

PRINCIPLES OF LONG-TERM INVESTING

Increasing your wealth over time is about more than making the right stock picks or always buying low and selling high. Too often, we see intelligent investors shoot themselves in the feet by making fundamental errors in their investing strategy.

Over the years, we have observed the effects of fear, greed, lack of discipline, groupthink, and many other pitfalls that investors experience. Accordingly, we have compiled this list of seven principles of long-term investing. These principles are by no means exhaustive, nor will they guarantee investment success, but we hope that you will find them useful in helping you make investment decisions.



Engineered for the Investor

WEALTH MANAGEMENT

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FOCUS ON THE TOTAL REAL RETURN OF YOUR INVESTMENTS

To maximize investment growth over time, it's critical to factor in the effects of fees, taxes and inflation on your returns. Many posted investment returns explicitly exclude the effects of fees, which come right off the top of each year's gains, so it's important to dig a little deeper and find out how much that performance is costing you each year.

Taxes can also take a serious bite out of your investment gains each year and it's important to structure your investments to account for taxes on capital gains, dividends, and income. While we don't believe that taxes should be the primary driver of an investment strategy, incorporating tax efficiency into your overall plan will help you keep more of what you earn. If taxes are a problem for you, we strongly recommend that you consult a qualified professional who can help you structure your investments to manage taxes.

Inflation, the increase in the cost of goods over time that erode your purchasing power, is another insidious force that can eat away at investment growth each year. For example, a candy bar that cost 25 cents in 1975 would cost over a dollar today, due to the effects of rising prices. That same candy bar would cost approximately \$1.35 in 2020 if we assume an annual inflation of 4 percent per year. Consumer prices have risen each year in the United States. In the century since the U.S. Department of Labor was founded and began tracking consumer prices, inflation has averaged 3.31 percent each year, which means that what cost one dollar in 1913 costs \$24.02 in 2015.ⁱ

To put these numbers in the context of investments, an assumed inflation rate of 4 percent will reduce the value of a \$100,000 portfolio invested today to approximately \$67,500 in just ten years; inflation means that your investments would have to grow to \$148,000 during that time period – a 48 percent gain – simply to keep pace with rising costs. And this number doesn't include the effects of taxes and fees on investment performance.

In an effort to reduce risk, many people over-invest in fixed-income securities like bonds, which are highly exposed to inflation risk since they do not have the same potential for capital appreciation as equities. We recommend that our clients' portfolios contain enough exposure to equities for their ability to fight inflation through growth. For the period 1928 to 2014, the S&P 500 returned an average annual performance of 11.5 percent, while 10-Year Treasury bonds returned just 3.5 percent.ⁱⁱ It can be psychologically difficult to weather the volatility of equity markets, but investors who fail to adequately plan for the effects of inflation risk running out of money later in life.

An investment strategy that fails to account for the effects of fees, taxes and inflation on overall return will severely handicap your ability to increase your wealth over time. After some research, you may find that in some cases, an investment with a lower return may actually have a higher total return once you account for taxes, fees, and inflation.

2 DON'T CHASE THE CROWD

No one knows with any certainty which direction markets will go in the future. However, a good axiom to remember is that it is usually wise to avoid following the herd. By the time your friends, family, neighbors and newspaper columnists are all investing in a particular sector or security, it's often too late to benefit because hype has already inflated the price. Whenever investment dollars charge in, prices soar and savvy investors usually move on. By the time the mass of average investors have caught on to a new fad, prices are often too high and investments are overvalued, making them a poor choice for investors who are seeking value.

We don't necessarily advise becoming contrarian investors, i.e. those who believe that crowds are always wrong and look for opportunities to invest against the prevailing trend. Instead, we strongly encourage an investment strategy that is based on objective research using the best information available, calculated choices, a realistic assessment of risk, and a determination to avoid emotional decision-making.

"Never follow the crowd."

BERNARD BARUCH

*Economic adviser to Presidents
Woodrow Wilson & F.D. Roosevelt*

Emotional investing is a well-documented pitfall among investors and it can have striking consequences for investment performance. A recent study found that while the S&P 500 returned 9.9 percent between 1995 and 2014, the average investor fared much worse, seeing only a 2.5 percent return during the same period. Much of the difference can be attributed to jumping in and out of markets during downturns. Letting emotion take over and following the crowd can be extremely costly to your long-term performance. ⁱⁱⁱ

3 REMAIN FLEXIBLE AND DIVERSIFIED*

In today's volatile markets a successful long-term investment strategy can often benefit from flexibility and proper diversification. Diversification is one of the pillars of modern investment theory and can be a powerful tool to reduce certain types of risk in your portfolio. Be sure that your overall portfolio contains

"Diversify. In stocks and bonds, as in much else, there is safety in numbers."

SIR JOHN TEMPLETON

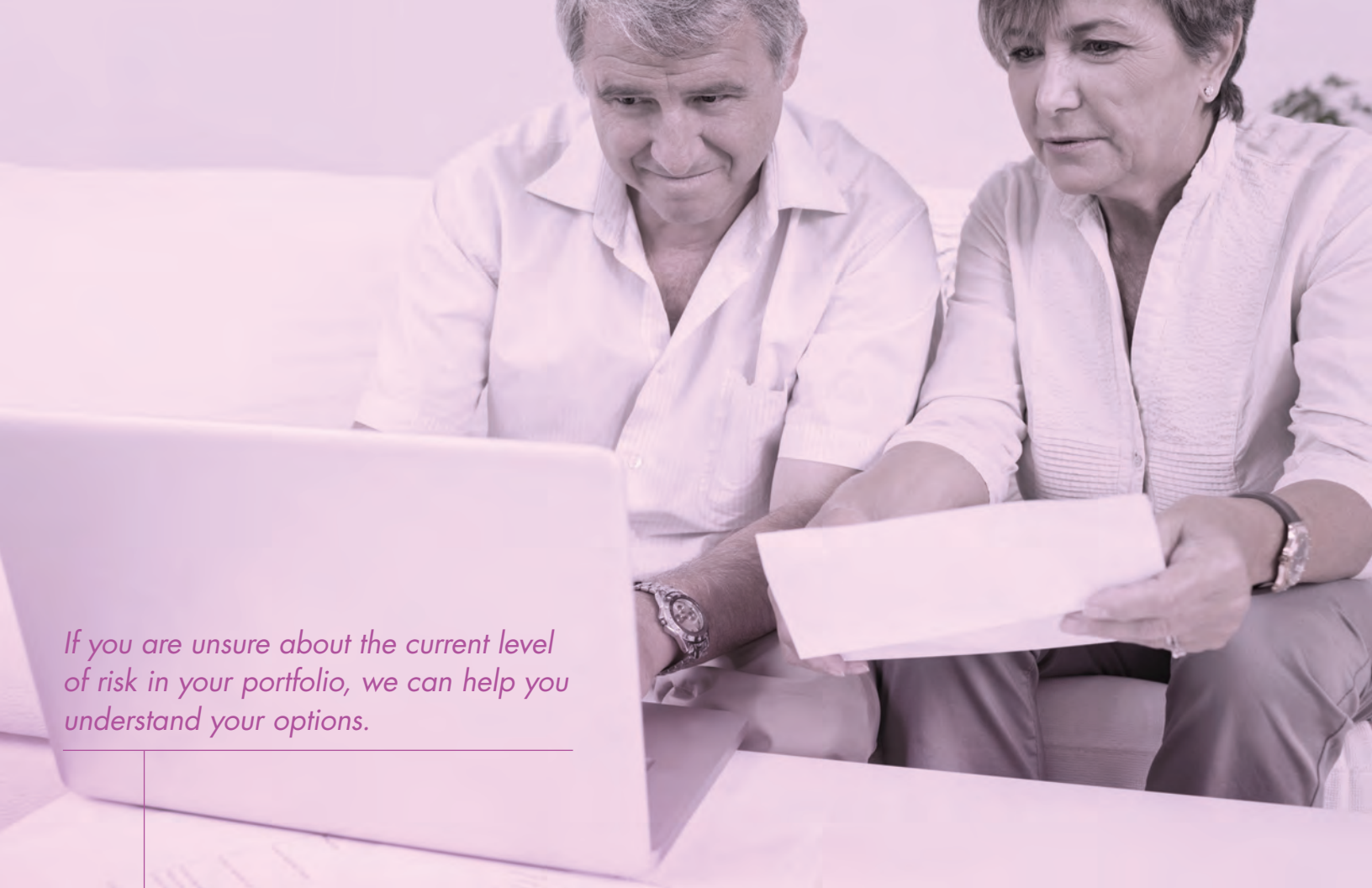
Stock investor, philanthropist

a variety of quality investment types, including stocks, bonds, international securities, and a few alternative investments if your risk profile and investment goals support them.

That's not to say that diversification can guarantee success. No matter how careful or prudent you are, you cannot predict or control future market movements. Much of the market volatility of the last few years has been driven by economic events that are outside any investor's control. Global economic events, natural disasters, and government activities can all cause large-scale market movements. While we can't diversify away all forms of risk, a flexible strategy can help you find investment opportunities in many market conditions.

On the level of individual companies, any number of unforeseen factors can affect a stock's price: Natural disasters, supply line disruptions, unexpected technological advances by a competitor, or the loss of a major partner can all cost a company millions of dollars in losses and affect its value to your portfolio. Since it's impossible to predict these events, it's important to implement an investment strategy that diversifies by industry, by risk level, by country, by investment type, and other factors. While diversification can't always protect your assets in times of widespread market declines, by spreading investment risk among a wide variety of securities, we hope that what affects one part of a portfolio doesn't

* Diversification does not guarantee profit nor is it guaranteed to protect investments from losses.



If you are unsure about the current level of risk in your portfolio, we can help you understand your options.

to eat away at the long-term value of your investments. The challenge is in ascertaining how much risk is right for you and your portfolio. Determining risk tolerance and the appropriate amount of risk for your investment goals is one of the most important things we help our clients with.

Obviously, no one wants to see their portfolio lose money at any point, but it's important to understand that, generally, one must take on more risk in order to achieve higher long-term returns. It's vital to be honest about your ability to withstand short-term swings in value and take investment losses in the pursuit of returns.

Another essential question that you must answer is how much risk you need to take on in order to meet your investment goals. The right risk allocation for a portfolio will depend on a number of factors, including your expectations for return, investment objectives, time horizon, and appetite for risk.

Many popular asset allocation tools focus on age – or time until retirement – as the primary driver of an allocation strategy. While this can be useful, we believe that age is only one factor in determining a proper asset allocation strategy; other factors include liquidity needs, net worth, and investing priorities. Unfortunately, many simple age-based allocations fail to adequately account for longer lifespans and the effects of inflation, putting investors at risk of running out of money later in life.

Today's markets can be unforgiving of the wrong risk management strategy. Ultimately, holding the wrong amount of risk means that you may not realize the investment gains that you expect or that you may experience wider swings in portfolio value than you can stomach. If you are unsure about how much risk you are taking or have questions about managing risk in volatile markets, please give us a call. We can help you understand your options.

“The game of life is the game of everlasting learning. At least it is if you want to win.”

CHARLIE MUNGER
Investor, philanthropist



6 LEARN FROM YOUR MISTAKES

The words “this time is different” are among the most costly words in the history of investing. One of the key differences between successful long-term investors and those who are not, is that successful people learn from their own mistakes and commit to never making the same mistakes twice. Even when a mistake results in a large loss, take a step back to review the actions that led to the loss. Don’t compound the errors by taking bigger risks in an effort to recover your money. Determine where you went astray and take steps to ensure that you avoid the same mistake in the future.

Many common investing mistakes can be attributed to emotional decision-making. Whenever you make financial or investment decisions, you will confront the challenges of overcoming fear and greed. Fear can cause you to run for the exits when markets decline or your portfolio takes losses. Greed can encourage you to chase fads and take on too much risk in the pursuit of a big score. However, by recognizing your emotional triggers and engaging your rational mind, you can overcome your impulses and cultivate discipline.

Working with a financial professional can help avoid emotional decision-making and many other pitfalls commonly encountered by amateur investors. It’s our job to remain focused on the long-term strategy and act as a voice of reason when emotions run high. In today’s world of high-tech investing, major financial decisions are only a click away and investors pay a high price for short-term thinking. Professional financial representatives can be invaluable for their ability to answer questions, provide reassurance, and keep financial strategies on track despite volatile conditions.

7 AGGRESSIVELY MONITOR YOUR INVESTMENTS, OR PAY SOMEONE SKILLED TO DO IT

When markets are rising and amateur investors are doing very well, it’s easy to forget that protecting your assets during declining markets requires skill, discipline and constant attention. Investors need to expect and be prepared to react to fast-moving markets. No market

rally is permanent and no decline lasts forever, meaning that there are no investments that you can buy and forget about. The pace of change of today's markets is too great for investors to be complacent. For example, the 30 companies that make up the Dow Jones Industrials, which are some of the largest publicly traded companies in the U.S., have changed numerous times since the Dow's inception in 1896. These companies were removed as they declined, were acquired, went private, or simply went bankrupt.

Investing with long-term assets is not child's play since most investors can ill-afford to lose their nest egg. Today's markets are no place for dabblers without the time, patience, discipline, and diligence needed to do a proper job. If you aren't completely sure that you have what it takes to manage your investments well, it may be time to find a professional financial representative with the skills and experience to do it for you.

CONCLUSIONS

Achieving long-term investing success is challenging and requires discipline, time, and skill. While it's not possible to predict future returns or market movements, it is possible to develop strategies that mitigate risk and place us in the best position to achieve reasonable returns. No strategy is perfect, but our experience has shown that when used with prudence, these guiding principles can help investors achieve financial success over the long term. We hope you've found these rules useful and that they will help you in your financial journey.

Footnotes, disclosures, and sources:

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Investing involves risk including the potential loss of principal. No investment strategy can guarantee a profit or protect against loss in periods of declining values.

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ⁱ CPI-U (1913-2014). Federal Reserve Economic Data. Source: <https://research.stlouisfed.org/fred2/series/CPIAUCNS#>. [Accessed 19 November 2015]

Bureau of Labor Statistics. Inflation Calculator. Source: http://www.bls.gov/data/inflation_calculator.htm [Accessed 19 November 2015]

ⁱⁱ Annual Returns on Stock, T.Bonds and T.Bills: 1928 – Current. Aswath Damodaran. Source: <http://www.stern.nyu.edu/~adamodar/pc/datasets/histretSP.xls> [Accessed 19 November 2015]

ⁱⁱⁱ Dalbar Inc., J.P. Morgan Asset Management. The S&P 500 Index is a broad-based, unmanaged index not available for direct investment. Results reflect the reinvestment of dividends. Average asset-allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total returns where applicable) and represent the 20-year period ending 12/31/14 to match Dalbar's most recent analysis. Data are as of September 30, 2015. Source: https://www.jpmorganfunds.com/blobcontentheader/202/900/1158474868049_jp-littlebook.pdf [Accessed 19 November 2015]



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