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EDITORIAL & OPINION

Principle-driven investing; leave the stress

'Quality of life' component of real returns is an alien idea to many in market

WEALTH MANAGEMENT
BY MONTGOMERY TAYLOR

Years ago, as a CPA, I had a nice elderly Italian lady as a tax client. For some reason she reminded me of Phyllis Diller and she made me smile. I was amazed that she had a bank CD in possibly every bank in town. She earned about $40,000 per year in interest income from these bank accounts. One year while talking to her about her tax preparation, I asked her if she would be interested in lowering her taxes by moving some money to an investment vehicle where we had more control over taxes. She brushed off the question. The next year, during tax preparation, I asked her again. She told me that she had tried that before and lost money. I asked her when that was, and she said "1929."

Wow! She was burned 50 years earlier on a stock investment and had vowed to keep everything in the bank after that. Well, if keeping all of your money in the bank meets all of your financial objectives and you live a comfortable life free of financial worry, that is fine. For most people, however, I believe you really need a balanced approach—putting some money into low-risk, income-oriented investments and some money into higher-risk, growth-oriented investments (marketable securities, rental real estate, etc.). One gives you comfort and stability and the other gives you growth.

My investment philosophy is that the most successful investment portfolios are those that are principle-driven and fundamentally managed for the specific achievement of your long-term financial goals, rather than attempting to capitalize on perceived current trends in markets and/or the economy. Such portfolios also lead to an infinitely less stressful life. (That there is a quality-of-life component to real returns is an idea completely alien to addicts of today's stock market culture.)

Most investors should not be seeking the maximum return possible anywhere in the universe, but rather the best return available with the least stress. I believe that if Investor A gets a 9.5 percent lifetime return, thereby achieving his goals with the expenditure of little or no time and energy, while Investor B gets 10.7 percent working on his portfolio nearly every day, Investor A has "outperformed" by a significant margin.

The principle-driven portfolio management belief system thus begins with the dictum that "performance" is not a financial goal, and that the only rational basis for the construction and management of a long-term portfolio is your long-term financial goals. Thus, questions like "When will the Fed start raising rates?" and "What will the S&P 500 earn this year?" are subordinate, by several orders of magnitude, to the questions that really matter: (1) "Who is this money for?" (2) "What is this money for?" and (3) "When will this money be needed?" Or, if you prefer: the portfolio doesn't follow the market, it follows your human needs.

The second great belief implicit in the principle-driven portfolio is that individual investors should not be managing their own investments; that the money should be professionally managed. The reason is that the dominant determinant of real-life long-term return isn't what the portfolio does; it's what the investor does. That is, investor behavior dwarfs investment performance in determining the actual return that investors get. I've been speaking with people who are sitting on a lot of cash. They tell me they don't know where to invest it and they're too busy to figure it out. So, there it sits, earning nothing! Of course, I tell them they need to put that money to work in a balanced portfolio.

The bottom line is this: if you don't have enough money to guarantee that your lifestyle will be paid for from low-risk bank CDs, money markets, U.S. Treasuries, bonds or insurance company contracts, you will need to allocate some segment of your nest egg to some higher-risk, growth oriented investment. Otherwise, as you know, your fixed-income lifestyle will be eaten alive by taxes and inflation. Don't just think in terms of an investment "return." Think deeper and consider the "real-rate of return," which is what is left after inflation and taxes.

The one thing you may remember about Grandpa's pension was that it was fixed, and possibly with no cost of living adjustment at all. The guaranteed pension check in the mail each month was the good part. The bad part was there was never a pay raise. The growth segment of your retirement portfolio is there to give you a pay raise.

Montgomery Taylor, CPA, CFP, is a Quilly Award-winning, best-selling author and considered one of the top wealth managers in the country. Mr. Taylor 707-576-8700, TaxWiseAdvisor.com, is the author of The New Rules of Success and Before It's Too Late: Retirement and Estate Solutions.

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