

## Diversity Article – January 2011

### Investing Basics

Investing can seem awfully complicated. Or, you can make it simple. Focusing on a few key strategies that guide investment decisions can relieve a lot of anxiety. These strategies will not get rid of risk, volatility, or that unpleasant experience of watching your account value go down. But, if followed over the long-term, they should help your account values grow and keep you from being your own worst enemy.

- 1) The most important factor for growing your accounts is, well, to contribute to them! Start young and be consistent. If you get a raise, use a portion of it to increase your salary deferral to your 401(k). The younger you start, the more time you will have for your account to grow. While a 25-year old could accumulate \$1 million by age 65 by investing \$381 per month, someone starting at age 35 would need to invest \$820 per month. A 45 year-old would need to sock away \$1,920 per month, and a 55 year-old a whopping \$5,778 every month.
- 2) Do some work to come up with an asset allocation that makes sense for you. An asset allocation tells you what portion of your portfolio to put into different asset classes, such as large cap Stocks, small/mid Cap stocks, international stocks, and fixed income (bonds). The key factors for determining your asset allocation are: your age and how close you are to retirement, your financial goals, and your risk tolerance. You can work with a financial planner to come up with a recommended asset allocation, or look for resources on line. If you have a 401(k) or similar account through work, you should have educational resources available to you that will help you figure this out. You can apply your asset allocation to your work retirement accounts as well as other accounts.
- 3) Once you have an asset allocation strategy, stick to it. Don't listen to the talking heads who say buy this now, sell that now, everyone should be in fund X, and asset class Y is going to tank. If you are in it for the long term your best bet is to stick to an appropriate asset allocation that gives you good diversification, and ride out the ups and downs. As your life situation changes you may need to shift your asset allocation (more conservative as you get closer to retirement, for example).
- 4) Rebalance to your asset allocation periodically. This means that if your allocation calls for 40% in large caps, and large caps go on a tear and become 55% of your portfolio, you should sell some and put those proceeds into the asset classes that are below their recommended allocations. This is hard to do because you will be selling an investment that has been doing well and buying one that has not. But, that's exactly what you want to do – buy low and sell high. It takes discipline and a commitment to your strategy. You can rebalance based on a time period (every 6-12 months, for example), or when your allocation gets significantly (more than 5-10%) out of whack. Decide on your approach and stick to it.
- 5) Be aware of expenses. A fund with high expenses has to perform better than a fund with low expenses to produce the same returns. If you want to minimize fees you can look for low-cost index funds. But, if you want actively managed funds or funds that, for example, avoid certain kinds of companies and engage company management around environmental

or human rights issues through shareholder activism, your expense fees will tend to be somewhat higher than with index funds. You can still earn competitive returns, though. Keep in mind that return data is usually net of expenses. Stay away from funds that have expenses significantly higher than other funds in the same category.

- 6) Don't abandon a fund based on short-term performance alone. In general, you want to choose funds that have experienced management (more than 3 years), reasonable expenses, and 3-year and 5-year returns competitive with other funds in the same asset class. If the account is taxable you also want to choose funds with low turnover. Even excellent funds are going to be in the lowest performing quartile for some periods of time. Of the top quartile large cap managers from 1999-2008, 77% were in the lowest performing quartile for at least one 3-year period during that decade!
- 7) Think about your portfolio's performance in terms of your own financial goals, and not "market returns." If the S&P 500 or Dow goes up 20% in a quarter, that doesn't mean your portfolio should have gone up that much. Depending on your asset allocation, your portfolio likely has some bond funds or other asset classes in it that did not go up that much. But, when the S&P500 goes DOWN 20% in a quarter, your asset allocation will be protecting you from some of that decline. To compare "apples to apples" you need to compare your portfolio's returns to returns for a portfolio with the same asset allocation (which can get complicated). What's most important is not that you "beat the market" (which is close to impossible for mere mortals over the long-term) but that your accounts grow to help you meet your financial goals.

*Kathy Stearns is a fee-only financial planner and investment advisor in Boise. She sells no products and earns no commissions. She is an Investment Advisory Representative of First Affirmative Financial Network (SEC File #801-5687), which serves socially conscious investors and has nearly \$700 million under management. Prior to becoming a financial planner she spent more than 20 years working in the nonprofit sector to increase economic opportunities for the disadvantaged in developing countries and the US. Her website is: [www.arcadvisers.net](http://www.arcadvisers.net). The views herein are those of the author and do not necessarily reflect those of First Affirmative, its management or staff.*