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WE MEAN BUSINESS

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DARE TO BE DULL

## Enduring the pain of the slip and slide stock market

Who else remembers those summer days, a yard full of neighborhood kids and a Slip N Slide?

One after the other, we dove on and slipped and slid across the unexpectedly hard lawn. With our bruised and scraped elbows and knees, we had to acknowledge that there was a downside to being carried along by momentum, fun though it looked.

As I write this column, the headlines are talking about another momentum slide — downward — as the markets are hitting lows not seen since 1997. And the pain that goes with this slide makes those bruises and scrapes of childhood pale in comparison.

Yes, it's a fact that the S&P 500 Index finished 2008 a full 26.5 percent below where it started 10 years earlier. But it's also a fact that a simple moderate risk portfolio (60 percent stocks and 40 percent bonds) of three index funds earned 36 percent during this same period. How can we have this more than 62 percent difference, you might ask? Let me explain.



R O T H  
Allan

look at the three simple secrets of this portfolio performance.

### Asset allocation

This simple portfolio was only 60 percent in stocks. The other 40 percent was in boring bonds. Investing in the stock market has always been risky, so having a shock absorber is the key to investing.

And that shock absorber must be real, not something disguised as AAA-rated insured bond derivatives brought to us courtesy of Wall Street.

Many investors that have come to me recently have had losses in their bond portfolios that nearly equal what they had in their stock portfolio. When it comes to bonds and bond funds, the only way to get more return is to either reduce costs or take risks.

A low-cost, low-risk bond fund did its job by providing a cushion.

### Consistency

I've said for a long time, "if you can't be right, at least be consistent," and it's rebalancing that keeps things consistent. In essence, this portfolio timed the market by:

- Selling some stock during the late 1990s before the tech bubble began.
- Buying some stock during 2001-2002 before the raging five-year bull.
- Selling some stock during the five-year bull, thereby providing a partial shield for this financial pickle we now find ourselves in.

Appears so simple, right? Then why couldn't we do it? Because risk is not something investors can be consistent about. We're herd animals, and that's how we roll in the herd, even the gurus.

Three years ago, when we were fearless risk cowboys, the gurus were predicting up markets, with one predicting Dow 40,000. Today we are fearful risk weenies, and that same guru now predicts Dow 3,800.

Do we bother to Google to find out that this was the same guru? Nope, we do just the opposite. We hop on the next herd going to buy high/sell low.

### Costs

We take all of the risks and yet pay our expert helpers 2 percent or more to outsmart someone

else's helper. It's a game that has a 99.9 percent chance of long-term failure. The simple portfolio doesn't play this loser's game.

### How to handle the pain

Watching the current market slide, and our nest eggs decline, absolutely stinks — no two ways about it. I'd be lying through my teeth if I said it wasn't painful to me. The truth is that I have my grumpy, complaining, "I can't take it anymore" moments — just like everyone else.

Nonetheless, it isn't the first time I've felt the pain and it won't (unfortunately) be the last.

And even though this might be the most painful time in my lifetime, I know giving in would be a whopper of a mistake. Am I guaranteed that rebalancing will work as well during the next 10 years as it did in the past? Of course not. I can only go with the odds and with what has historically worked.

I envy my son's blissful youth because money is still abstract for him. I can't turn back the clock, but I can try to emulate the consistency that seems to work in all markets.

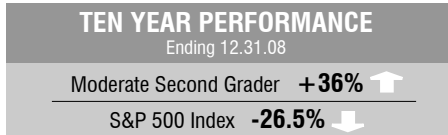
It's possible that "this time, it's different." It's also possible that I'll win the lotto or catch Angelina Jolie on the rebound.

All I can say is that every time I've heard about a new paradigm, reacting to it has been the wrong thing to do.

*'This time, it's different' has a lousy track record*

Year	New paradigm
1999 Bull	It's a new age economy and cash flow doesn't matter. Stocks will go up forever.
2002 Bear	The economy is in trouble and, after losing half their value, stocks will continue to fall.
2007 Bull	There is no problem lending money to people who can't pay it back because real estate values will always go up. The Dow will soon be at 40,000.
2009 Bear	Capitalism is dead. Get out of the market now!

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For argument sake, let's call this simple portfolio the moderate version of the "second-grader portfolio." This, of course has nothing to do with my just-released book of a similar name. This portfolio is comprised of the following:

- 40 percent Vanguard Total Stock Market Index Fund (VTSMX)
- 20 percent Vanguard Total International Index Fund (VGTIX)
- 40 percent Vanguard Total Bond Fund (VBMFX)

To achieve this 36 percent gain, the investor would have had to buy these funds and then rebalance once a year. That is to say, in years when stocks went up, we'd have to sell some to get back to our targets above. When stocks went down, we'd have to buy some.

This approach of owning the whole market and sticking with target allocations is incredibly simple. But we humans should never confuse simple with easy. Sure, a 36 percent gain isn't great, but most people had losses during this period of time. Let's