Getting Down to Essentials

One of the best books I’ve read recently is “Essentialism: The Disciplined Pursuit of Less” by Greg McKeown. Essentialism is the mindset of focusing time and energy on whatever is most important and blocking out everything else. This is often easier said than done in today’s highly distracting environment. Since reading this book, I’ve been thinking about how to apply an Essentialist philosophy to our money and investments. What are those most important characteristics of a successful investment strategy?

Diversification

Sometimes overlooked as nonessential, diversification is anything but. The idea is to spread our money across different things so we don’t get burned if something performs poorly. Said another way—never make a killing and never get killed. But too often, I find that people are not nearly as diversified as they should be, even though they claim to understand its importance.

For example, some investors receive stock in their own company as part of their benefits. The stock may grow to a sizable position and represent an unduly large portion of the investor’s wealth. Still, investors tend to hold onto company-granted stock, even though they believe in diversification. Their action is, therefore, inconsistent with their belief. The following two questions can be helpful when faced with such a dilemma:

1. IF I SOLD THE STOCK AND IT PERFORMED REALLY WELL, WOULD IT CHANGE MY LIFE?
2. IF I HELD IT AND THE COMPANY WENT BANKRUPT, WOULD IT CHANGE MY LIFE?

If you answered no to question 1 and yes to question 2, you’re not alone. The trick is to ask the questions in the first place. Asking the right reflective questions can help us make better decisions. In this case, you might discover for yourself that diversifying is a better choice for you and your family than hanging onto an excessively large position. You won’t be able to avoid the routine, temporary declines when the market goes down, but chances are, you won’t get killed either.

Rebalancing

You’ve done all the right things. You’ve worked with me to develop a portfolio that meets your specific timeframe and objectives. For sake of example, let’s say that allocation is 70% U.S. stocks and 30% international stocks.
A year later, the stock market and, fortuitously, the U.S. portion of your portfolio have gone up. Unfortunately, however, the international portion of your portfolio hasn’t performed as well. As a result, the U.S. portion of your portfolio is higher than where it began the year before.

What should you do?
- **NOTHING.** My portfolio is performing well. Why should I get in the way?
- **REBALANCE.** Sell some of my U.S. stocks that have gone up in value and purchase international stocks with the proceeds to get back to my original allocation.

It may seem counterintuitive to sell what’s been working in favor of what hasn’t, but think about it. Rebalancing is a systematic approach of buying low and selling high. After experiencing a gain, it is natural to want to add to the things that are doing well and sell those doing poorly. Emotionally, that is the easiest decision. But it can be costly. Rebalancing helps remove the emotion from our buy/sell decisions.

**The Power of Investing**
I recently received an inquiry from a client who has been particularly anxious about the market in the last few months. He had been studying his financial history and learned that from 1929-1954, the stock market provided a 0% return (source: S&P500). What if history repeated itself at the exact same time he decided to retire?

I told him he had a legitimate concern. After all, what happens in the market is outside our control and the early years of retirement are particularly sensitive if you experience losses at the same time you’re withdrawing assets to meet expenses. However, having a well-diversified portfolio and rebalancing strategy can help moderate the fluctuations in value. In addition, understanding all the facts can be helpful...like this one:

**FACT:** True, there was no stock price appreciation from 1929–1954. If we include the reinvestment of dividends, however, the average annual return of the S&P was actually 6.28% from the market top in September 1929 through the end of 1954 (source: S&P500). Not so shabby.

The moral of the story? Even during difficult times and sideways markets, investors who are able to stick to their plans often find themselves better off than those who react to market movements and/or the news of the day.