Chapter 4

Principles for Effective Investing

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Brian Carlson, CFP® is a Certified Financial Planner™ and Director of Client Service for Summit Investment Advisors.

Working alongside clients since 2000, Brian has consistently delivered high quality advice, service, and attention to detail. He enjoys helping people navigate the complex facets of retirement planning, so they retire with the confidence they deserve.

Brian is a graduate of the University of Minnesota – Carlson School of Management.

Risk vs. Reward

One of the keys to confident investing is balancing the risk and reward of your investments over time. If you invest too aggressively by trying to find the perfect investment (the "needle in the haystack"), you are exposing yourself to the risk that your one investment won't pay off. However, if you are too conservative and keep your money hidden under your mattress,

you aren't giving yourself the opportunity for the long-term reward that investing can offer.

A way to balance the risk and reward potential in your investment portfolio is by diversifying your holdings. Think of diversification like owning a fruit stand. You wouldn't want to only sell oranges. What if an unforeseen event like a hurricane wiped out the orange crop for the year? You wouldn't have any product to sell! Instead, as a successful vendor, you would sell not only oranges, but also bananas, apples, etc. This way, even if one of your products had a bad season, you would still have several different types of fruit to sell.

The Benefits of Diversification

Diversifying your investment portfolio is much like that fruit stand. Instead of owning just one type of investment, say stocks, a diversified portfolio owns stocks and other types of investments or asset classes such as bonds, real estate, CD's and cash.

By diversifying your investments over time you are balancing out the risk you are taking. As world-famous investor Benjamin Graham put it, "Successful investing is about managing risk, not avoiding it."

Reallocating & Rebalancing

At Summit Investment Advisors, one of the ways we seek to improve results and reduce risk is through strategic allocation and rebalancing. This involves understanding where the economy is during the business cycle, so we can provide insight on the

appropriate asset allocation and the amount of risk we feel is appropriate.

Bear in mind, throughout retirement a retiree will go through several business cycles. The strategy that is most advantageous during the first 10 years of retirement may look very different for the next 10 years. Ongoing oversight can be crucial and may be helpful supporting your goals. Strategically rebalancing the portfolio is also very important when it comes to being prepared for volatility and helps to support long-term returns.[3]

Not only do we build diversified portfolios of different types of investments (stocks, bonds, real estate, etc.), but we are also keenly focused on the investment managers we use. Constantly identifying one of the best managers in each asset class for our clients can be a complex task requiring us to analyze such things as tenure, style consistency, expense ratio, and more.

Think of it as a baseball team. If it only has right fielders, it won't be a successful team. We need pitchers, catchers, infielders and the other two outfield positions. Now, what if on top of adding these different positions to our team, we could also add the very best player at each position to our team? Our team would be well positioned for consistent, long-term success. That is the approach we employ.

[3] Asset allocation does not ensure a profit or protect against a loss. Rebalancing a portfolio may cause investors to incur tax liabilities and/or transaction costs and does not assure a profit or protect against a loss.

The Question of Payment

One of the most common questions prospective clients ask a financial services firm is, “How do you get paid?” In this industry, there are two main ways that financial firms are compensated. One is a commission-based brokerage platform and the other is a fee based advisory platform.

To offer the most flexibility to our clients, we offer both options, but the vast majority of our clients prefer the fee-based platform, meaning there is a flat annual percentage cost based on the value of the assets managed. This arrangement creates transparency because the client can clearly see what the cost is for the services we provide. Additionally, we do not get paid differently depending on what investments we use in the fee-based platform.

While the vast majority of our clients utilize our fee-based platform, there are instances where a traditional brokerage platform may be preferred.

For instance, certain types of investment products such as annuities or other income generating products, may not be suitable for the fee-based platform and are more appropriate under the traditional brokerage platform.

Also, when a new client already has commission-based products, it makes moving their accounts easier when they can hold them here. In order to provide the most transparency and flexibility to our clients, we have the capability to operate under a fee based advisory platform, or a traditional commission-based brokerage platform.

What to Do?

Investors always have questions about where to put their money. “Should I be invested in the stock market today with everything that’s going on? Should I sell my investments and move to cash?” Often a client will tell us about a friend who sold everything just before a market turned south, and they wish they had been able to do the same thing.

We are professional investors, and we have very rarely witnessed success with attempts to time the market. Occasionally someone will cash in before a market downturn. But bear in mind, for that decision to add any additional return to your strategy, you must reinvest your portfolio at a lower point than when you sold. This would require investing into a very turbulent market, when the economic and market prospects are likely very uncertain. This type of strategy is very difficult to succeed with. Determining short-term moves in the market is near impossible. We like to tell our clients that when it comes to producing long-term quality returns, “It’s time in the market, not timing the market.”

Keeping Emotion Out of the Equation

It’s also important to avoid letting your emotions drive your decisions. Keeping your emotions in check is key to successful investing. We’ve seen clients who had a sentimental attachment to a stock. Perhaps they inherited it, or they had an attachment to the company. Emotionally driven decisions often lead to poor results. Decisions based on facts, research, and advice from a trusted professional have a much greater likelihood of success.

Having guidance through this decision-making process can be invaluable. Yesterday's truth is not tomorrow's, and no pattern will continue forever. It's all about making sure your investment strategy is aligned with your long-term goals and allocating assets appropriately as economic and market conditions change.

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Bonus Content

3 QUESTIONS FOR PAUL MA

Economist

Paul Ma is a lead portfolio strategist at Fidelity Investments. In this role, he assists the nation's leading investment professionals with their portfolio concerns.

Previously Mr. Ma managed equity portfolios at a variety of firms, and was a co-founder of LifeHarbor, which developed portfolio technology for financial institutions and wealth management firms.

We asked him to share his insights on investment strategies.[4]

SUMMIT
What is your most memorable lesson from investing?

PAUL
The importance of rebalancing. This is why a strategic, longer-term horizon is so important. By rebalancing strategically we are taking a contrarian approach. Think about January of this year (2020). After a 32% rally in stocks, our 60/40 portfolio became more like 65/35. When stocks are up, we have to sell them to buy bonds to get back to our 60/40 strategic allocation. When stocks

[4] Paul Ma and Fidelity Investments are not affiliated with or endorsed by LPL Financial or Summit Investment Advisors.

are low, we sell bonds. That happened this spring when COVID triggered a dramatic pullback in stocks and our ratio dipped to 50/50. You must have a long-term plan and stick to that plan.

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What are your thoughts on how human behavior and emotion factor in investments results?

PAUL

Human behavior is the number one thing in investing! People spend most of their time and energy focused on the short term. "What's in the news today? What's scary today?" Then they make poor investment decisions based off this. Human behavior has you do the opposite of what you should do in investing: Buy stocks when they rally, and sell when they crash. That's why it's so important for investors to work with a Financial Advisor, to help them keep a longer-term strategic focus and not make short-term emotional investment decisions.

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What are the important factors investors should pay attention to in the economy, to use in the decision-making process?

PAUL

That's a great question. Again, we emphasize a strategic long-term horizon, and try to deemphasize tactical, short-term things. What is the business cycle for the next 10 years? However, people want to look at things that help tactically in the short term. There are indicators out there. For example, weekly jobless claims. That data comes out every week. This is actually a very good LEADING

indicator for how the economy is doing. For example, the last time weekly jobless claims began coming down from their highs was in March of 2009. You may recall, that was the exact start of the last bull market. If you rely on things like the unemployment rate, GDP and PMI, those are lagging indicators. Leading indicators like weekly jobless claims are important.