

INVEST LIKE THE PROS

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Recently, we discussed running our financial lives with the same level of commitment that we give to any other business venture. As CEO of “You, Inc.,” you are responsible for ensuring that your investments are handled prudently. Unfortunately, many individual investors operate their investment portfolios on an ad hoc basis. The results of such investing can be devastating. Between 1984 and 2003, the S&P 500 index delivered an impressive average annual return of 12.98%. Yet according to Dalbar, Inc., the average equity investor earned only 3.51% for the same period.

Institutional investment managers (e.g. pensions, foundations, etc.) have a fiduciary duty to prudently manage their clients’ assets. Rather than “wing it,” the pros run their portfolios according to a detailed written document known as an Investment Policy Statement.

<p>An investment in knowledge always pays the best interest. Benjamin Franklin</p>

Creating and using a written investment policy compels you to become more disciplined and systematic, thereby eliminating sloppy errors and increasing the probability of reaching your investment goals. Here are seven steps to establishing an investment policy:

1. **Set clear and concise long and short-term goals and objectives.** This can be anything from early retirement to purchasing a new home.
2. **Define the level of risk that you are willing to accept.** Determine, in advance, the maximum downturn you are willing to accept in a single year without terminating your strategy.
3. **Establish your expected time horizon.** For a portfolio with a significant allocation to equities (stocks), this should be a minimum of five years. A portfolio with less than a 5-year time horizon should contain predominately fixed income investments (e.g., bonds).
4. **Determine your rate of return objective.** One effective strategy is to establish your personal benchmark, using your investment goals and the amount of time you have to achieve them. A personal benchmark will be a more meaningful measure than using the S&P500, the Dow, or the NASDAQ.
5. **Select the asset classes you will use to build your portfolio.** Using realistic long-term capital market expectations, you can map your target rate of return to the types of assets that have the highest degree of probability of helping you realize your objectives.
6. **Document the investment methodology** to be utilized in the management of your portfolio. Passive investing? Active investing? A combination? Individual stocks and bonds, mutual funds, ETFs, REITs, commodities...?

7. **Establish the means for making periodic adjustments to your portfolio.** The investment policy statement creates a benchmark for reviewing performance. If your objectives are clearly articulated, it is much easier to measure portfolio performance and determine whether adjustments are necessary.

For years, the pros have understood the tremendous value of operating by a written Investment Policy Statement. Your obligations to the people that depend on you are just as important. So, don't "wing it." Commit your strategy to writing and then follow through. And, if this sounds too daunting to do by yourself, work with a reputable financial advisor to help you write a strategy to guide your investments no matter what the markets bring. We are here to help.

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