Wealth Management # 3 - Investment Consulting

Investment consulting addresses the challenge of wealth preservation – how your financial assets should be positioned to provide the maximum potential for you to achieve your financial goals, while incorporating your risk tolerance, time horizons, income need, etc. Investment Consulting is the foundation of upon which your future financial health will be built.

Unfortunately, investors are bombarded with information from all directions: friends, work colleagues, internet, television, magazines, and newspapers. What’s worse, much of the information is contradictory, and just becomes noise. It becomes impossible to identify useful information from the rest, and instead investors start making financial decisions based on emotions, not logic. Our white paper titled “Intelligent Investing” explores this subject in more detail.

A logical investment approach is built around six factors:

1. Gap Analysis and Road Map

This factor is highly important, yet many investors do not recognize its importance. First, the Discovery Meeting and Investment Plan Meeting help identify what financial assets you have, what you actually need to achieve your financial goals, and identifies whether there is a gap. If so, it becomes necessary to identify what needs to be done to close the gap. Therefore each investor should have a specific road map that details what needs to be done and what type of investments need to be used to provide maximum potential to close the gap while minimizing the risk of losing money.

2. Diversify the Investments

Most people understand the basic concept of diversification – don’t put all your eggs in one basket. However, using several mutual funds investing in large US. stocks isn’t diversifying. The objective is to spread your money across multiple asset classes and across different financial markets pursuant to the road map designed earlier.

3. Reduce Volatility

If you have two investment portfolios with the same average arithmetic return (let’s say 8% average annual return over 5 years), you’d expect both portfolios to end up with the same final value. However, this is only true if both portfolios have the same amount of volatility. In fact, the portfolio with the lower volatility will have a greater compounded return, thus a higher final value, as shown in the table on the next page.

	Low Volatility		High Volatility	
Year	Annual Rate of Return	Ending Value	Annual Rate of Return	Ending Value
1	8%	$108,000	30%	$130,000
2	8%	$116,640	-20%	$104,000
3	8%	$125,971	25%	$130,000
4	8%	$136,049	-20%	$104,000
5	8%	$146,933	25%	$130,000
Arithmetic annual return	8%		8%	
Compound annual return	8%		5.39%	

4. Think Globally

Investors in the U.S. tend to favor stocks and bonds of U.S. based companies, encourage by the media who typically only talk about companies their audience recognize. However, although the U.S. financial markets are still the largest individual markets in the world, the U.S. stock market represents only 33%[(1)] of the investable capital in the world, and the U.S bond market is less than 45%[(2)]. Not only are there more opportunities overseas, global diversification has historically helped reduce volatility.

5. Use Appropriate Investment Techniques

In the financial markets, extended periods of upward price movements are called secular bull markets, and periods of downward movement are called secular bear markets. Investors need to work towards their financial goals regardless of what period is occurring. In a bull market, a buy-and-hold approach of index funds can work well and be very tax-efficient. In a bear market it becomes necessary to be more tactical and search out more defensive investments. Income-paying investments can also be a positive as you can live off the income (or buy additional investments) while waiting for the bear market to finish.

6. Monitor Progress

The objective is not to take high risk to beat an index (e.g. S&P 500), it's to achieve your financial goals with as little risk as possible. Therefore, are the investments on track to meet your financial objectives? Are investment changes necessary due to changes in your financial plan? It is imperative to monitor progress towards meeting your specific goals, and to make changes if necessary.

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References:

1 Wikipedia’s citation regarding the 21 most active global stock markets
2 Wikipedia’s citation regarding the U.S. bond market