The Lost Decade—The Lost Nest Egg

By Montgomery Taylor

The first decade of the 21st century ended at midnight on January 1. Investors say good riddance. The S&P ended 2010 worth only 1 percent more than 10 years ago, a performance only a flea's eyelash superior to 1930 to 1939, the decade following the Great Depression. The Dow Jones Average rose only 7 percent over the past 10 years—annualized less than 1 percent per year. Grandma's CDs did better. Along the way, and accelerated at the end, government manipulations of markets (Fannie Mae, Freddie Mac and the prime evil housing bubble), and once revered "great American companies" exposed as little more than giant frauds collapsed. Wealth literally disappeared. This, rather ironically, invites more government interference. Maybe the worst impact: the rank and file retail investors have left the markets *en masse*, especially baby boomers, leaving the trading volume thin and in the hands of giant institutional funds, resulting in markets that are much more about minute-by-minute speculation than true investment. With real recovery a distant uncertainty, what's here now is weak, fragile and propped up by taxpayer dollars being shuffled from one pocket to another—many stents that are barely keeping the arteries open.

In 1970, when another 10-year term of market retardation and malaise began, Americans had only $48 billion invested in mutual funds. A whole lot of ordinary wealth was in the safest of places—including homes being paid off with equity intact. At the end of 2000, we had $7 trillion in funds in the markets, including nearly everybody's individual retirement accounts and pension funds. Wall Street had made itself seem a safe alternative to federally insured savings accounts at the bank and sucked in peoples' old-age funds. Then it ate the money.

Boomers in trauma

The mass-affluents' wealth and sense of wealth skyrocketed on the back of the housing bubble and irrational exuberance over the stock market. Then it crashed. Early boomers' and seniors' wealth were badly wounded and retirement plans voided. The affluent and ultra-affluent got burnt as badly in percentage terms, but are least affected in real terms—if you have $20 million in assets reduced to $12 million, but have a current six-figure income and only spend $200,000 a year, you have burns on your fingers (and maybe on your psyche), but your lifestyle is intact. If, however, you have $2 million in assets, and see it reduced to $800,000, have an income that has stalled or shrunk, debt, and spend more than you make, you're in trauma, not just mentally but in actuality. Your upward movement has ended and you're trying to slow your downward slide—and you're definitely looking down.

What should you do?

Bury your money in the backyard and hide under your bed? No. Park you money in bank CDs at near zero percent? Of course not. Keep your investments with the financial adviser who sat with you through the lost decade? No, that would be insane. You know the definition of insanity don't you: Doing the same thing over and over again and expecting different results.

The problem with financial advisers

Upon entering the business, advisers were taught that the most important decision affecting a client's portfolio was asset allocation. Once the appropriate asset allocation was decided on—based on the client's risk tolerance profile, it was set in stone and not to be tampered with. It's a risk management technique. The idea is that if one asset class is declining, another asset class will be rising, therefore offsetting the other's decline and avoiding significant portfolio losses. The adviser may have even gone into a discussion of certain assets having negative correlation, *blah, blah, blah*. Well, how did that work for you in 2008?

And, when you called up your financial adviser in 2008, concerned about the market crash, you were probably told, "You have to think about the long-term. Yes, the market is down a bit now, but it will come back—now isn't the time to panic and sell out. That would be the worst thing you could do." This line is also taught to all new financial advisers—to help them keep client relationships—and is linked to another teaching, on the issue of market-timing being a losing strategy.

The basic tenants are: set your asset allocation; hold fast to it—never sell out or try to time the market. In other words, just ride the roller coaster. Again, how did that work for you in 2008?

New school, tactical techniques

Instead of the old school, buy-and-hold investment philosophy, I've updated things for the real world and the global economy we now live in. I use a "tactical asset allocation" strategy that periodically changes allocations based on where we are in the economic and market cycles. Certain stock market indices are monitored with the aid of trend analysis, moving averages and Bollinger bands. When the broad market falls below my set targets, I know a correction is forthcoming, and I begin reducing my exposure to that class of stocks and moving the money to safety.

How did that work for me in 2008? For the calendar year, my typical client portfolio was down 12.85 percent while the S&P 500 Index was down 37 percent.

Looking back over the past five years, I have plenty of client portfolios that have beaten the S&P 500 Index using this tactical asset allocation strategy. This is true even though I have, in some instances, lagged the market in 2009 and 2010. Since 2008, I've placed more emphasis on preservation of capital because I'm ultimately as interested in the return *of* my clients' money as the return *on* their money.

Two worrisome concerns

The affluent or even moderately affluent boomer-turning-senior faces two very real financial concerns. The first, even among those with seven-figure asset bases, is expressed as "running out of money before end of life." And in a close second position, "losing control—of health, wealth, independence—to family, to government."

If these are your concerns, don't be naïve. Burying your money, taking it to the bank or sticking to the old school, buy-and-hold program won't solve the problem. In this new decade, you need to be thinking more tactically, using market cycle trends and exit strategies. Otherwise, if you lost in 2008, you'll lose again in the next crash. Take control of your money—and your life.

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