some amount of stocks, bonds, commodities and real estate in their portfolios (the targeted mix of asset classes is your "target asset allocation"). "Alternative investments" is a catchall phrase that includes many different strategies, some much riskier than others. Some market "experts" are saying that diversification did not work during the market meltdown of 2008-2009, but some bond categories (read: Treasuries) actually performed pretty well. I believe part of the increased volatility we are experiencing today is the result of the marketplace re-examining just what is a

risky asset and what is a risk-free asset. The old definitions have been thrown out the window (with good reason), and this re-examination isn't over yet. While it goes on, the correlations among asset classes may be higher than normal. Diversification, however, is not dead. I also strongly suggest that in both stock and bond portfolios, international investments be included. Our world is now a global one and other parts of the world are out-growing us and will do so for decades to come. The dominance that the United States enjoyed throughout the 20th century is over and is in a long-term decline. China, for example, is about to become the 2nd largest world economy behind ours, and some predict it will overtake us in a decade or two.

4. Rebalance. A general rule of thumb is to automatically rebalance when your actual allocation differs from your target allocation by 10% or more. This helps to "buy low, sell high". If this activity were put into practice in 2007, you would have likely been selling stocks as they approached their peak. (How great would that have felt?) That is exactly why this type of disciplined process works. The key word here is "discipline"; you must implement the process and not allow greed to take over.
5. Review Your Goals. At least once each year, review your investment goals to ensure you have the proper asset allocation. A general rule of thumb that I live by: DO NOT have any money in the stock market that you may need over the next five years. Some of my colleagues even suggest this be seven years! I'm leaning this way, too, given the increased volatility we have been experiencing. But, you may say, the bond market pays nothing! Short term government bonds have interest rates of less than 1%, not even covering inflation. There are pockets in the bond market that pay more, but basically, there is no free lunch. Unless you want to increase your risk appetite, the equity markets are too volatile these days to risk money you may need to count on. HOWEVER, this is also a good time to review your risk tolerance (how much risk you can bear emotionally) as well as your risk required (what amount of risk you must take to in order to meet your goals). It is not always a fun process but those who take the time to do this will be very glad they did.

For those of you who read this whole email, I hope it helps with some important reminders. If I can help anyone with any of these principles, let me know!

Margie