



## BALANCE LONG- AND SHORT-TERM STRATEGIES FOR YOUR CLIENTS

In today's environment, helping clients requires exceptional balancing skills.

You are walking a tightrope, balancing uncertainty (clients' doubts, as well as your own) and real-life stock market declines that are impacting the lives and plans of your clients.

In addition, many investors have lost faith in the most fundamental of investment strategies: long-term buy-and-hold for equities and bonds. This strategy was unsuccessful in the past year, triggering widespread doubts regarding its basic validity.

Despite our growing understanding of behavioral finance and the emotions that interfere with objective assessment of financial planning models, no one has yet developed a way to see through the clutter and the complexity that impact our perspective. In fact, in a circular fashion, it is the very inability of most folks to see through these complexities that creates opportunity.

So even in the midst of this uncertainty – in fact, especially in the midst of this uncertainty – it is important to identify the elements of today's economy where you do have a high level of confidence. The next step is to find opportunities and solutions that can help resolve both the realities and the emotions that your clients feel.

As long as your clients stay with you, they will look to you for leadership – even if they are balky and difficult and do not seem inclined to listen to your counsel. Leadership on your part means identifying an overall point of view or concept that underpins the investment strategies you employ. This does not mean finding a formula that can be applied, cookie-cutter fashion, to each client. It does mean a thorough review of your belief system, based on your rational assessment of market conditions and a decision about to how to proceed conceptually and deliver success.

## Does the fundamental long-term buy-and-hold strategy still work?

"Is Markowitz Wrong? ..." questions the FPA Journal in January, 2009, representing the emotions of the moment.

And how about this one?

"The Death of Equities" announces Business Week. And the date for that cover is 1979, when the S & P 500 Index hovered around a mere 100.

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The most fundamental market strategy incorporates buy-and-hold with asset allocation and periodic rebalancing – that is, Modern Portfolio Theory, first articulated by Harry Markowitz in 1952. This view that investment diversification reduces overall risk, along with the associated long-term investing strategy, is being questioned and challenged by clients and industry experts alike.

Have the markets changed in some fundamental way so that basic premises of investing need to be reinvented? Or are we merely enduring a blip in the long-term growth of the economy and the equities that underlie that growth?

### ***This time it's different! The case against buy-and-hold***

Let's face it. Buy-and-hold did not work for investors in 2008, and so far the jury is out for 2009. The S&P 500 Index opened January 2, 2008, at 1469 and closed out the year at 903, a decline of more than 38%.

Then, in 2009, the S&P 500 reached a 12-year low of 677 on March 9. A 37% rally peaked at 929 on May 8.

Triggered by the subprime mortgage collapse, severe disruptions across the biggest financial and manufacturing corporations in the U.S., have changed the financial lives of most Americans in some

way, possibly for decades to come. The death and destruction of some of Wall Street's most venerable firms, the freezing of trillions of dollars of unmarketable securities, government loans and intervention, and the potential demise of the already-weak American auto industry have set off emotions that emerge daily as investors turn on their favorite news programs.

Since we have not experienced such sharp and extreme financial events in recent memory, is it time to take another look at market actions in 2008 and 2009? Investors are asking, "Are our most hallowed financial principles proving themselves wrong?" The answer comes back, "Asset allocation and long-term buy-and-hold are just not going to work anymore."

### ***This time it's different! The case for buy-and-hold***

According to Sir John Templeton, the billionaire mutual fund pioneer, the four most dangerous words in investing are "This time it's different."

Is it possible that Templeton is correct and events of the past 18 months are simply a short-term aberration in the very-long-term growth of the global economy?

Consider this: Investors who were caught up in the emotions of September-December, 2008 and sold out their portfolios are the very same people who missed the S&P 500 run up of 37% that peaked in early May.

One of the most powerful arguments for the buy-and-hold strategy comes from the yearly Dalbar studies which track individual vs. institutional returns over a 20-year period. For the year ending in December 2007, the average large cap mutual fund returned 10.81% while individual investors averaged a 4.48% return. Dalbar attributes the individuals' lower return to emotion-based attempts to time the market and not sticking with a long-term buy-and-hold strategy.

In a recent blog posting, Investnet vice president Brett Leach reports on Nick Murray's new book Behavioral Investment Counseling, citing Murray's premise that the "dominant determinant of long-term returns is based on ... the behavior of the investor himself."

You can't evaluate a long-term strategy based on short-term results. The evidence for the success of a long-term strategy is overwhelming, and it comes in just about every form imaginable – charts, graphs, statistics and countless examples. Recent surveys show that many advisors still believe in the long-term growth process. But the reality is that portfolios have lost significant value, clients are unhappy, and most Americans are finding that their lives have changed since the market collapse in 2008.



How can you hold to a long-term strategy and still find satisfactory ways to help clients meet their goals and feel comfortable with their investments?

One of the most valuable ways to lead your clients is to recognize that their lives have changed – both their perceptions of risk and very possibly the reality of risk. Begin meetings with that perspective and open the door for honest and meaningful conversations.

### **Review, Reassess and Revise Risk Tolerance**

These days, looking at their monthly statements is a stomach-twisting experience for most investors. Visions of postponed and cancelled vacations, changing college plans or a more distant retirement come to mind. The numbers on the statement trigger anxiety, fear, anger, remorse – powerful emotions that swirl around the visions.

A critical part of your balancing act is to help clients address both the emotional and practical sides of their situations. One way to approach this is to review and reassess risk perceptions, which have undoubtedly changed since mid-2008. People have become more financially conservative, emphasizing paying down debt and preserving assets they might formerly have been willing to put into higher risk/higher growth investments.

Before you sit down with a client, take a few minutes to review your risk assessment questionnaire or checklist. With change touching the lives of so many Americans, there could be a few questions to add. For example:

- What is happening in the areas of employment, home equity and college planning?
- What steps is your client taking to address a potential loss of retirement income?
- How are time horizons changing?
- What levels of debt is the client carrying? Has the credit rating been increased or decreased? What steps are being taken to manage and pay down debt?
- Many people who might otherwise be managing well have been impacted by situations of extended family members. Has an adult child moved back home, for example?

The answers to these questions could take your meeting in an entirely unexpected direction.

Practical, real-life situations are changing for people and bringing new challenges. Even high net worth clients – those whose lives will be comfortable even with a 30% drop in liquid assets – are fearful. Painful experience has generally pushed individuals toward the more conservative end of the risk spectrum.

After updating information on their current life situations, it is important to re-evaluate the attitude toward risk using the seven measures of risk assessment – those that determine portfolio allocation and range from capital preservation to aggressive. Even while the buy-and-hold strategy is maintained, you and the client may decide to move a notch or two closer to the conservative end of the range.

In addition to the practical information and potential actions that will be gained from reassessing risk with your client, this is a dialogue that focuses on the client – not the market or past history. It shows you care, and that kind of communication will strengthen your relationship.

### **Use Strategies that Fit Today's Market**

Even if you, the advisor, are a rock-solid and committed believer in long-term strategy, there is immense pressure from some clients to “please do something.” According to Spectrem Group, which specializes in consulting on high net worth clients, many wealthy individuals expect to move to other advisors, despite the fact that they don't directly blame their current advisors for losses.<sup>1</sup> Moreover, almost all advisors have a strong desire to help clients meet their goals and live the lifestyle they want. That's a big reason why they enter the business in the first place.

One potential way to add balance to a long-term strategy is to allocate a portion of the portfolio to tactical investing. These more-opportunistic funds are designed to try to take advantage of short-term market swings and provide low volatility and low correlation to traditional long-term strategies.

To meet these needs, Portfolio Management Consultants launched two dynamic portfolio solutions that can be applied to most, if not all, risk tolerances. The Risk-Based PMC Tactical ETF Portfolio Series incorporates five portfolios that span from Conservative to Growth. These portfolios aim to provide continuing equity and fixed income exposure as well as the ability to weight allocation based on market conditions. They are designed to provide advisors with a straightforward process that tries to align the appropriate portfolio with the client's objectives and risk profile.

The Country and Sector Rotation Tactical ETF Portfolios seek to enable investors to participate in domestic and international equities when conditions deem favorable for P/E expansion. They also seek to allow for tactical pullback when conditions are expected to deteriorate.

This core-satellite approach can aid as an effective supplement to a long-term strategy and/or it can be incorporated into the portfolios of clients who are currently fearful of any buy-and-hold strategy.

### **Looking forward**

Even if you maintain a firm belief in long-term investing and asset allocation, there is no doubt that there will be permanent shifts in the financial markets and governance.

In a new survey by InvestmentNews, almost half of advisors said that in the future they will "soothe clients' fears of the market." About 30% expect to take a more holistic planning approach. Others will be more conservative and stay away from complicated investments.<sup>2</sup> One observer expects advisors to pay more attention to macroeconomic events in the U.S. and globally.

Smart advisors will learn from the volatility and gyrations of 2008-2009, and they will adjust their practices accordingly.

**Where Do We Go From Here?, a white paper issued by PMC, presents a more analytical approach to topics discussed in this document.**

<sup>1</sup> "Downturn alters behavior and attitudes of advisers," InvestmentNews, May 18, 2009, page 38.

<sup>2</sup> "Advisers face 'substantial' turnover of wealthy clients," by Mark Bruno, InvestmentNews, May 25, 2009, page 13.



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