

## Dave Fulkerson's October '05 Newsletter

This month I would like to talk about risk. A former colleague, let's call him Harold, came in the office last week for a review of his financial situation. He recently turned 60 and wants to retire in two years. His account was badly damaged in the bear market of 2000-2002. In an effort to "make up the losses" he has allocated his 401K and IRA's into an aggressive portfolio of energy, telecom and growth mutual funds and stocks. In an attempt to communicate how much risk was involved in his current portfolio, I realized he didn't have a real understanding of risk.

According to Webster, risk is: the possibility of suffering harm or loss; danger. An accurate description of Harold's investment exposure. My definition of risk is the potential permanent loss of capital. As most of you are investors of one level or another, it is important for you to understand the risks you face and minimize them at all times. Why? Let's take a look at an example.

An investment that gained 10% for three years in a row would have an average annual total return of 10%. In the 4<sup>th</sup> year, if the investment were to lose 10%, the average annual total return would drop to 4.6%. How much would the investment have to return in the 5<sup>th</sup> year to get back to an average annual return of 10%? This may shock you...**34.4%**! Well in excess of market norms. And this is not a play on numbers, the 10% loss can happen in any of the 1<sup>st</sup> four years and yield the same results. This example is designed to illustrate the importance of looking at more than returns when picking an investment.

Selecting investment managers is a critical part of any financial plan. It is important to understand not all managers are created equal. Just like some engineers are better than others, some doctors, some golfers and some investment managers are better than others. Selecting the "Tiger Woods" of investing is key to long-term success. When you are selecting investment managers, it may help to consider the following:

- **Consistency.** Eliminate managers who have not produced consistent long-term results with low relative volatility. Compare their results against those of peer groups with similar objectives or against relevant benchmarks such as the S&P 500 Index.
- **Results.** Look at results from various time frames such as rolling three year averages to develop an understanding of how the manager performed in various market cycles. Every investment has a disclaimer "Past performance is not a guarantee of future results" and this is true. But past performance is one of the best indicators we have for indicating who to trust with our hard earned money in the future.
- **Experience.** The perspective and prudence that come from experience in multiple market cycles is critical to managing risk and limiting losses in market downturns.
- **Philosophy.** Learn and understand the investment approach behind the numbers. Determine if the manager's philosophy is consistent and tested over various market cycles.

In my assessment, the key to long-term investment results is managing risk and reducing draw-downs in our accounts. If you feel you need help managing risk call for an appointment.



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