



Economic Vomitivity and Financial Planning as Dramamine

Webinar presented September 21, 2011

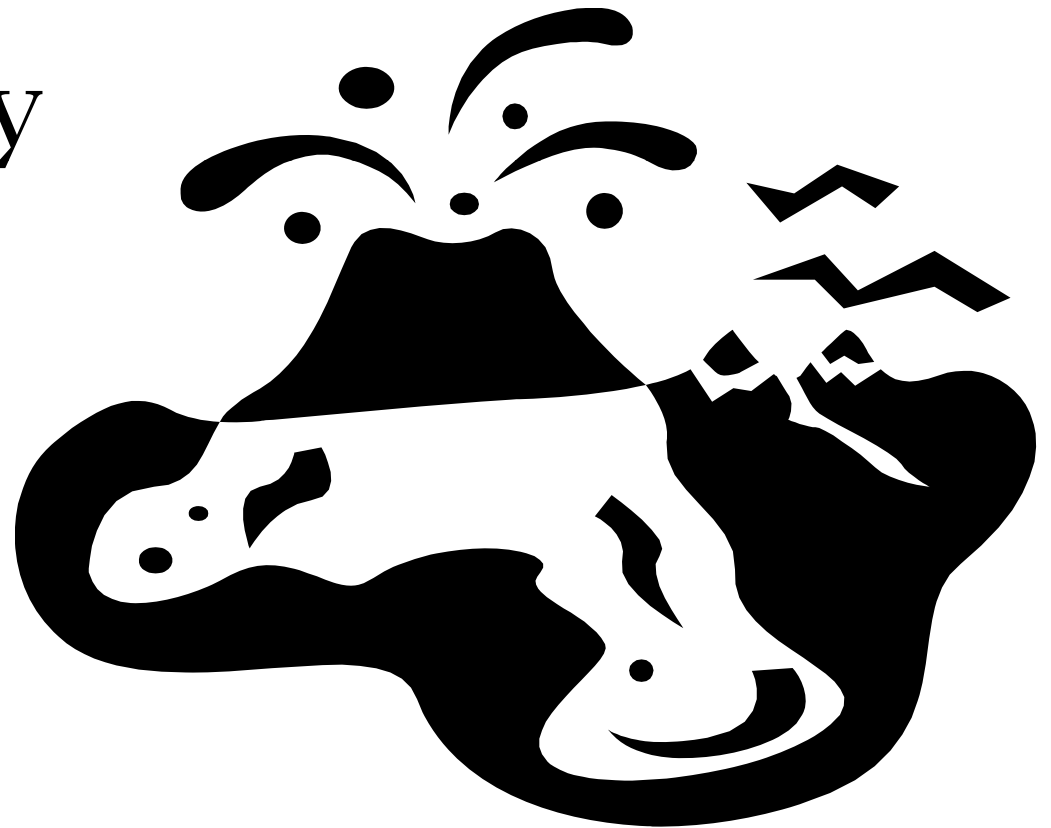
LIVE BIGSM

Fear and Loathing

- Sources of anxiety abound . . .
 - The economy
 - The financial markets
 - Personal financial security
 - Ability to reach goals

Fear and Loathing

Many of us are still
traumatized by
the economic
meltdown of
2008/2009



Fear and Loathing

While the media continues to feed our amygdala, as a result of which, our “risk perception” is dialed up for “fight or flight”



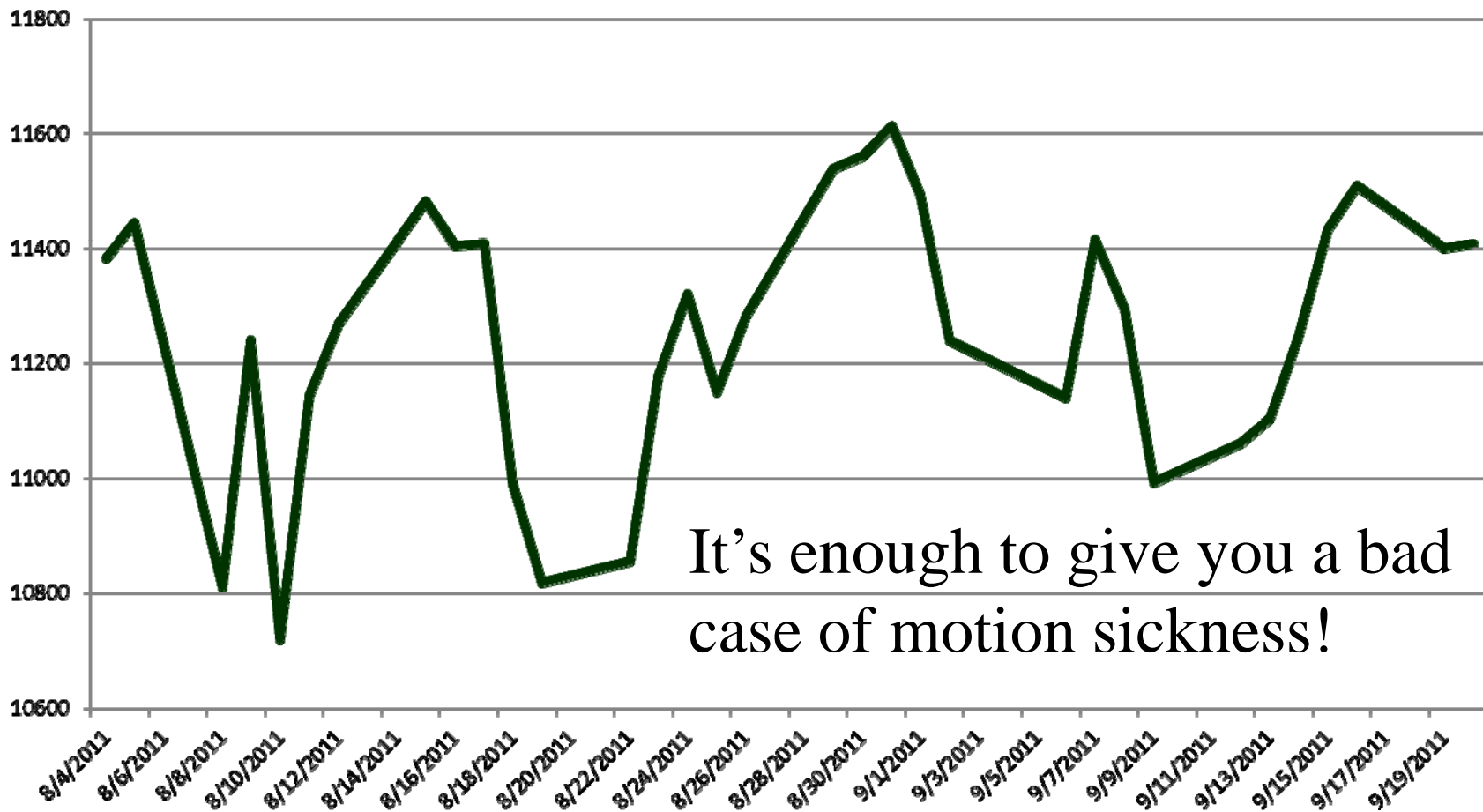
First, the Bad News

- Economic uncertainty has increased
 - Slowdown + Sovereign Debt Crisis = ?
- Market volatility has increased
 - Transaction timing carries more risk
- Political uncertainty has increased
 - Harder to assess policy responses
 - Harder to institute policy responses
 - Greater tax uncertainty

Economic Uncertainty

- US GDP growth slowed to 1% in the 2nd quarter
- Unemployment remains above 9%
- Businesses are not investing/hiring
- Rising inflation may be a worry
- Trailing 12-month inflation up to 3.8%

Market Volatility



Political Uncertainty

- Fiscal response is extremely unlikely (and problematic in any case)
- Federal Reserve responses limited
 - Short-term interest rates near zero
 - Quantitative Easing at an end
 - Adding a “twist” won’t do much
- Tax uncertainty makes financial and investment planning even harder

Now, the Good News

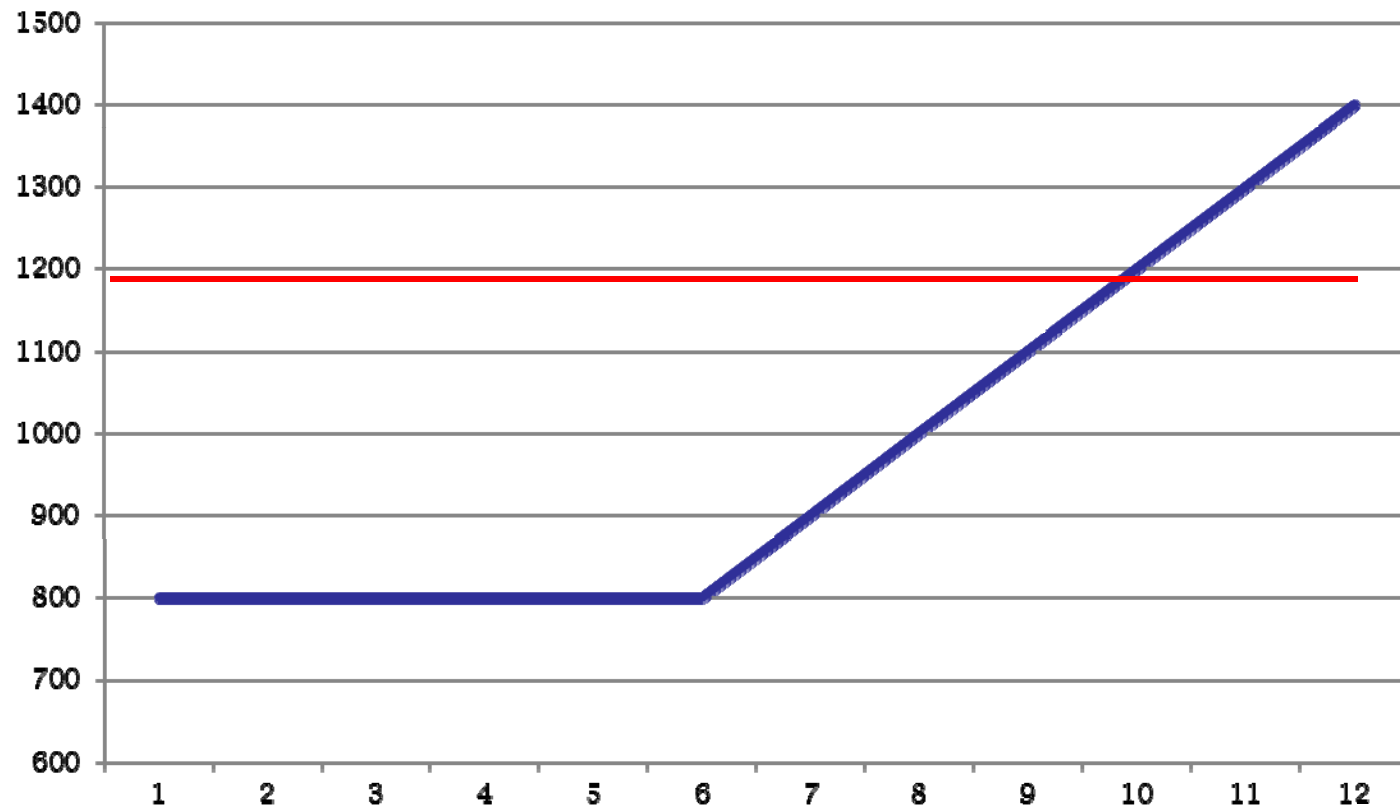
- A double-dip recession is still not the most likely scenario
- Corporate profits continue to rise, even in the face of slow growth
- Markets are more volatile, but haven't actually yielded much ground
- There are techniques available to mitigate the risks

Two Paths Toward Risk Control

- Portfolio insurance
- Policy-Based Financial Planning
 - Cash management Policies
 - Diversification Policies
 - Rebalancing Policies
 - Safe-Withdrawal Policies

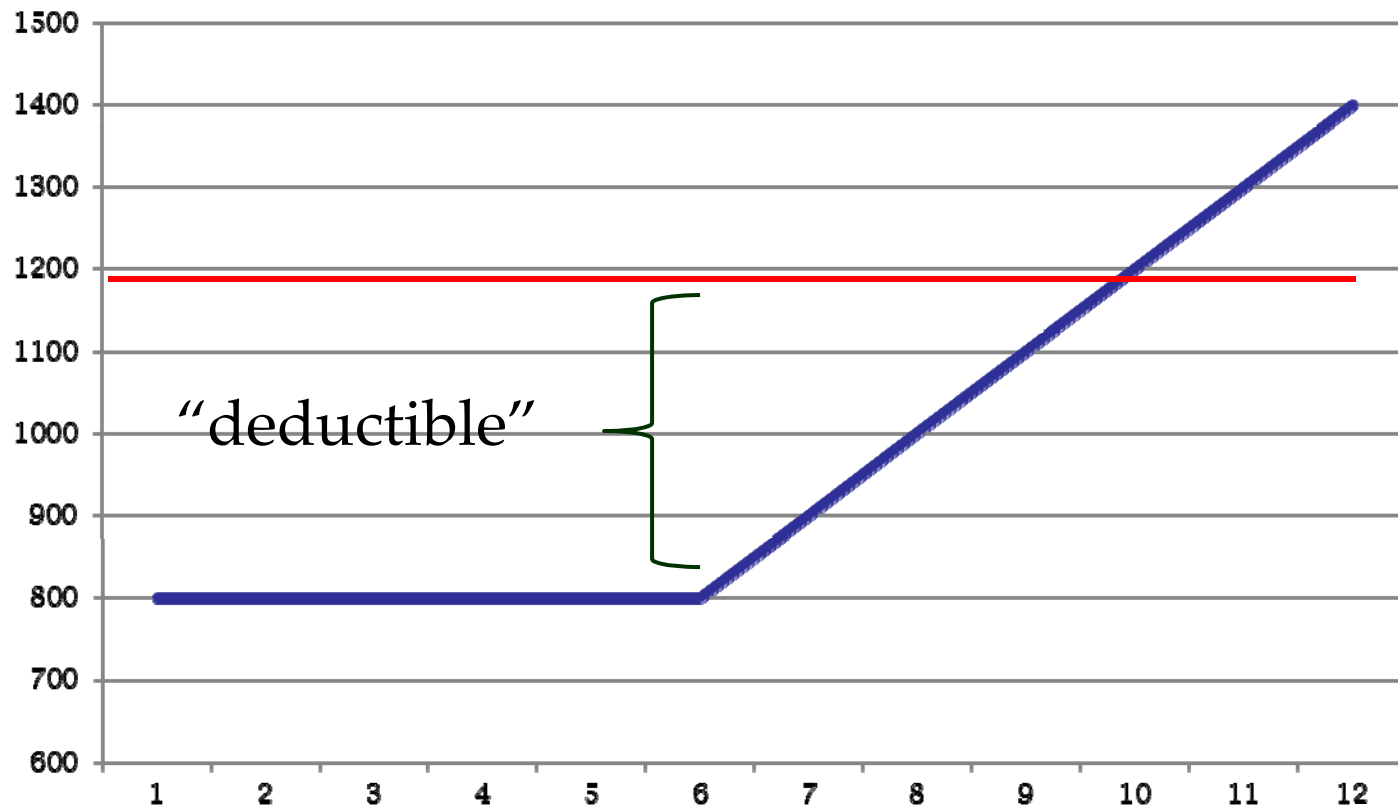
Portfolio Insurance

- “Long” Puts



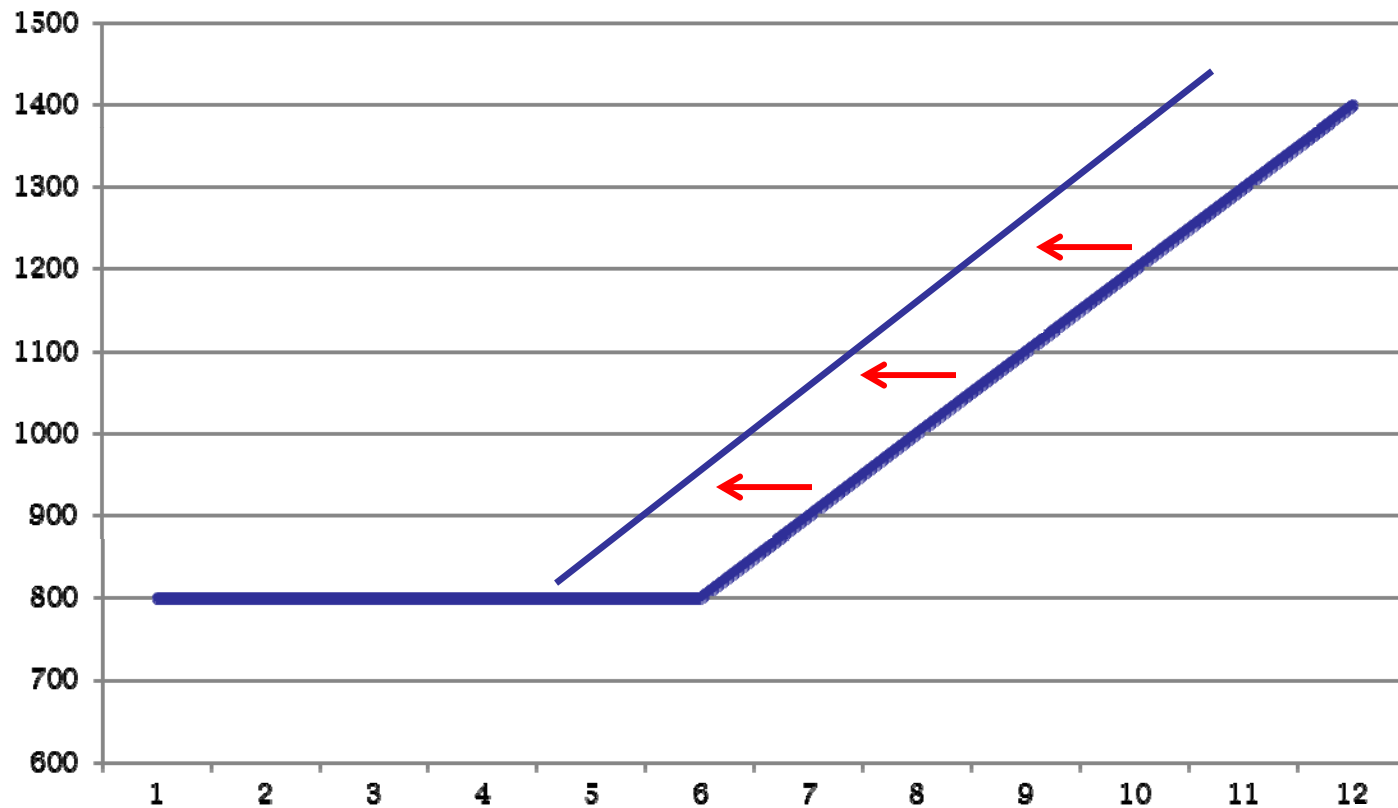
Portfolio Insurance

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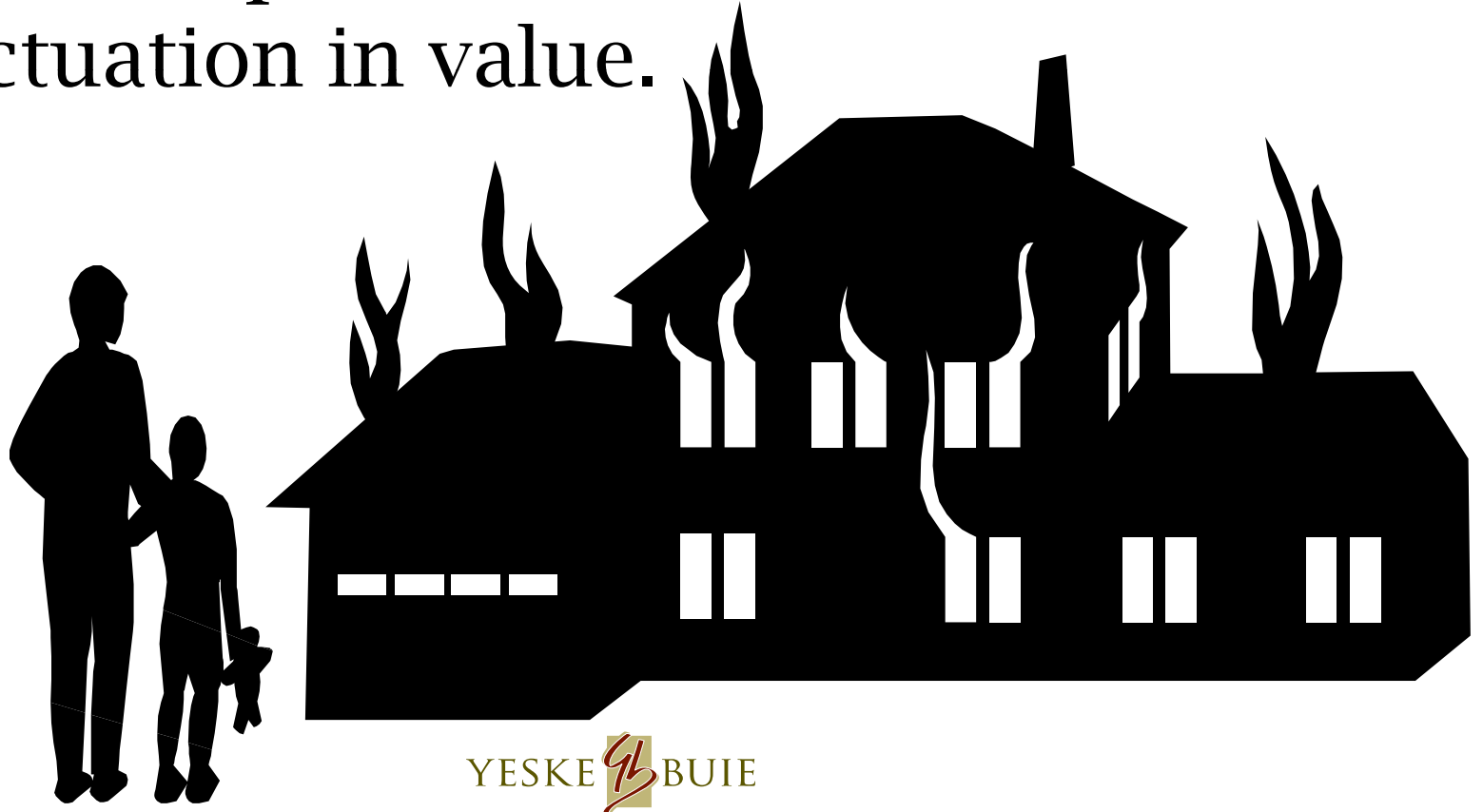
Portfolio Insurance

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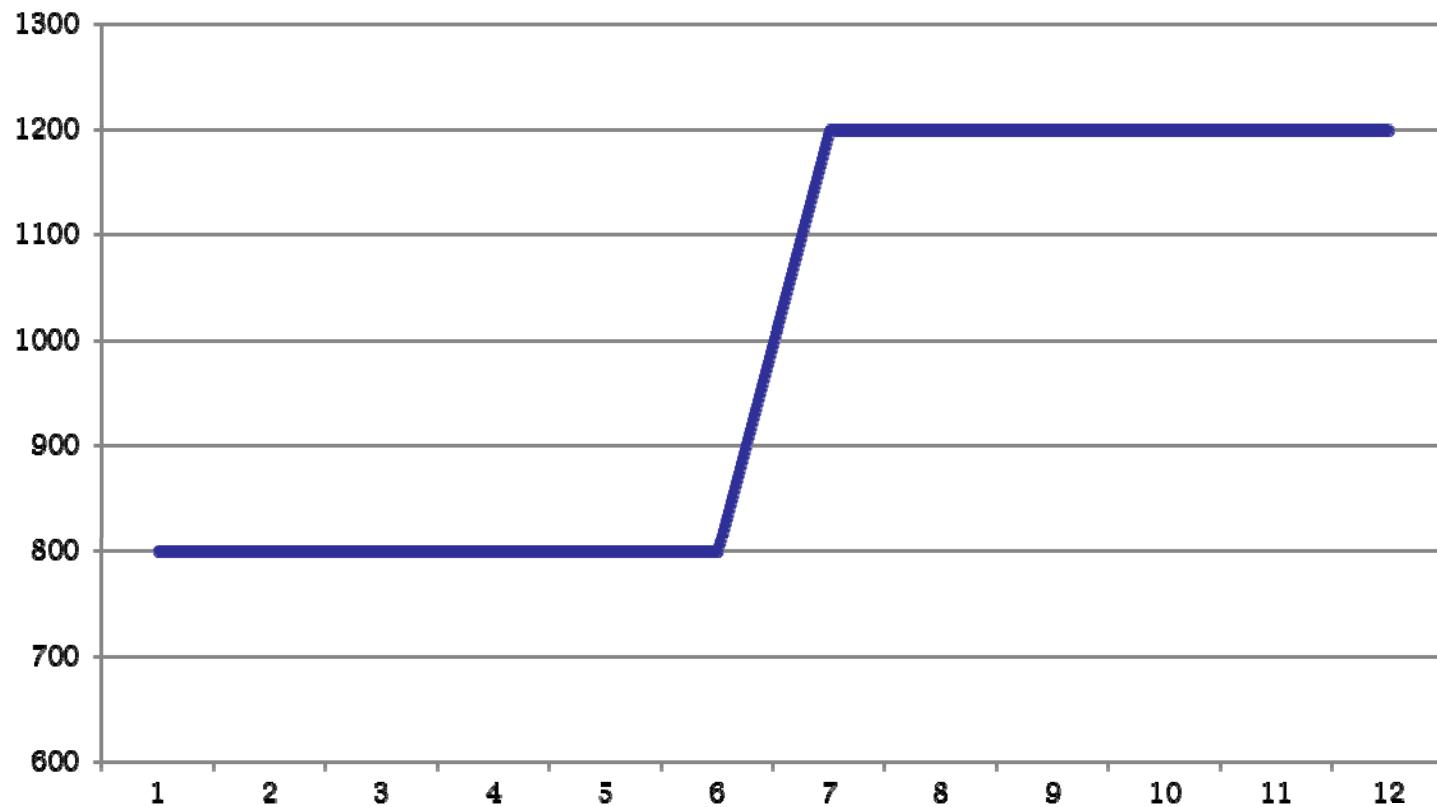
Portfolio Insurance

- There's a difference between insuring against a permanent loss and a fluctuation in value.



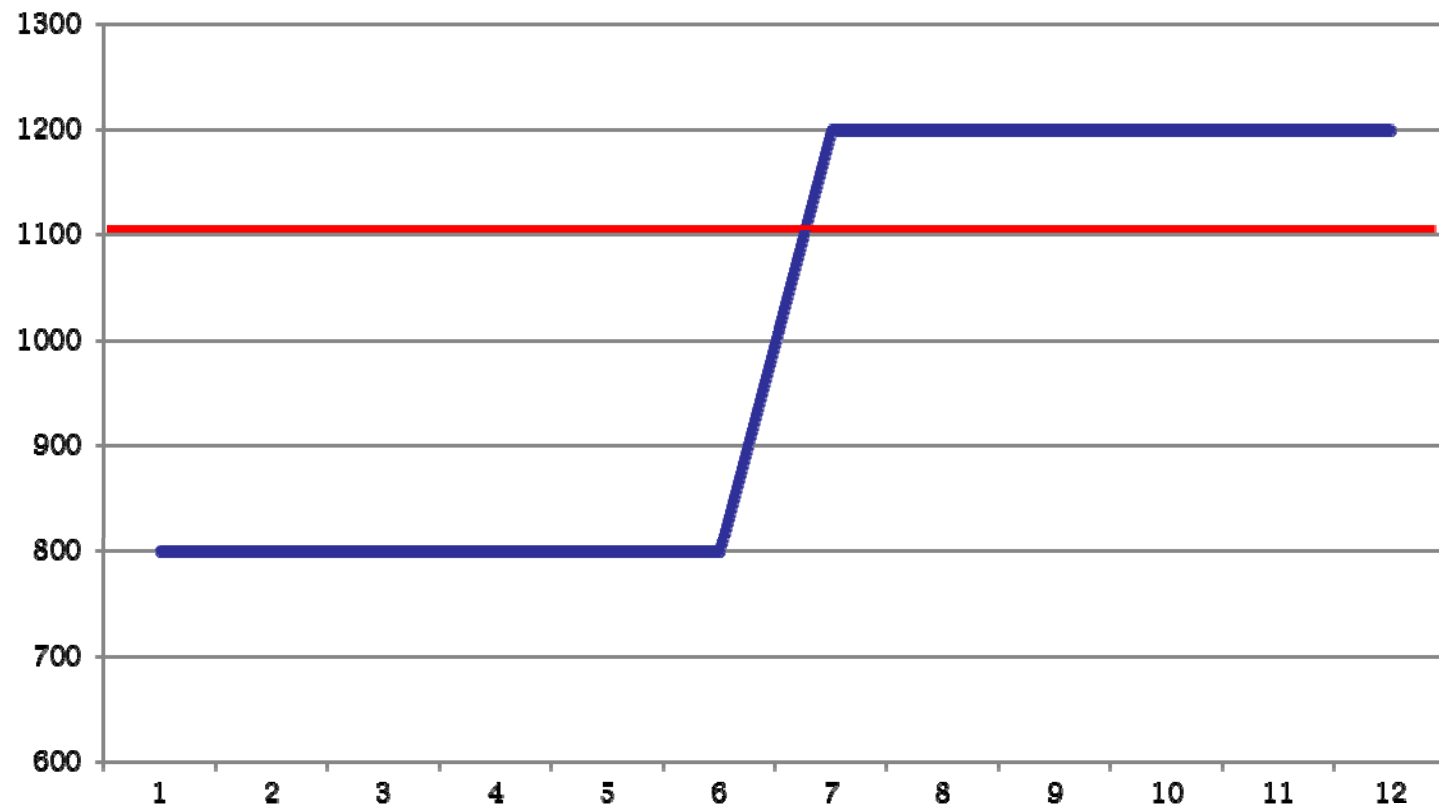
Portfolio Insurance

- “Costless” Collar



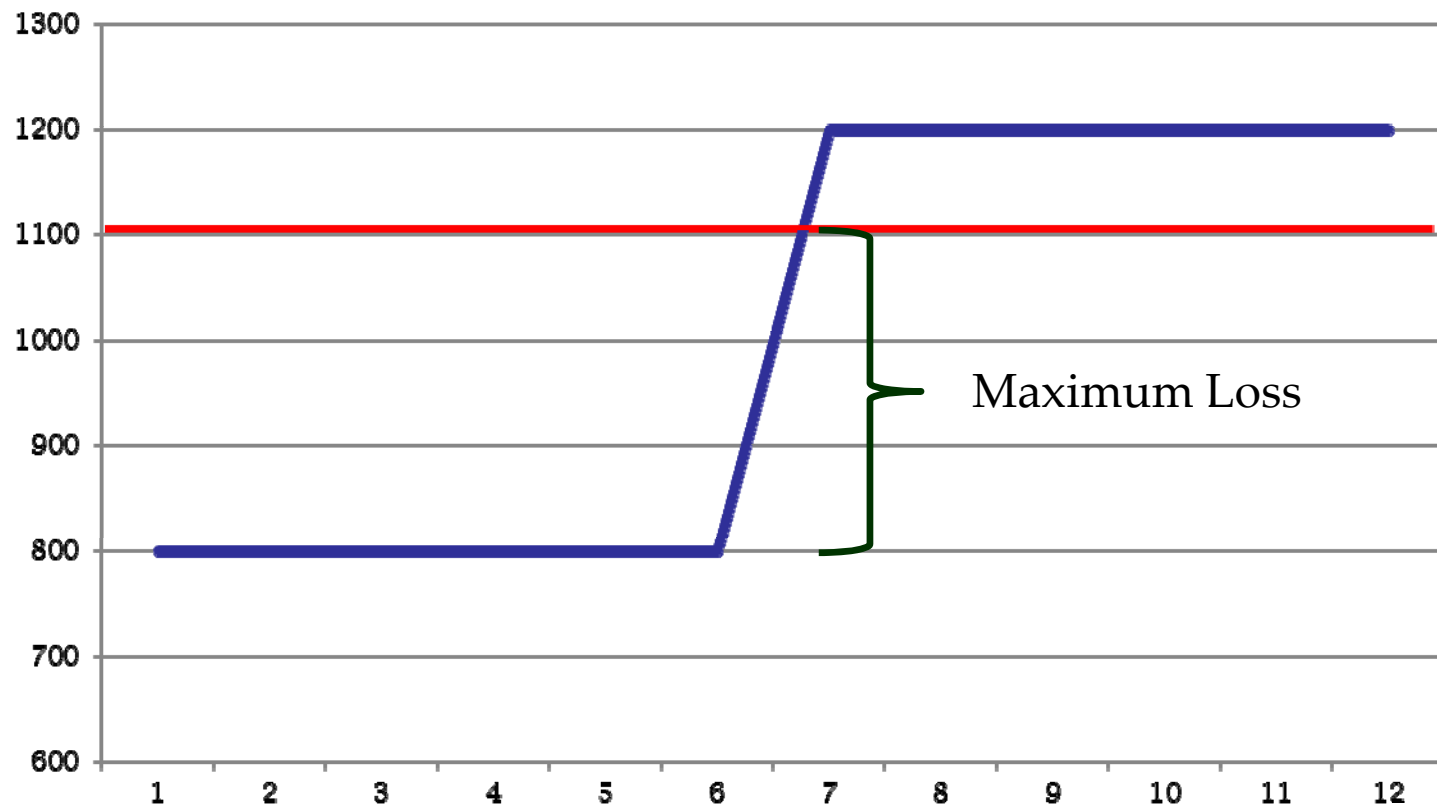
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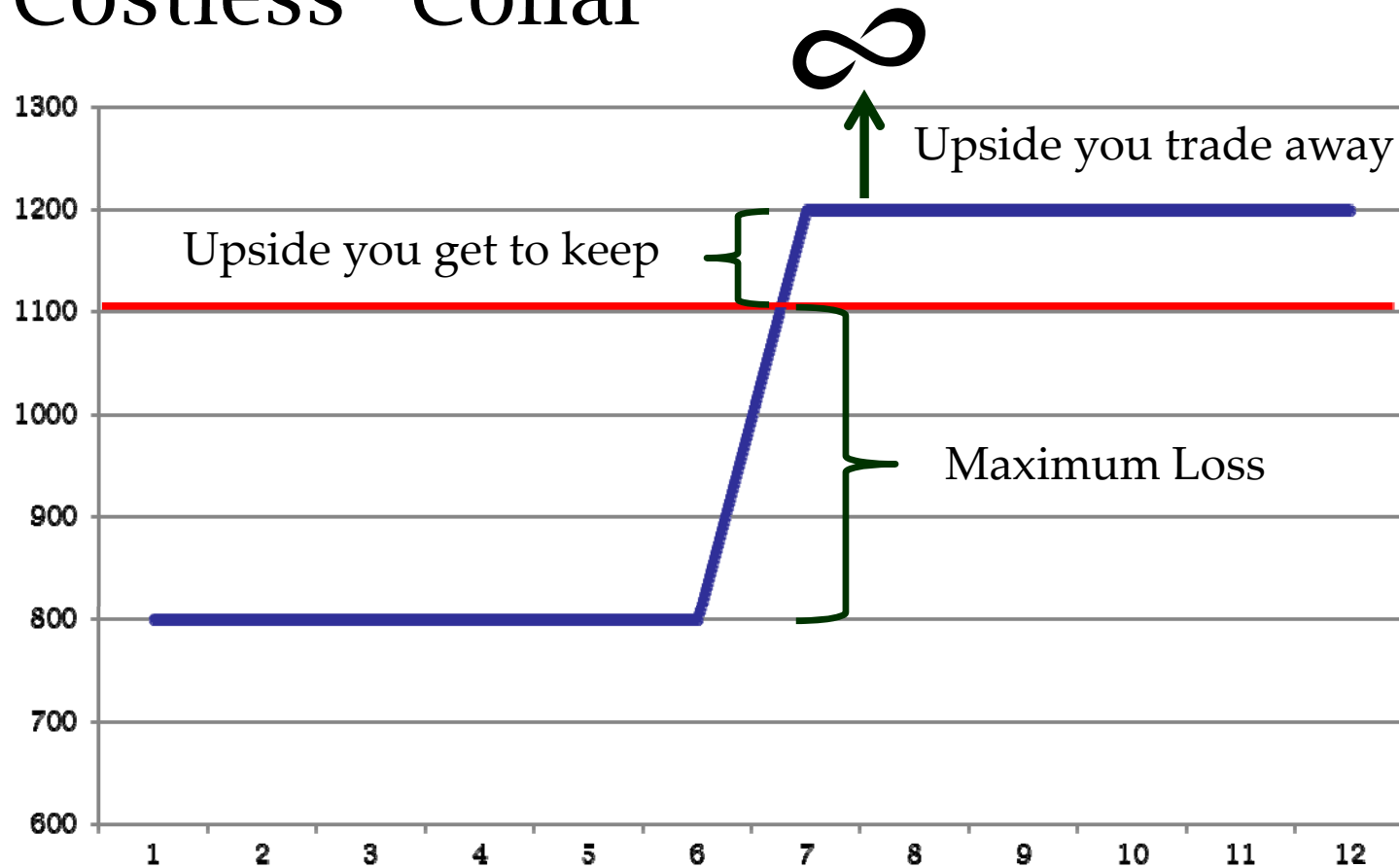
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Portfolio Insurance

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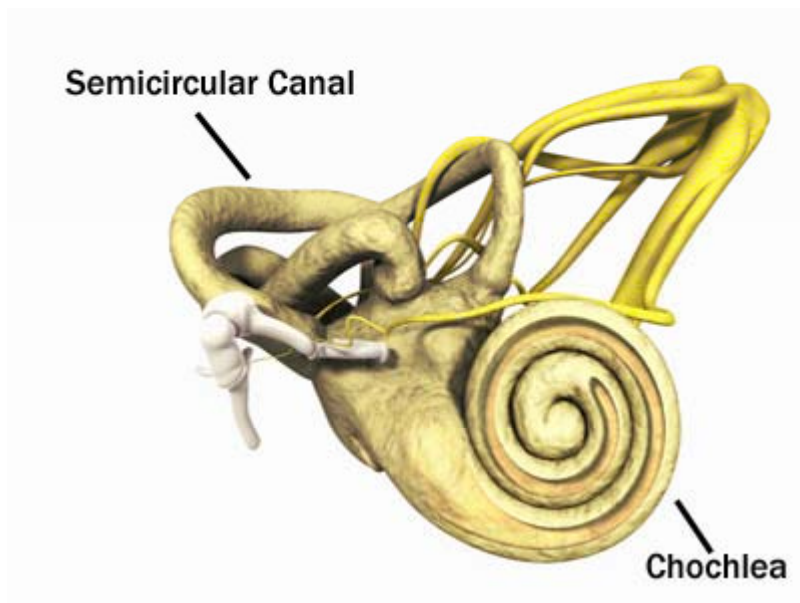


Portfolio Insurance

For long-term investors, we believe the cost of “portfolio insurance” is disproportionately large. In other words, it isn’t worth the cost unless you have a specific, short-term need.

Motion Sickness

Chaotic movement can sometimes overload the part of the brain that processes motion



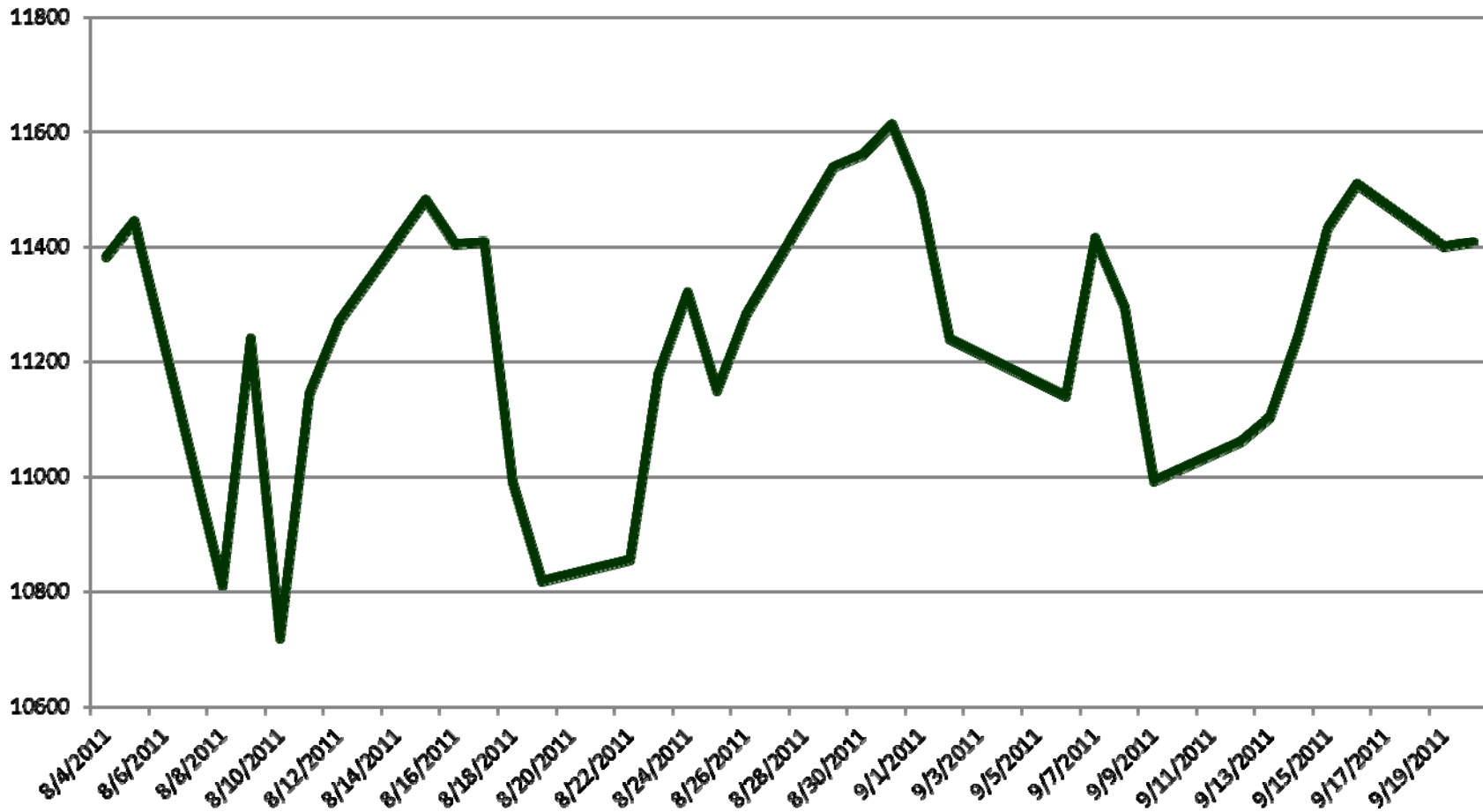
Managing Motion Sickness

- Avoid reading while a passenger in a car (not to mention, while driving)
- Watch the horizon while on a rocking boat (diminishes the sense of motion)
- Wrist bands (distraction)
- Dramamine

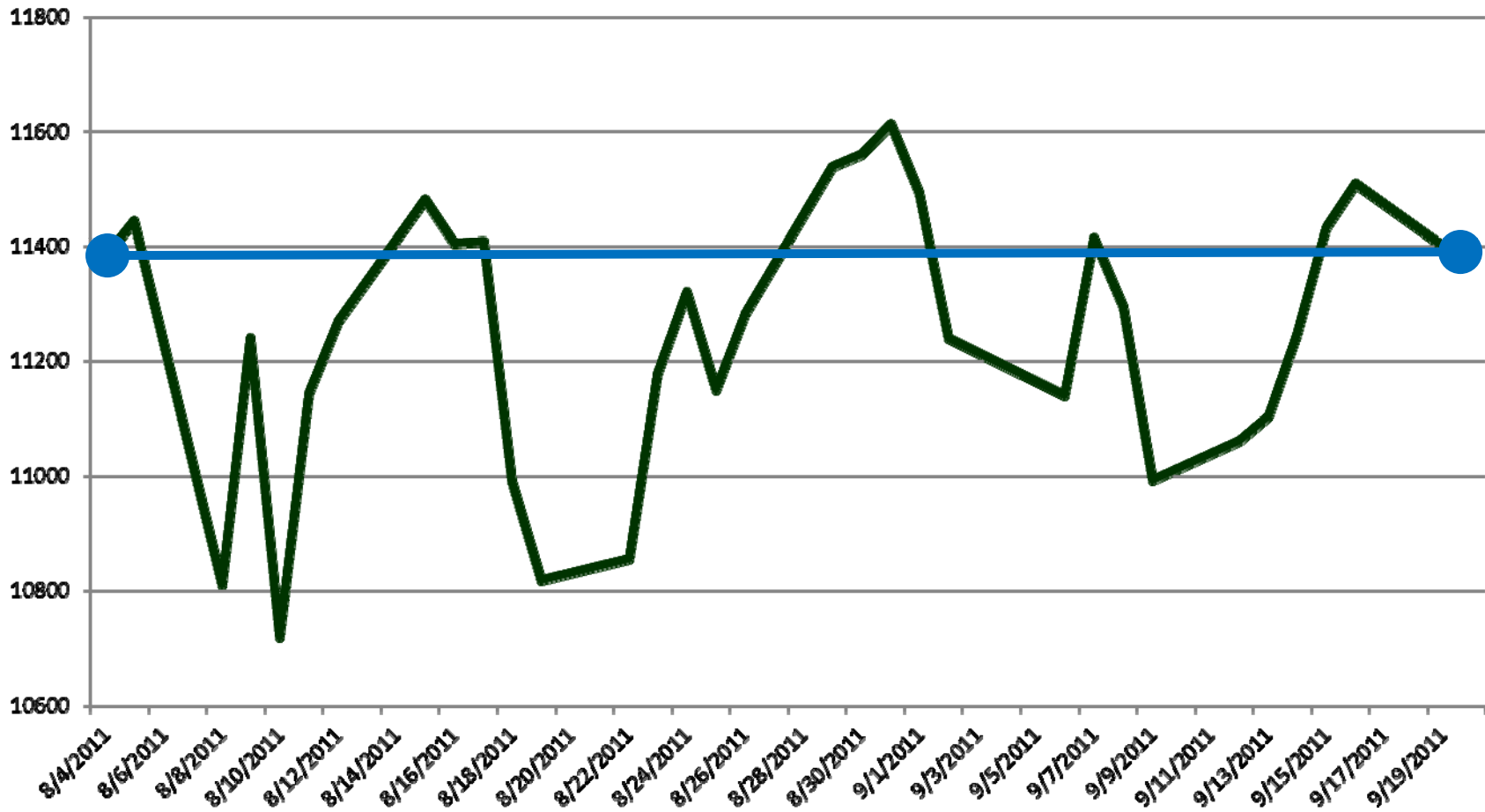
Financial Planning Dramamine

- Resetting Our Risk Perception
- Policy-Based Financial Planning
 - Cash management Policies
 - Diversification Policies
 - Rebalancing Policies
 - Safe-Withdrawal Policies

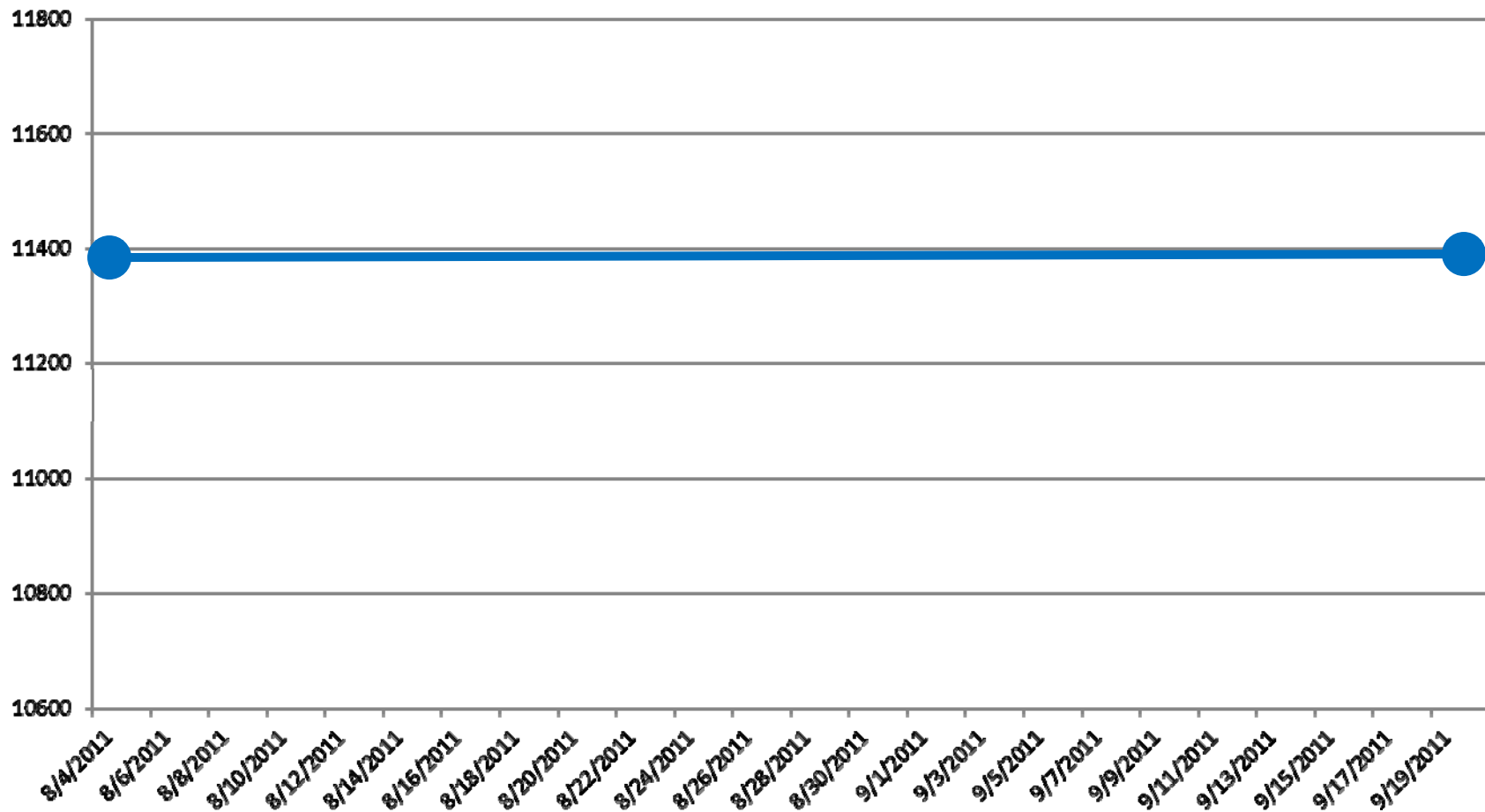
Risk Perception



Risk Perception

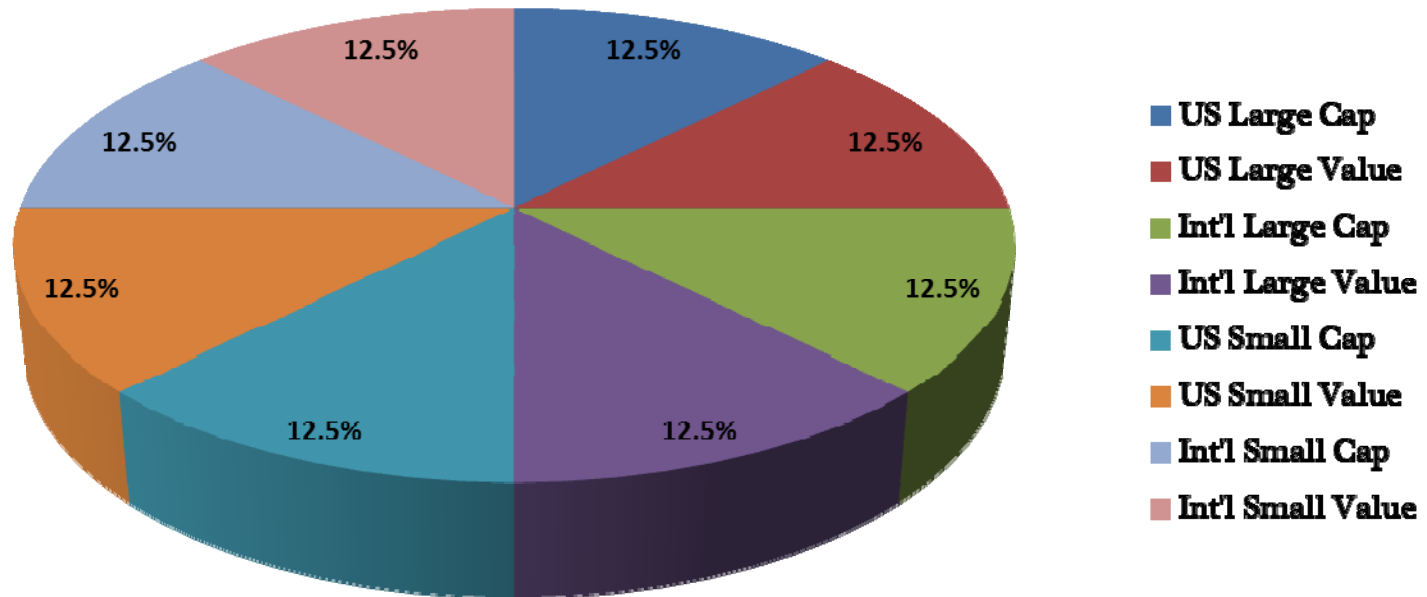


Risk Perception Reset

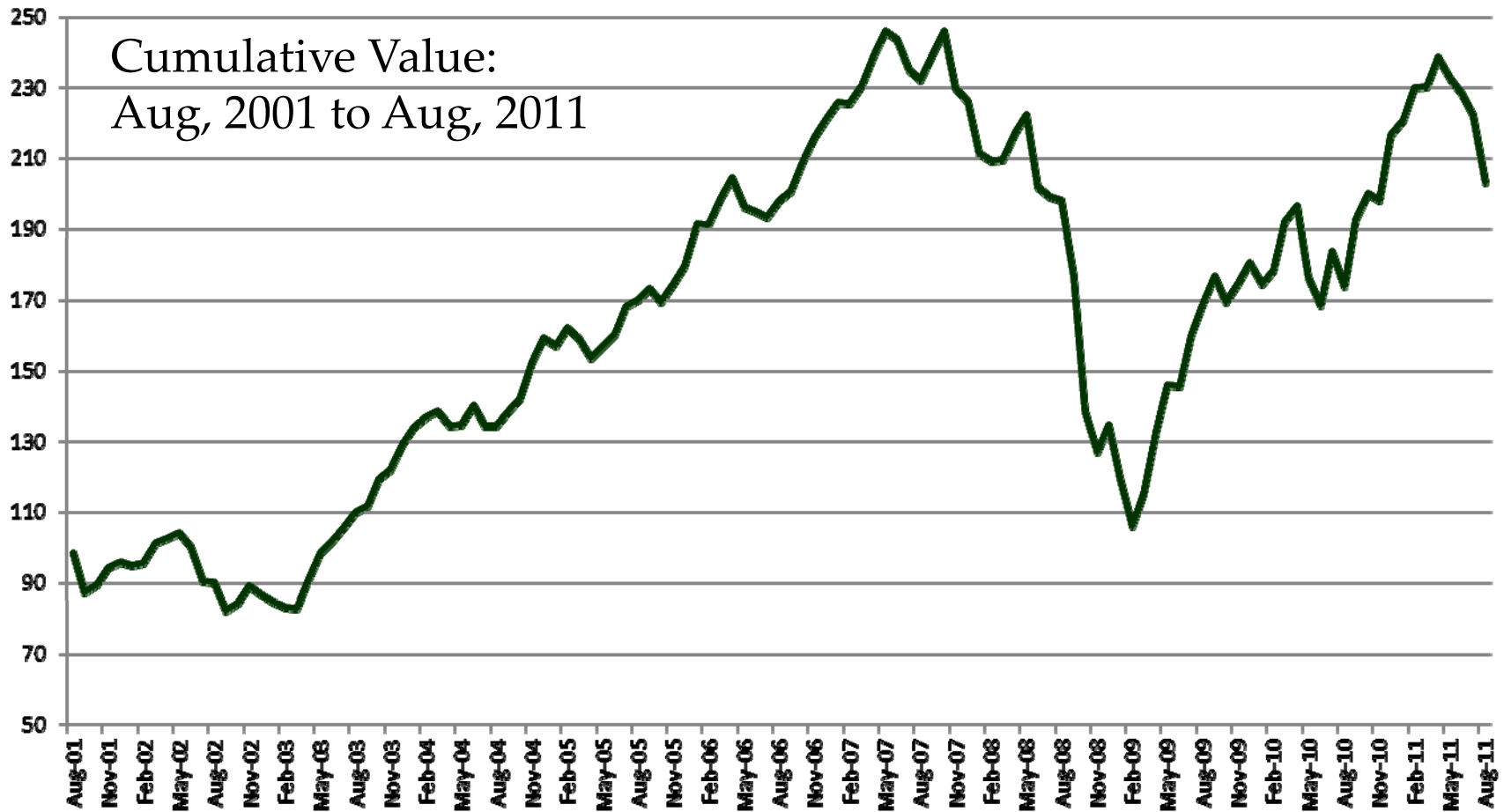


Risk Perception

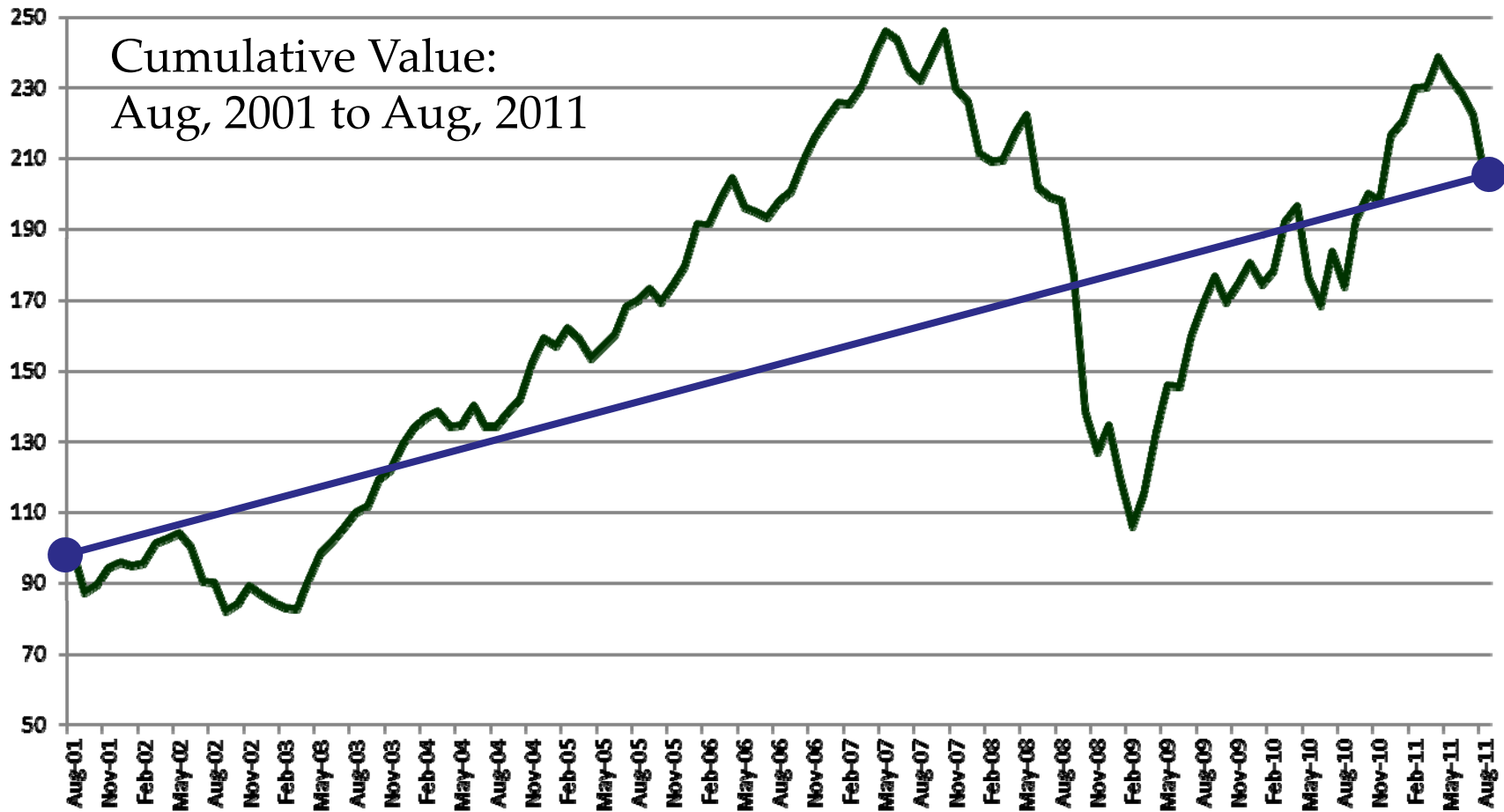
- Start with a diversified global portfolio



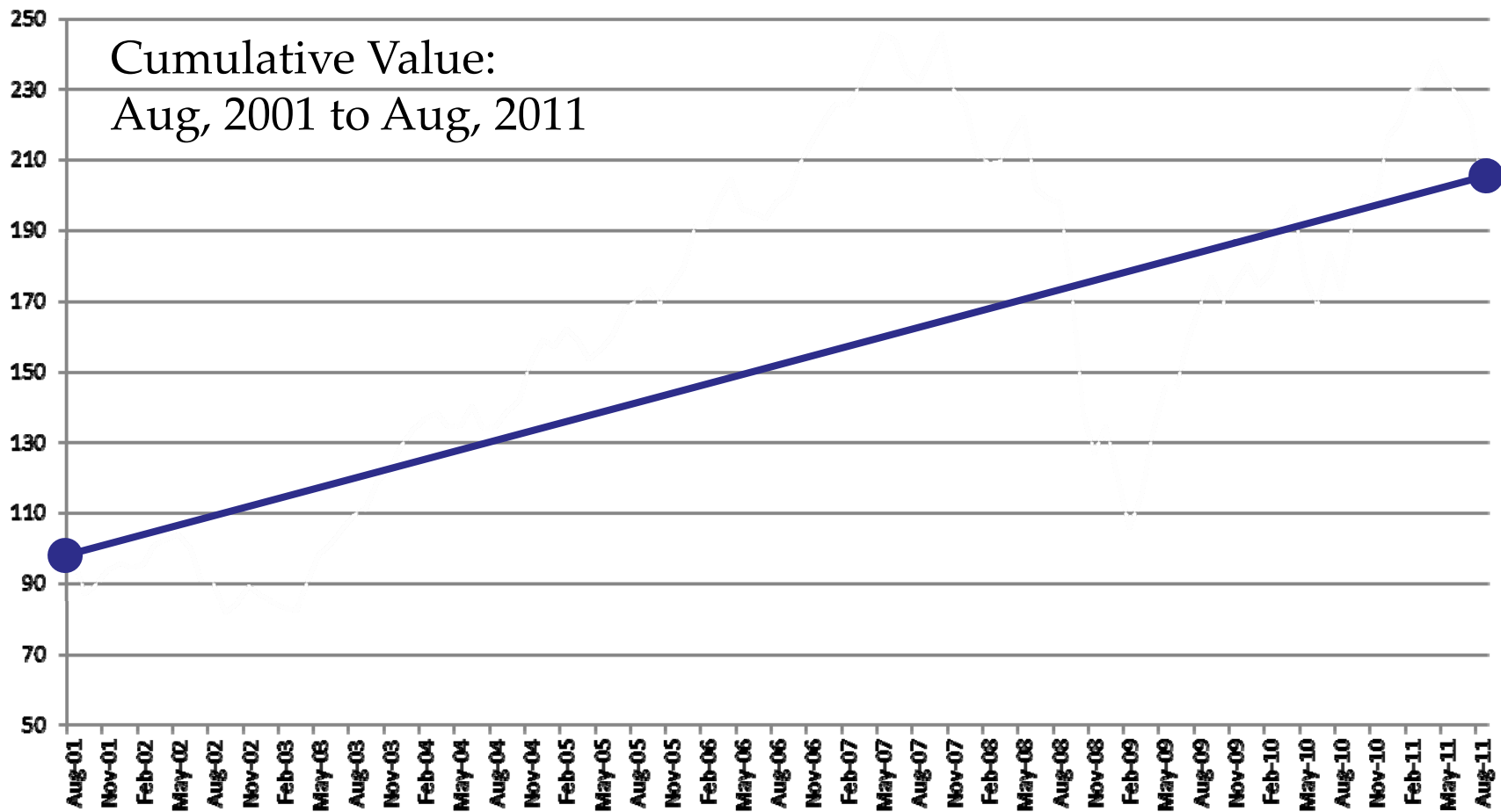
Risk Perception



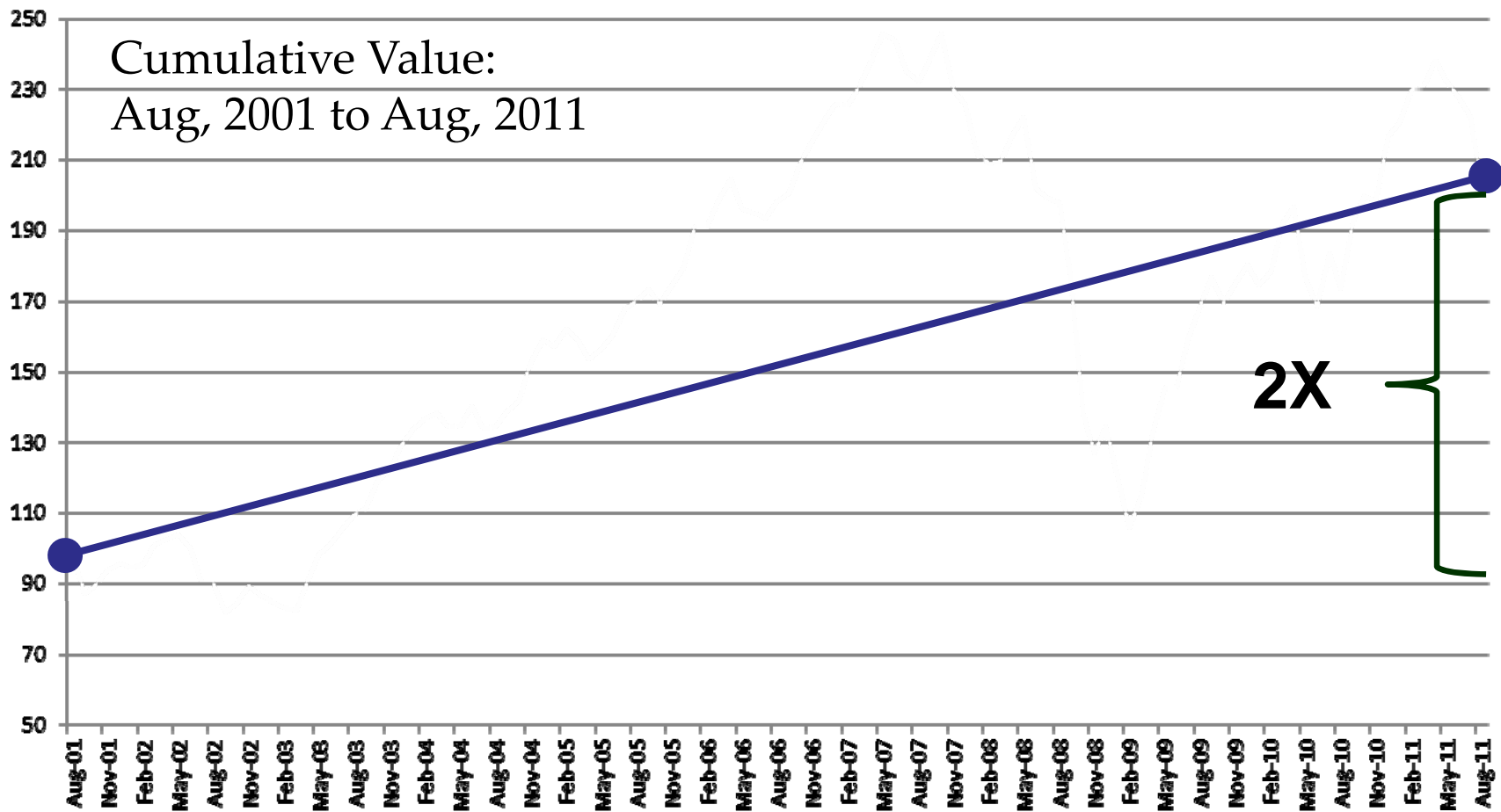
Risk Perception



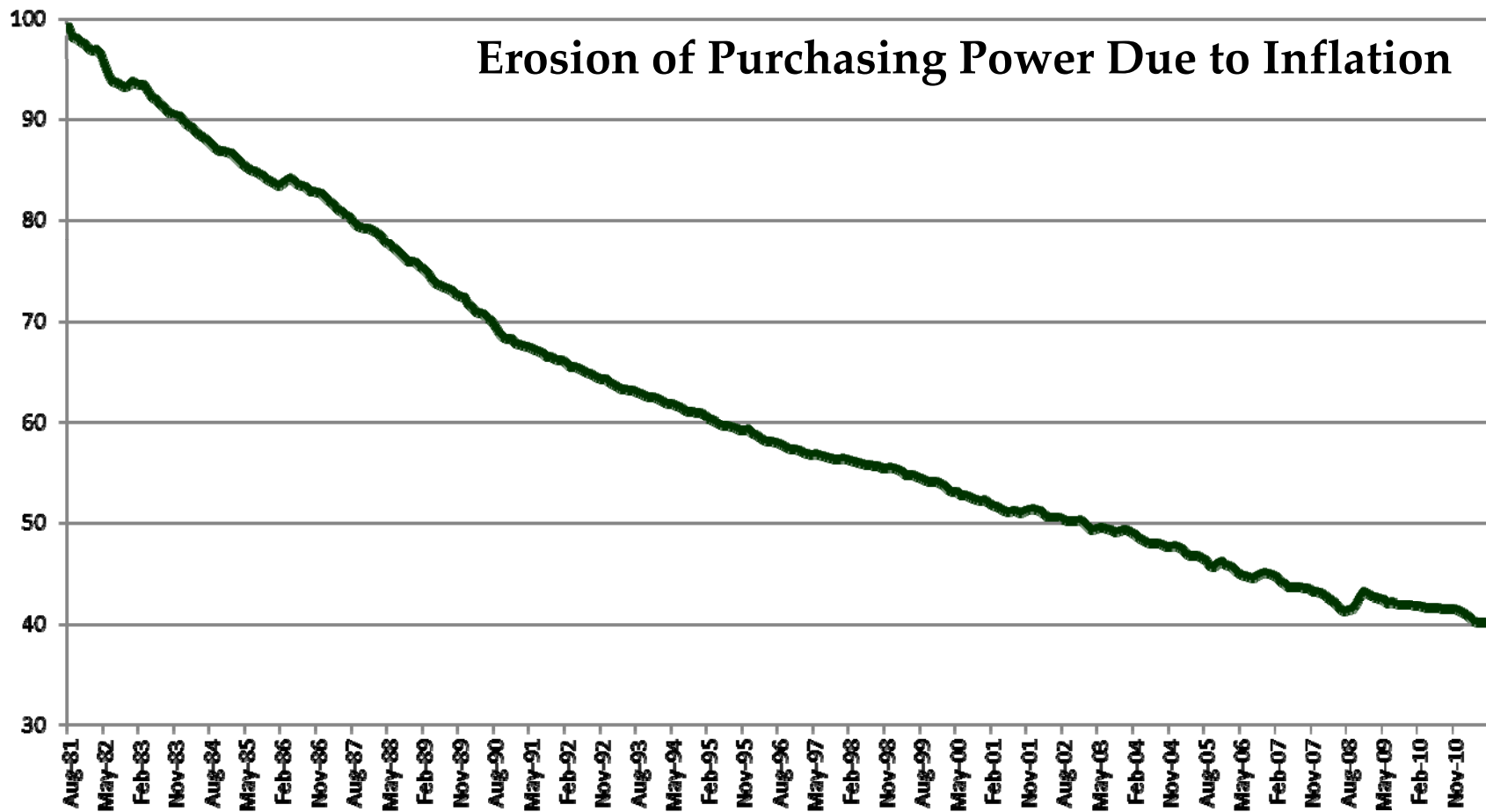
Risk Perception Reset



The Lost Decade (NOT)



Risk Perception



Risk Perception

“What changes, and very radically, is risk perception,” said Dave Yeske, a financial planner in San Francisco. “The scariness of short-term volatility disproportionately blinds us to the long-term scariness of inflation,” he added, saying that the recent inflation rate of 3.6 percent would erode your purchasing power by half in 20 years.

New York Times, September 15, 2011

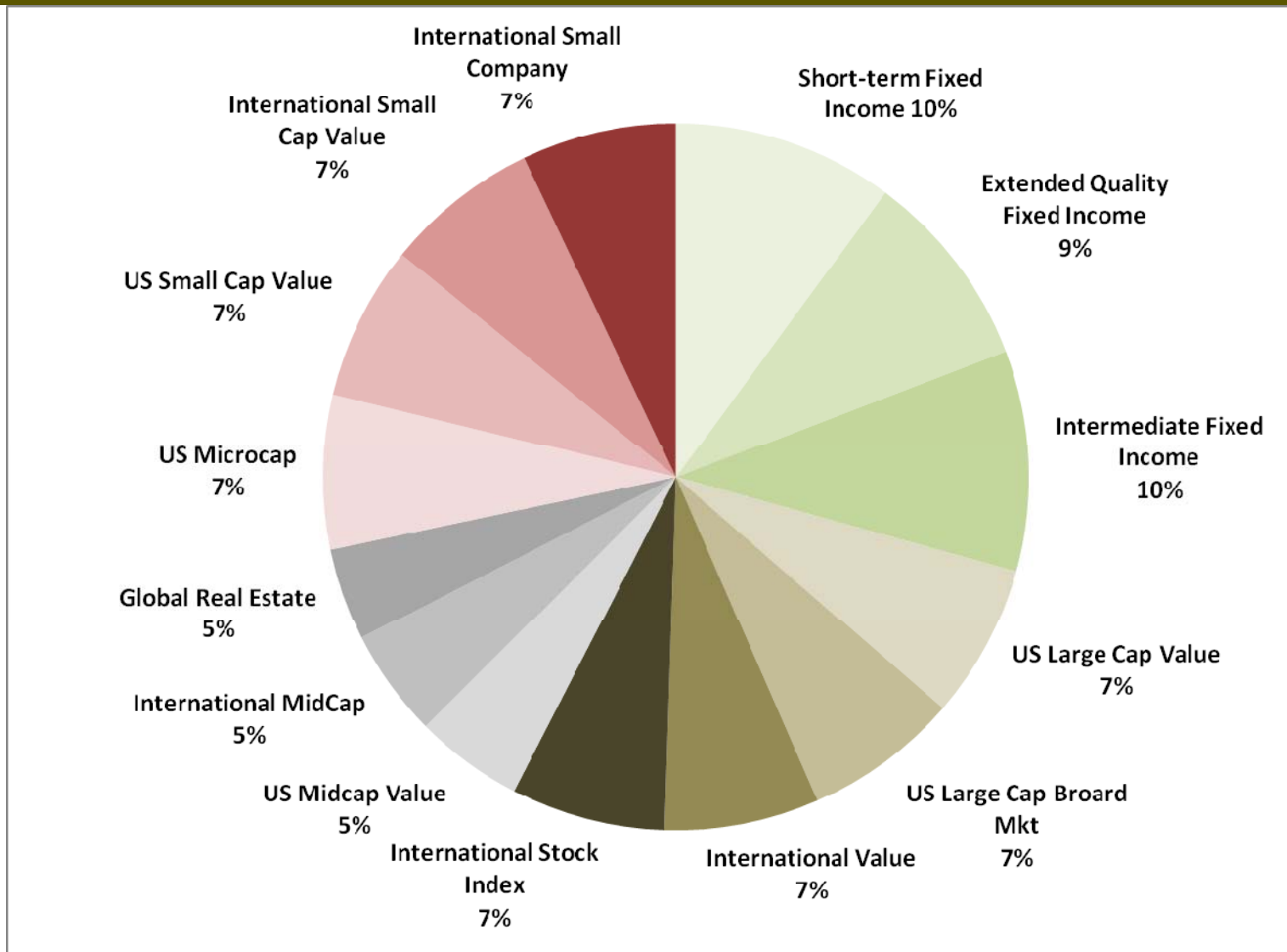
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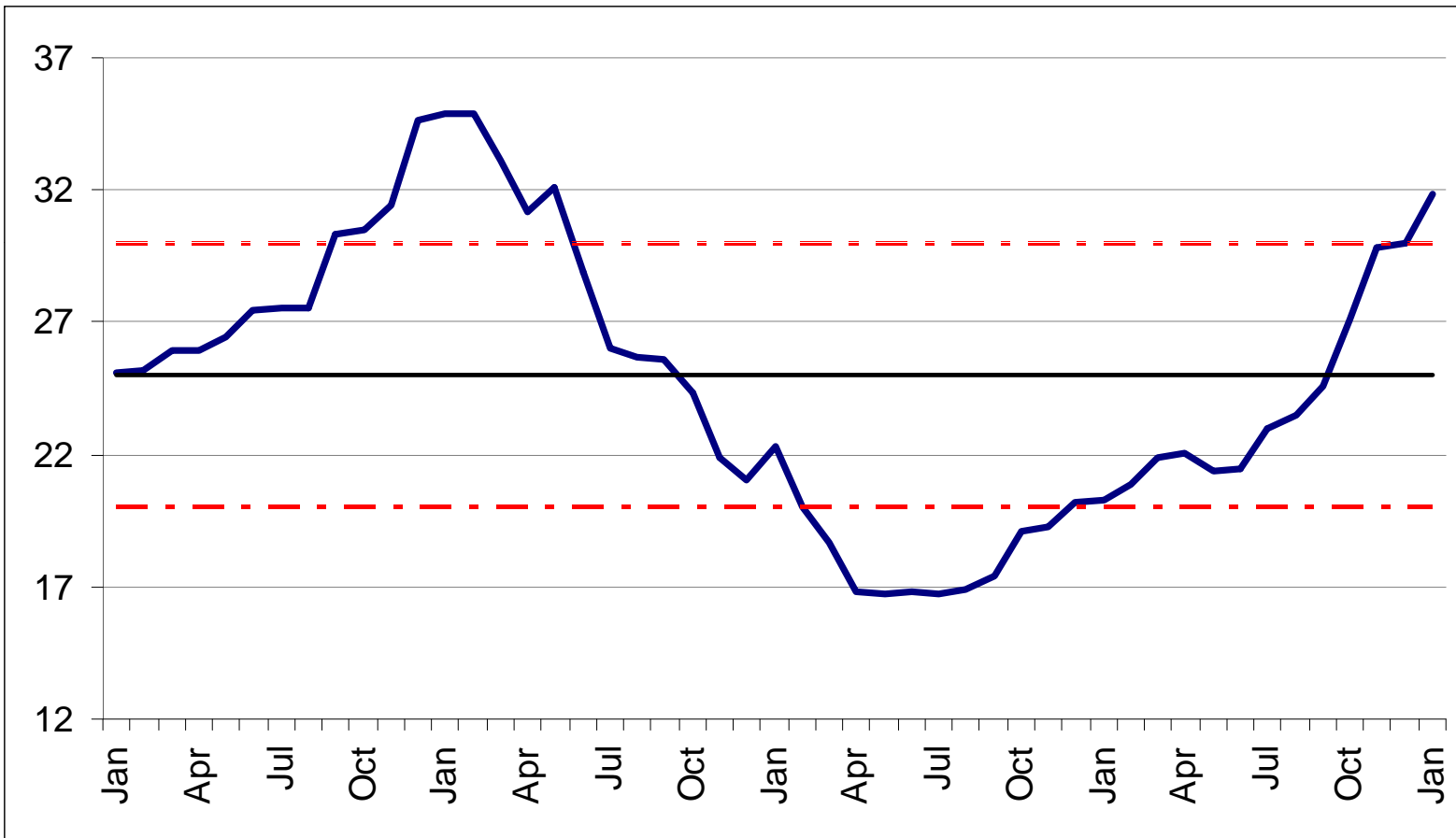
Cash Management Policies

- Emergency Fund
- Funds earmarked for S/T goals in cash
- One-year spending target in cash
- Top up cash to target whenever portfolio is rebalanced
- “Firewall” rebalancing for spending portfolios

Diversification Policies



Rebalancing Policies



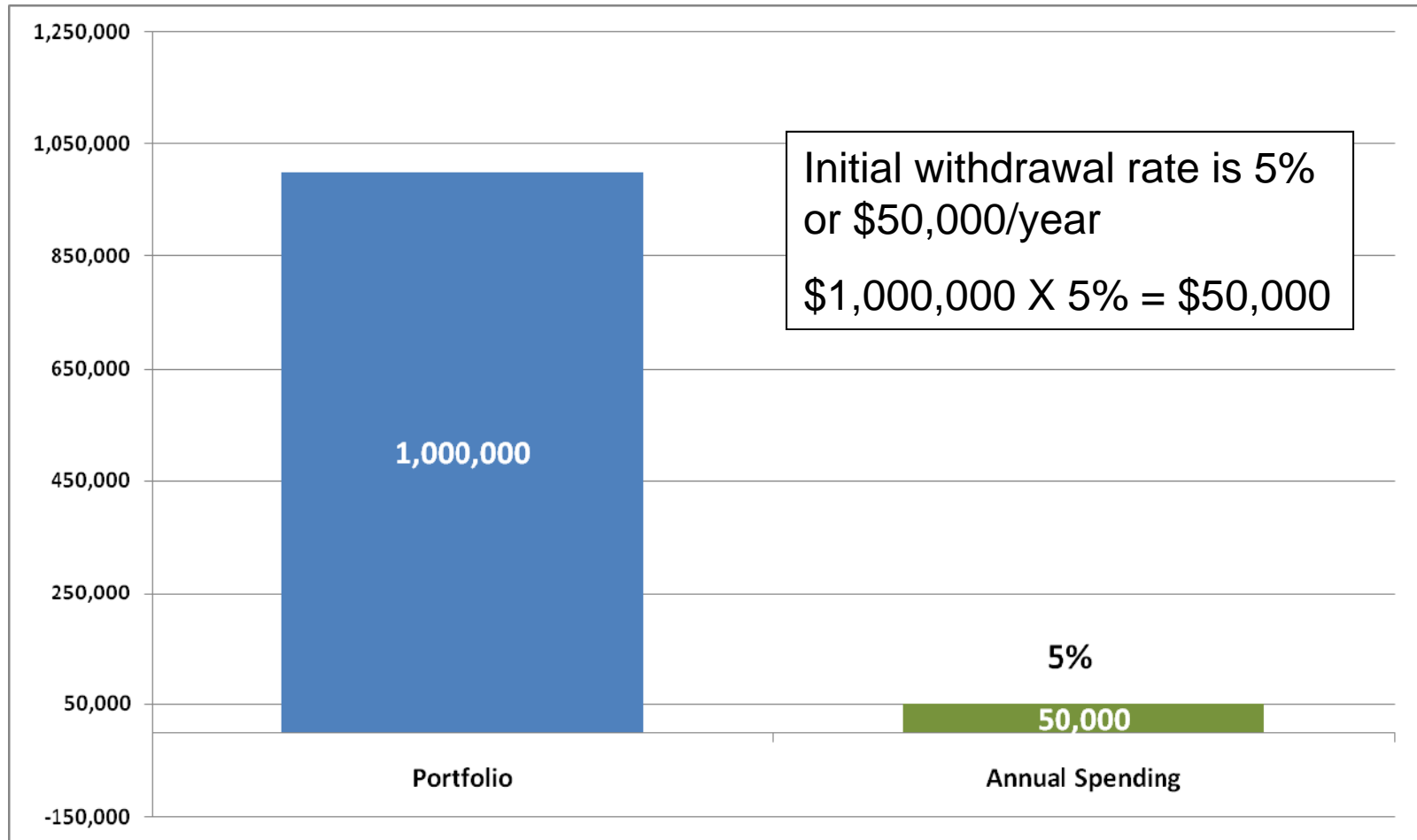
Safe Withdrawal Rate Policies

Prosperity Rule

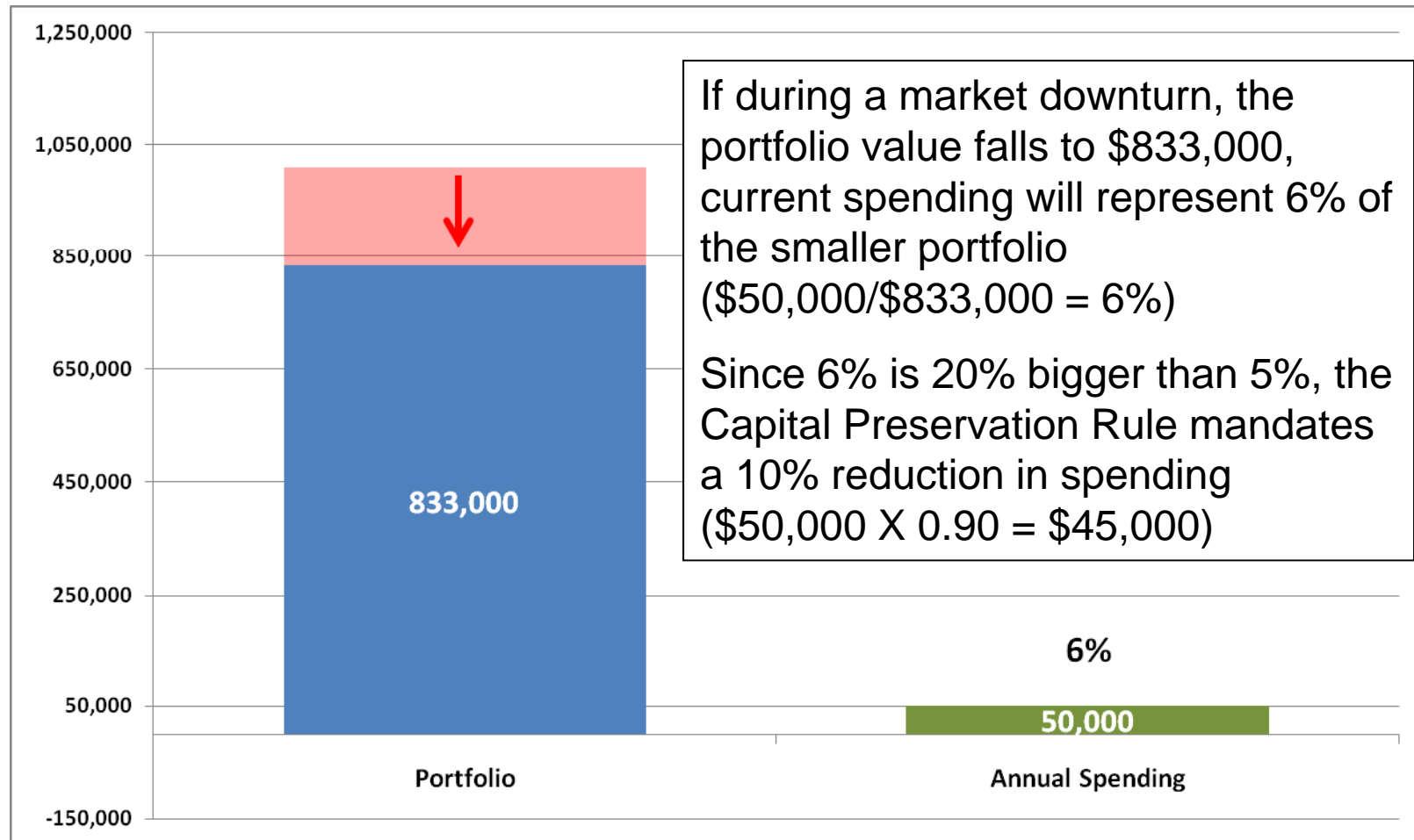
Capital Preservation Rule

Inflation Rule

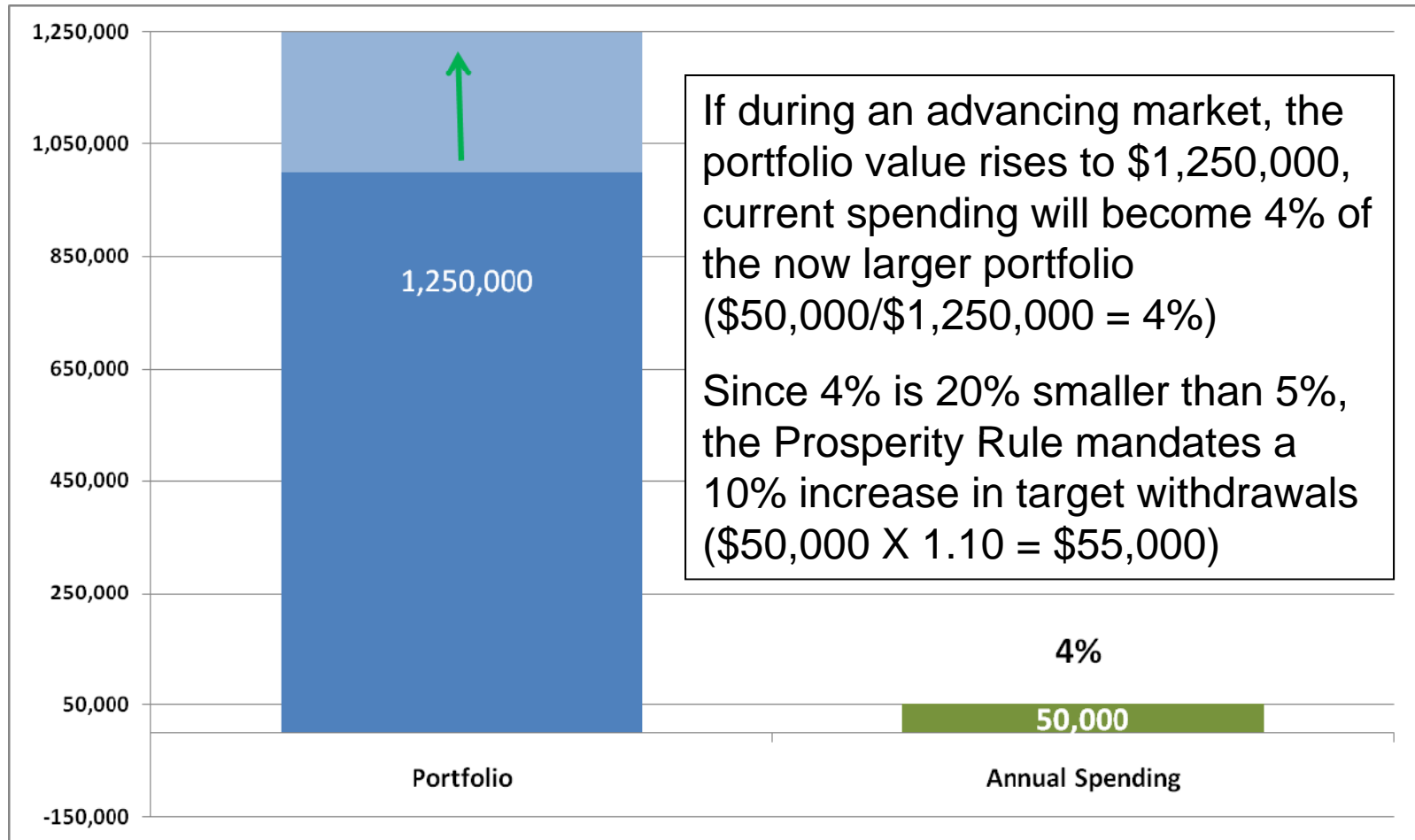
Application of the Policies



Capital Preservation Rule

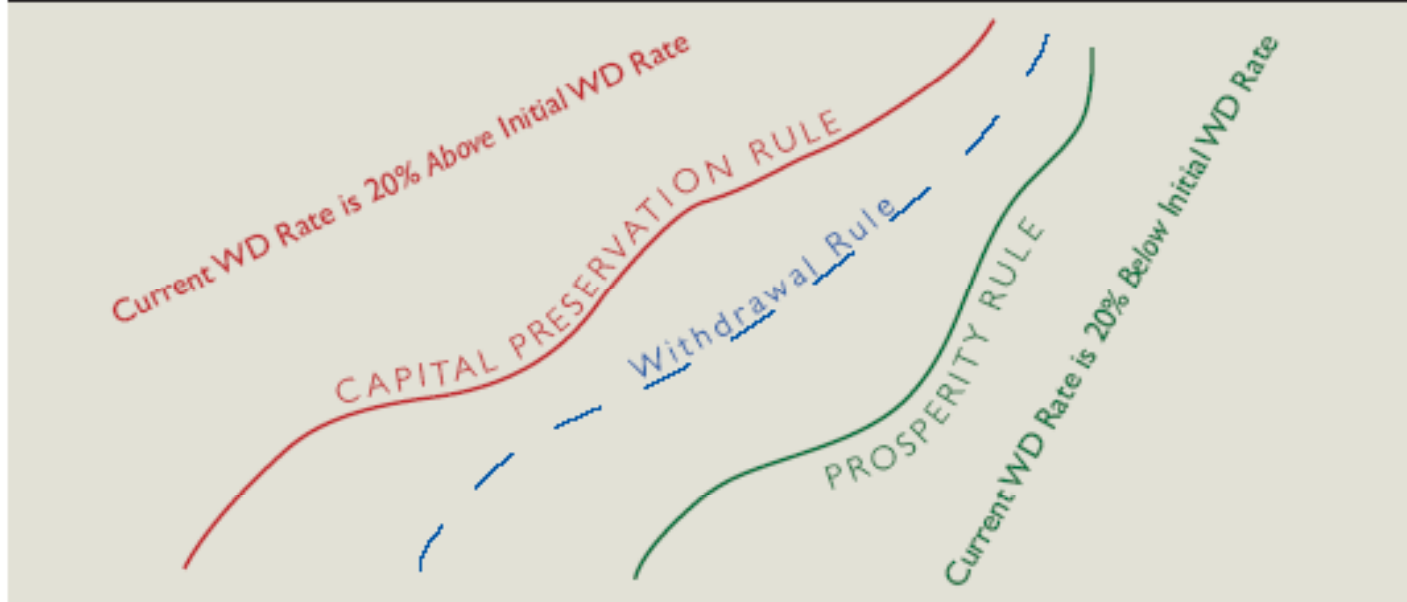


Prosperity Rule



Decision Rule Guardrails

Figure 1: Decision Rule 'Guardrails'



Grounded Wisdom

- A commitment to a grounded investment philosophy
- A commitment to the financial planning process and perspective
- Keeps us rooted in something solid and not scrambling to make reactionary changes
- It's better to be resilient than nimble!