Five Simple Strategies for Improving Your Investment Results

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(John Wiley & Sons, 2010)

Five Simple Strategies for Improving Your Investing Results

- Simple Strategy #1: Focus on what you can control, tune out what you can't.
- Simple Strategy #2: Find your own true north.
- Simple Strategy #3: Use simple but effective building blocks.
- Simple Strategy #4: Cheap out.
- Simple Strategy #5: Put it on autopilot.

Simple Strategy #1: Focus on what you can control/ predict, tune out what you can't.

In the category of what you *can't* control/predict:

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In the category of what you *can't* control/predict:

- The direction of the economy
- The direction of interest rates
- The direction of the dollar (or euro, or yen..)
- The rate of inflation
- What stocks will return in the future
- What bonds will return in the future

Simple Strategy #1: Focus on what you can control/ predict, tune out what you can't.

So just what can you control?

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So just what can you control?

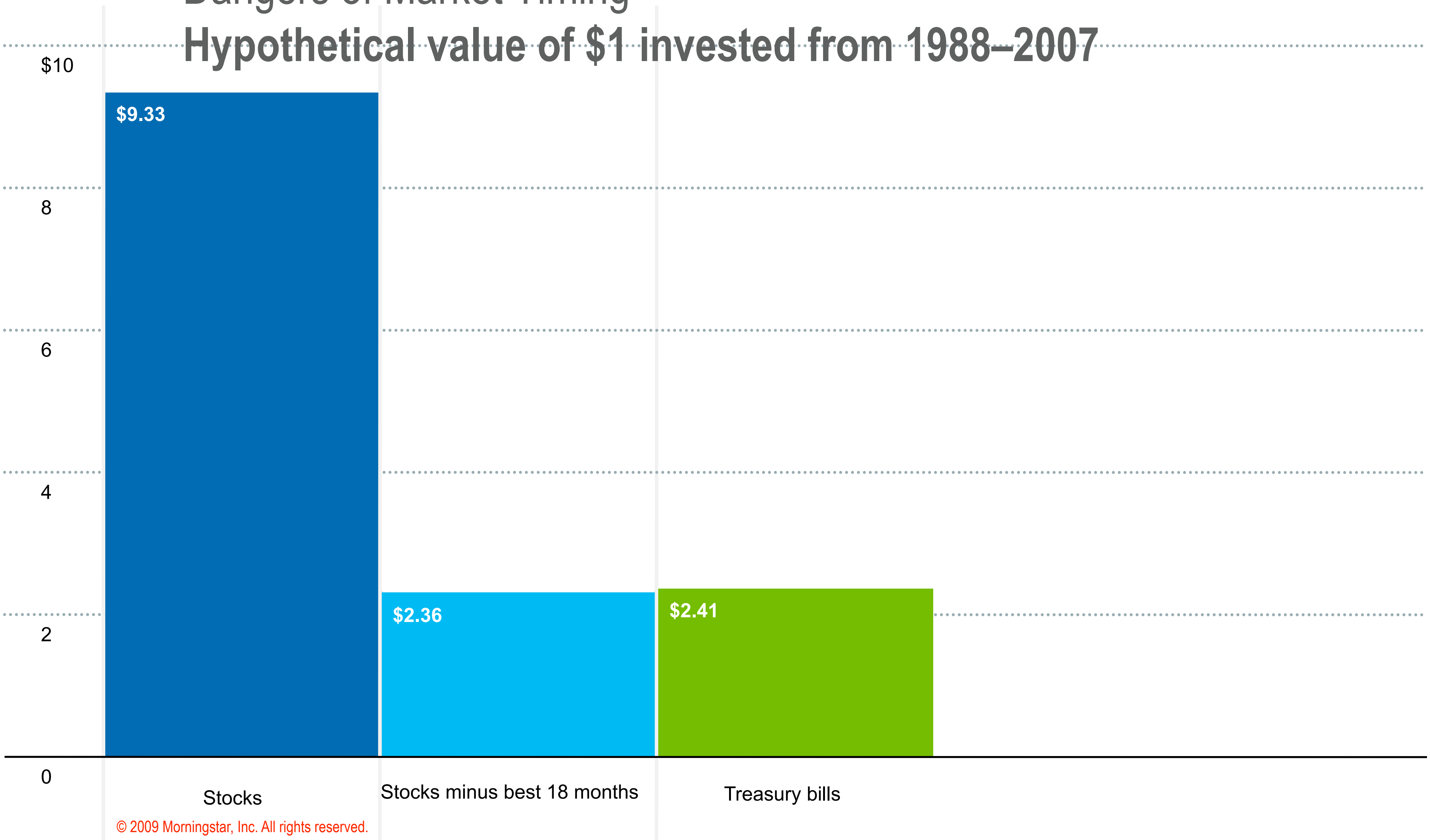
- Your savings rate (doh!)
- Your stock/bond/cash mix
- The quality of investments that you choose
- The total investment-related costs you pay (including tax costs)
- Your own emotions

Simple Strategy #2: Find your own true north.

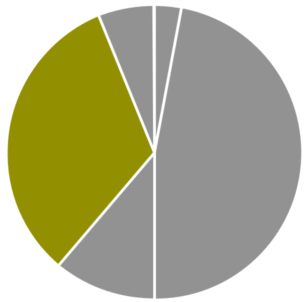
- Proper fund/stock/bond selection matters, but two other factors have a bigger hand in whether you reach your goals: how much you save and how you've split your money among stocks, bonds, and cash.
- Two strategies for asset allocation: tactical (aka market-timing) and strategic (aka buy and hold).
- Tactical would be ideal, but there's one problem: It doesn't work consistently.

Dangers of Market Timing

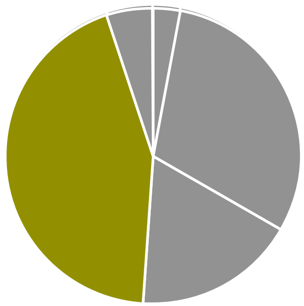
Hypothetical value of $1 invested from 1988–2007



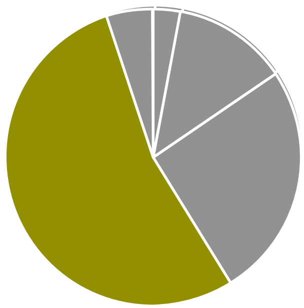
A Starting Point for Strategic Asset Allocation: Morningstar Lifetime Allocation Indexes



Retiring in 2010: 50% bond, 11% foreign stock, 33% U.S. stock, 6% commodities



Retiring in 2020: 32% bond, 18% foreign stock, 45% U.S. stock, 5% commodities



Retiring in 2030: 14% bond, 26% foreign stock, 55% U.S. stock, 5% commodities

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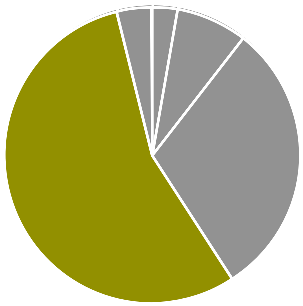
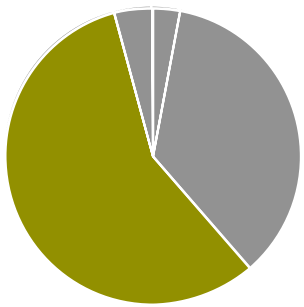


Retiring in 2040: 8% bond, 31% foreign stock, 57% U.S. stock, 4% commodities



Retiring in 2050: 7% bond, 34% foreign stock, 55% U.S. stock, 4% commodities

Tailor your stock/bond/cash mix to suit your personal circumstances. Factor in:

- Your own human capital (Are you a stock or a bond?)
- Longevity: Does it run in your family? (If so, more stocks)
- Other assets/sources of income during retirement, such as a pension (if so, more stocks)
- How much you've saved (if the answer is "not much," consider adding more stocks, but don't go overboard)
- Risk capacity (if low, fewer stocks)
- Desire to leave something for children/grandchildren (if so, more stocks)

Check up on where you are now, then compare that to your target allocations.

Use the following tools to give your current assets a checkup:

- Use Morningstar Instant X-Ray (free tool) to determine your portfolio's asset allocation and style-box positioning. Save your portfolio on Morningstar.com for ongoing tracking purposes. (X-Ray is located on Tools cover page of Morningstar.com.)
- Check up on whether you're on track to meet your retirement goals using T. Rowe Price's free Retirement Income Calculator: http://www3.troweprice.com/ric/ric/public/ric.do or the Retirement Calculator on Morningstar Investment Research Center.

Simple Strategy #3: Use simple but effective building blocks.

- Don’t assume fancy/complicated strategies are better than more straightforward ones.
- Fewer, well-diversified investments can get the job done just as well.
- You’ll also have fewer moving parts to oversee on an ongoing basis.
- Broad-market “index” funds and exchange-traded funds make good starting (and ending) points.
- So do well-diversified active funds.
- All-in-one target-date and balanced funds can also be very effective.

Favorite Core U.S. Stock Funds

Index Funds and ETFs

Fidelity Spartan 500 Index

Fidelity Spartan Total Market

Schwab S&P 500

Schwab Total Stock Market

Vanguard 500 Index

Vanguard Total Stock Market Index

Vanguard Dividend Appreciation

Active Funds

American Funds Washington Mutual

Dodge & Cox Stock

Fidelity Contra Fund

Selected American

Sequoia

Sound Shore

T. Rowe Price Equity Income

Vanguard Equity Income

Favorite Core International Stock Funds

Index Funds and ETFs

Fidelity Spartan International Index

Vanguard All-World ex-US (ETF)

Vanguard Total International Stock Market Index

Active Funds

Artisan International

Dodge & Cox Global Stock

Dodge & Cox International

Harbor International

Masters' Select International

T. Rowe Price Global Stock

Vanguard International Growth

Vanguard Int'l Value

Favorite Core Bond Funds

Index Funds and ETFs

Vanguard Total Bond Market Index

iShares Barclays Aggregate Bond Index (ETF)

Active Funds

Dodge & Cox Income

Fidelity Total Bond

Harbor Bond

Metropolitan West Total Return Bond

T. Rowe Price Spectrum Income

Favorite All-in-One Funds

Target-Date Funds

Vanguard Target Series

T. Rowe Price Retirement Series

Stock/Bond Funds

Dodge & Cox Balanced

Oakmark Balanced

T. Rowe Price Personal Strategy Income

Vanguard Wellington

Vanguard Wellesley Income

Vanguard STAR

Simple Strategy #4: Cheap out.

Financial firms work hard to bury fees in fine print, but investors face costs at many levels. Among the biggies are:

- Commissions to buy and sell
- Fund expense ratios
- Company-retirement plan administrative fees
- Investment related taxes

All of these expenses can eat into your take-home returns.

How Costs Affect Returns

Domestic Equity Funds’ Expense Ratios and Subsequent Performance

Category Expense Quintile	% Surviving Period	Average Cat. Rank	Average Std. Dev. Rank
Cheapest Quintile	74	48	51
2	66	48	48
3	61	46	52
4	60	56	52
Most Expensive Quintile	46	54	53

Average Performance and survivorship rates over 10-year period by expense quintiles based on 1999 expense data

Fees Matter
Especially for Bond Funds…

Category Expense Quintile	% Surviving Period	Average Cat. Rank	Average St. Dev. Rank
Cheapest Quintile	73	36	46
2	67	43	48
3	64	50	49
4	59	58	53
Most Expensive Quintile	54	69	60

Average Performance and survivorship rates over 10-year period by expense quintiles based on 1999 expense data

Fees Matter, and Investors Have Gotten the Message

Expense Ratios at least 20% less than broad group average	Expense Ratios +/- 20% of broad group average	Expense Ratios at least 20% greater than broad group average
$1,300 B	$185 B	($116 B)

Estimated flow figures for five-year period ending 7/31/2009

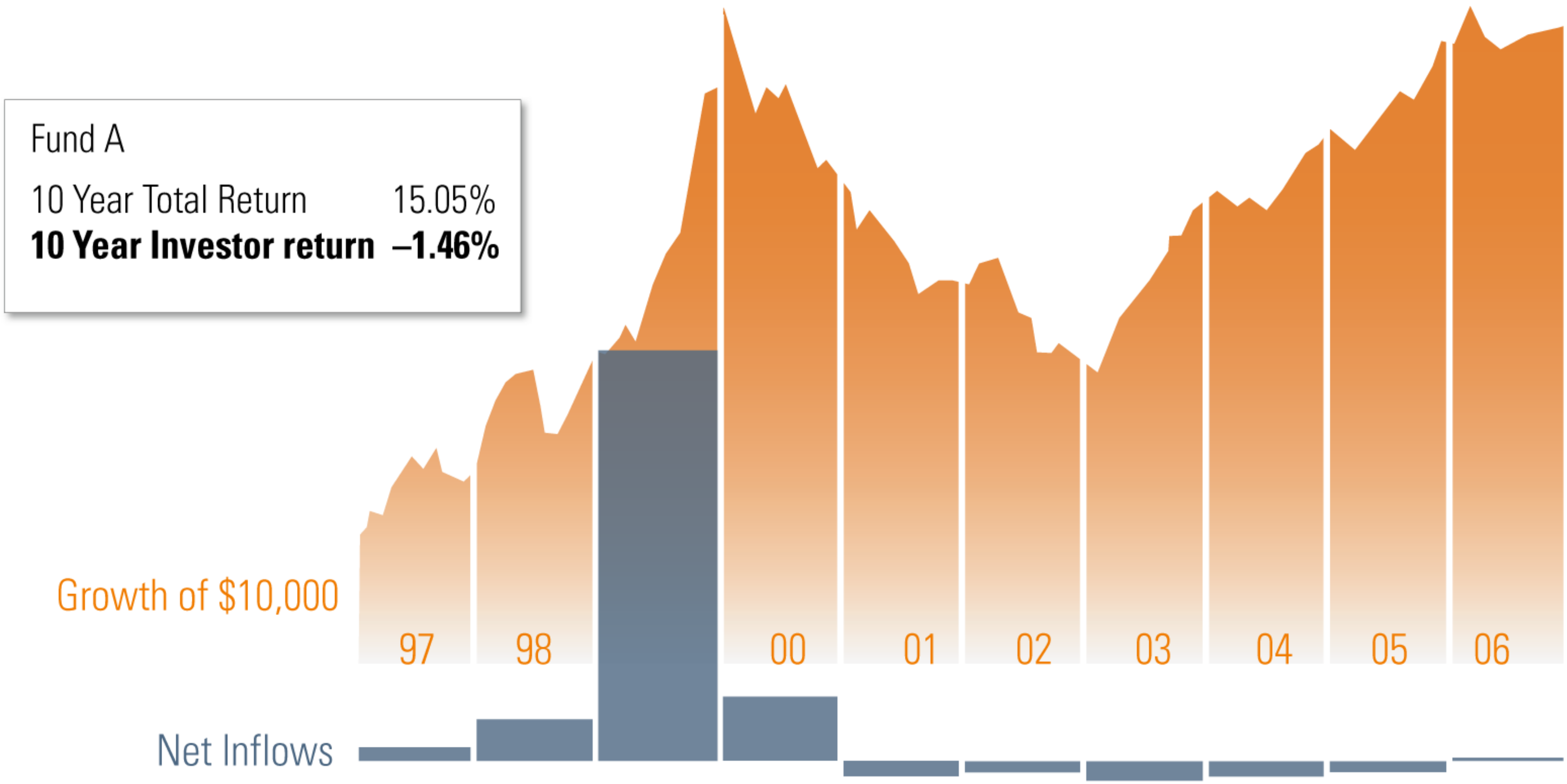
Best Strategies for Cheaping Out

- Trade infrequently (limits commissions)
- Watch fund expense ratios like a hawk (seek stock funds with ERs < 1.0%, bond funds with ERs < 0.75%)
- Stay attuned to 401(k) admin expenses (ask HR for "Summary Plan Description"; >0.50% per year is red flag)
- Pay for advice on an a la carte basis (Garrett Financial Network advisors charge on an hourly basis)
- Take full advantage of tax-sheltered vehicles to limit tax costs: 401(k), 403(b), 457, IRAs

Simple Strategy #5: Put it on autopilot.

- Emotions play a role in how we invest, and it's usually not a good one.
- Investors systematically reduce their own returns due to poorly timed buy and sell decisions.
- What's emotionally satisfying is often a bad idea from an investment standpoint.

Mind the Gap

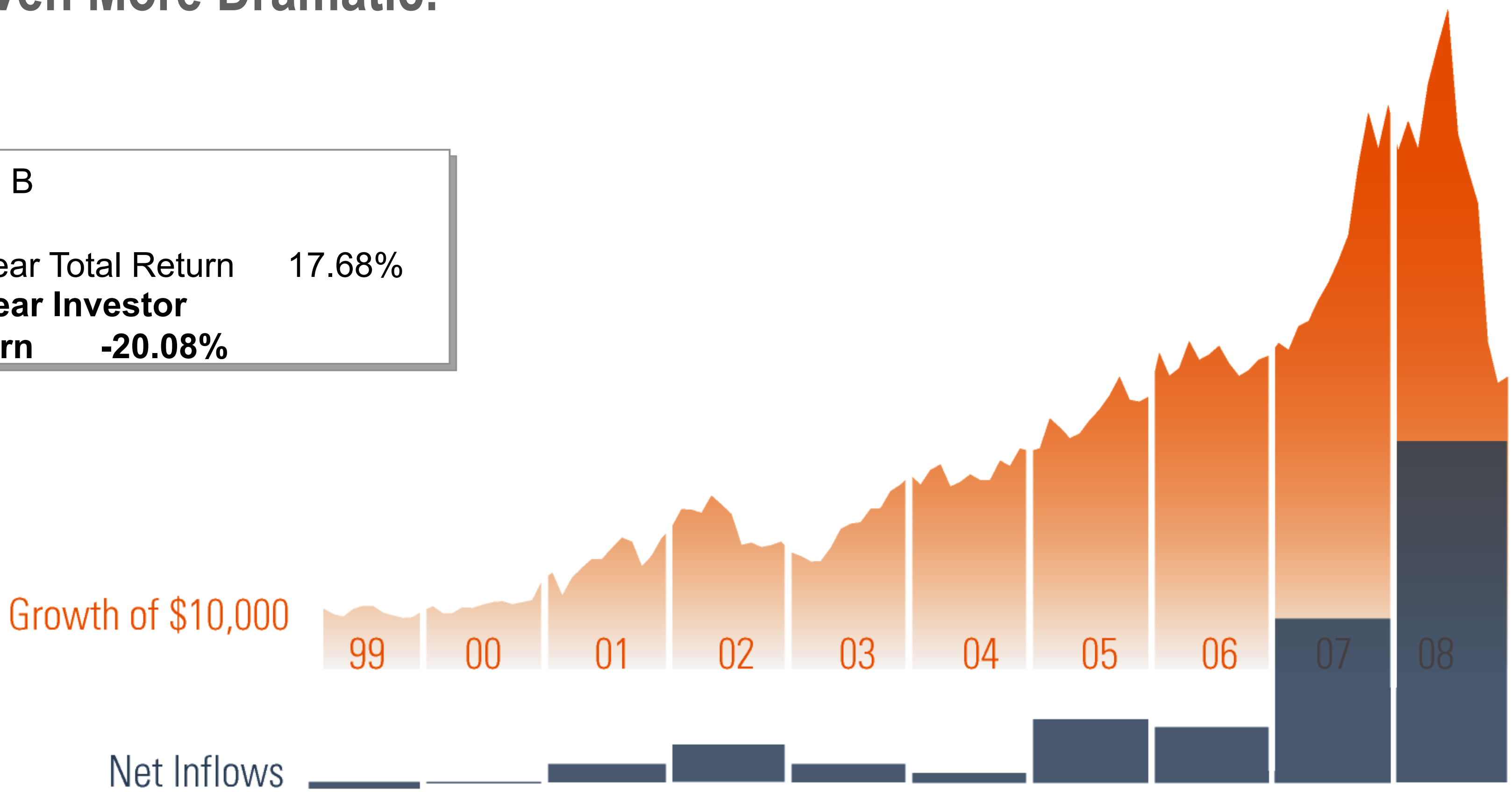


Annual Return (%)	12.7	34.9	120.1	–17.1	–27.8	–17.7	43.8	20.9	24.4	8.8
Net Assets ($mil)	5.3	9.9	72.4	118.9	69.1	45.6	52.2	51.9	57.1	63.2

Even More Dramatic!

Fund B

10 Year Total Return 17.68%
10 Year Investor Return -20.08%



	99	00	01	02	03	04	05	06	07	08
Annual Return (%)	5.6	45.0	38.2	–27.9	65.0	11.0	21.5	11.2	76.4	–55.7
Net Assets ($mil)	69.0	78.9	249.6	385.0	773.6	924.6	1636.1	2276.4	5460.5	4160.7

Simple Strategy #5: Put it on autopilot.

To help combat the urge to act on emotion, put your investments on autopilot:

- Automatic 401(k) contributions
- Automatic 401(k) contribution increases when you get a raise
- Automatic investment plans for other accounts, such as IRA (side benefit: enables you to get started with a smaller sum)
- Conduct a once-yearly checkup, and make changes only if your investments are out of whack with your targets.

Questions?

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