

Personal investment strategies

Budgeting and 'human' risks

BY MICHAEL J. HELGESEN



HELGESEN

Conventional personal investing – CPI – often mirrors the methodology used by institutions despite obvious and significant differences. Institutions, for example, “last forever,”

while individuals produce salaries from work that eventually run dry and have lives that end, often leaving widows or widowers.

Both institutions and individuals balance risks and rewards, but the risks each has to manage are very different. The predominant risk for institutions is market volatility, while running out of money after retirement is the primary risk for individuals. That’s why individuals must successfully manage the events that can cause this to happen, namely excess inflation, increased taxes, early job loss, runaway health care costs, needy family members, etc.

CPI strategists preach the importance of diversification. Diversification is necessary but it only protects individuals against “concentration and volatility risk,” not the other risk hurdles they have to leap.

Conventional thinking for personal investment is only marginally influenced by the priorities of individual investors – everybody is more or less treated the same. It often employs a shortcut for determining portfolio composition based on “risk tolerance and time horizon” questionnaires, which are often too general to capture the individual’s spirit or taste for risk let alone take into account health, family

circumstances, unplanned contingencies or legacy goals.

CPI asset allocations frequently overlook critical time connections between investments and goals and almost always ignore the need for bear market and contingency reserves that are essential to preserving wealth. While most strategists recommend a three- to six-month emergency fund, very few suggest growing it to 18 to 24 months at retirement when it is most needed because of cyclically occurring bear markets.

As frightening as bear markets are to accumulation investors, they can devastate retirees taking withdrawals from plummeting assets, deprive portfolios of the capital needed to fuel the next rebound and potentially precipitate a downward spiral as fixed withdrawals are made from a shrinking asset base.

Strategists who limit asset allocations to investment products miss opportunities to transfer risks to third parties. The use of insurance products, especially newer ones, is often more cost-effective than self-insuring all of the risk of running out of money.

CPI typically underestimates the seismic change individuals experience at retirement as they shift from asset accumulation to distribution. Managing income from an asset base requires drastically different skills than those used to accumulate assets. The risk of loss is much higher, mistakes are often costlier, tax management more critical and budget management becomes a new imperative for many.

A subtle variation of this idea is that CPI usually fails to notice the movement of time that requires a shift in asset allocations as individuals get

closer to achieving their goals. We call this phenomenon “aging.” For example, assets should be reallocated to less volatile investments as children approach college, lest the market drop at the very time the cash is needed for tuition.

There is an alternative to conventional personal investment – SFS mapping. This is a visual process that identifies current and emerging expenses like family events, contingencies, legacies and, of course, retirement and then graphically plots each in time along an individual’s lifespan. This simple graph allows investors to see expenses as they emerge along with corresponding investments designed to fund each liability or goal. Liabilities and investments emerge in a sawtooth pattern and undergo aging reallocations as individuals progress toward their goals. This alternative is in sharp contrast to the conventional methodology that relies on diversification as the primary risk management device and fails to provide for more human risks such as compensation changes, positive or negative family events, legacy goals, death and the effect of the passage of time on emerging personal liabilities.

Mike Helgesen is President of Sound Financial Services, Inc., a financial advisory firm in Ridgefield. Fee based advisory services are offered through SSN Advisory, Inc., a registered investment advisory firm. Securities are through Securities Service Network, Inc., member FINRA/SIPC, Office of Supervisory Jurisdiction, 10207 Technology Dr., Suite One, Knoxville, TN, 37932 – (865) 777-4677. Reach Mike at mhelgesen@ssnrep.com.