Perspectives

THIRD QUARTER 2015

Hatcher Financial
4647 N. 32nd St., Ste. 280
Phoenix, AZ 85018-3327

Making Benchmarks More Personal

By Wendy Matheny, CIMA®, MBA
IMS Regional Director, 1st Global

Goals navigate you through your personal, professional and financial life. Goals motivate you to focus on progression, the future and keep you on track when unexpected events and opportunities inevitably arise.

Setting personal goals to identify what it is that you want to gain from life is a crucial step in the financial planning process. These goals often include being able to fulfill the promises that you've made to your loved ones, enjoying your freedoms or leaving a legacy for the generations that follow. All of these contribute to living intentionally, with purpose and meaning by focusing on **what matters most**. However, the times we live in make it hard to remain focused on living intentionally because of the nonstop "noise" that surrounds us.

In a time of constant connectivity, you have more access to information than ever before. While this access to information has led to tremendous innovation and knowledge sharing, it does have a downside. In investing, we have been taught to keep our focus on the long term, but the ability to access financial information at any moment and a culture of breaking news, has created false pressure to measure performance against the news of the day. Hearing news headlines may trigger you to log in to check the performance of your portfolio. But what are you measuring against? Have you ever asked yourself – is this information relevant to my financial goals?

Managing Emotions and Expectations

While you may care more about your happiness and meeting personal objectives, the influences of short-term market volatility and financial noise don't go unnoticed. Richard Rosso of Clarity Financial in Houston[1] talks about the inherent need for individuals to care more about the clear and consistent path to reward (process and plan) than chasing rainbows in search of a pot of gold. As part of beliefs and philosophy, investors know and understand that risk and return are related. As you look at benchmarks and feel your individual portfolio isn't keeping up, you have to assess the goals you laid out to achieve, confirm the risk you are willing to assume, and measure the progress you've made in your long-term portfolio that goes beyond exceeding the quarterly return of a market index.

It may be convenient to use an index that is widely followed, such as the S&P 500 or the Dow Jones, but may not be the optimal measure of your plan's ability to meet the goals you have set. As a long-term, multi-asset class investor, you must remind yourself that you are not trying to time, speculate or fool the market. You must remain focused on having a long-term discipline, a truly individual plan and strategy, and a sound process to achieving your vision versus fulfilling an immediate, emotional need.

Develop or Review Your Vision

Developing and memorializing your vision can be challenging. One way is to start by covering the bases and then finish by imagining the possibilities. These are some things you can talk to your financial advisor about when it comes to life planning and goals:

Covering the Bases	Imagining the Possibilities
Send my Kids to College	Retire When I What to
Know my Business is in Good Hands	Have Confidence in my Plan
Achieve Freedom from Debt	Leave a Legacy
Never Being a Burden	Collaborating with my Team

Portfolio Behavior — What's Under the Hood?

To reinforce the importance of knowing what your portfolio is holding and how it might behave across time versus a benchmark, consider this example: If you looked at the approximately 6,000 publicly-traded stocks, you will find the majority of ***the value*** is concentrated in the top 200. While the smallest 3,000 publicly-traded companies represent 50 percent of the total number, they only represent a small percentage of the total market value. If you were an investor holding an equally-weighted stock portfolio containing **all US stocks**, the result is that the portfolio behavior would be more dominated by the small and medium sized companies. This behavior could be quite different from a standard equity market index, like the S&P 500, that represents the largest 500 companies by market capitalization.

If you find yourself comparing your portfolio's return to the return of an index, it may be time for you to re-review the role of your investments with your advisor, reconfirm the characteristics and long-term benefits of asset classes being used and their indexes and understand how rebalancing is keeping the market from pushing you into a different risk tolerance. Considering an investment mix that is better suited to your risk profile, based upon your risk profile, can be another alternative.

Key Takeaways

- Have a comprehensive, holistic plan that keeps your life goals at the forefront
- Review and memorialize the most important milestones as components of your personal benchmarks
- Do a review with your advisor on what is in your current portfolio, the specific roles of these investments and the opportunities to compound your wealth
- Keep your portfolio healthy and in alignment with your risk tolerance by rebalancing
- Review opportunities with your advisor for tax optimization in order to keep more of what you earn
- Review your goals periodically and account for any changes

Disclosures

Asset Allocation/Diversification of your overall investment portfolio does not assure a profit or protect against a loss in declining markets

S & P 500 Index: S & P 500 Index is an unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The S & P 500 Index serves as a benchmark for U.S. Large Company Equities. It is not possible to invest directly in an index.

Dow Jones: Dow Jones Industrial Average is unmanaged and measures broad market performance. It is not possible to invest directly in an index.

[1] Financial Life Benchmarking – The Pot Before the Rainbow, Richard Rosso, CIMA®, CFP®, 2011

Gravel Road Investing

By Jim Parker
Vice President, DFA Australia Limited

Owners of all-purpose motor vehicles often appreciate their cars most when they leave the smooth city freeways for rough gravel country roads. In investing, highly diversified portfolios can provide similar reassurance.

In blue skies and open highways, flimsy city sedans might cruise along just as well as sturdier sports utility vehicles. But the real test occurs when the road and weather conditions deteriorate.

That's why people who travel through different terrains often invest in a SUV that can accommodate a range of environments, but without sacrificing too much in fuel economy, efficiency, and performance.

Structuring an appropriate portfolio involves similar decisions. You need an allocation that can withstand a range of investment climates while being mindful of fees and taxes.

> **Owning a diversified portfolio is like having an all-weather, all-roads, fuel-efficient vehicle in your garage. This way you're smoothing out some of the bumps in the road and taking out the guesswork.**

When certain sectors or stocks are performing strongly, it can be tempting to chase returns in one area. But if the underlying conditions deteriorate, you can end up like a motorist with a flat on a desert road without a spare.

Likewise, when the market performs badly, the temptation might be to hunker down completely. But if the investment skies brighten and the roads improve, you can risk missing out on better returns elsewhere.

One common solution is to shift strategies according to the climate. But this is a tough, and potentially costly, challenge. It is the equivalent of keeping two cars in the garage when you only need one. You're paying double the insurance, registration, and upkeep costs.

An alternative is to build a single diversified portfolio. This means spreading risk in a way that helps your portfolio capture what global markets have to offer while reducing unnecessary risks. In any one period, some parts of the portfolio will do well. Others will do poorly. You can't predict which. But that is the point of diversification.

It is important to remember that you can never completely remove risk in any investment. Even a well-diversified portfolio is not bulletproof. We saw that in 2008–09, when there were broad losses in markets.

But you can still work to minimize risks you don't need to take. These include unduly exposing your portfolio to the influences of individual stocks, sectors, or countries—or relying on the luck of the draw.

An example is those investors who made big bets on technology stocks in the late 1990s. These concentrated bets might pay off for a little while, but it is hard to build a consistent strategy out of them. And these fads aren't free. It's hard to get your timing right, and it can be costly if you're buying and selling in a hurry.

By contrast, owning a diversified portfolio is like having an all-weather, all-roads, fuel-efficient vehicle in your garage. This way you're smoothing out some of the bumps in the road and taking out the guesswork.

Because you can never be sure which markets will outperform from year to year, diversification can help increase the consistency of the outcomes and help you capture what the global markets have to offer.

Add discipline and efficient implementation to the mix, and you may get a structured low-cost, tax-efficient solution.

Just as expert engineers can design fuel-efficient vehicles for all conditions, astute financial advisors know how to construct globally diversified portfolios to help you capture what the markets offer in an efficient way while reducing the influence of random forces.

There will be rough roads ahead, for sure. But with the right investment vehicle, the ride can be a more comfortable one.

This piece was originally prepared for "Outside the Flags," a weekly Web column by Dimensional Fund Advisors. It has been republished with permission.

1st Global®
RESEARCH & CONSULTING
12750 Merit Drive | Suite 1200
Dallas, TX 75251 | 877-959-8400
www.1stGlobal.com