

Formulate a personal investment policy

Investors should quit worrying about the message of doom and gloom from the financial media about rising interest rates. They should take the time to review or develop a written investment policy that is based upon their specific goals, timeline, and their desired rate of return which is related to how much short and long term volatility they can live with. Volatility is the variation in returns from day to day, month to month, year to year and so on.

The reason you put your investment policy in writing is so that you can bring it out when stocks fall or interest rates rise to see if it is still valid. Unless something has changed about your needs, your investment policy will still be valid, even if you need some coaxing and courage to stick by it. Here are some of the basic elements of an investment policy statement.

First, prioritize your goals for investment; determine what they will cost, and when you will need to access earnings or principal for each goal. For example, you might determine that you need \$1m (today's dollars) in 15 years to supplement your retirement income and maintain your lifestyle. Another goal might be to save \$30,000 (today's dollars) in 17 years to put your infant daughter through Cal State University Channel Islands. These are both long term goals.

Next, you consider what you think is a reasonable rate of return goal for your investments. Average rates of return for the past 75 years are readily available. They are not predictions about future returns, but these results do tell you the following: Low risk investments in T-Bills have earned the

Guest Column



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lowest rates of return. Long-term bonds earned more than T-Bills over the long haul. Large company U.S. stocks have averaged far more than long-term bonds, and small company stocks have earned slightly more (about 2% annually) than large companies. (Source Ibbotson Associates)

Now, doesn't everyone want and need the highest rate of return? Bill Gates and Warren Buffett might want high rates of return, but they don't need them. You and I want and need high rates of return, but we may not be able to handle the short term volatility that goes along with them. For example, a portfolio of 100% stocks might lose 50% of its value in a bear stock market. So, most people will seek a compromise between ultra safe insured deposit returns of 2% and the long term returns

of 12% in small company U.S. stocks. So, it is likely that a reasonable long term rate of return goal might be 6%, 7%, or 8%. Sometimes your goal is stated as a percentage plus the annual cost of living increase rather than a stated percentage rate, i.e. CPI + 4%, 5%, or 6%.

Last, your mix of investment classes is generated from your return goal. For example, if your goal is 8% annually, you can derive from historical returns that your portfolio will not be 100% stock. Likewise if your return goal is 4.5%, you might not need any stock at all.

Yes, there is more to an investment policy statement than this. And there is a lot more that is known from investment research that can assist you in designing efficient portfolios vs. ones that waste your resources. But the basics are here. Use a written investment policy statement to guide your investing. Stick with it unless your needs or situation change. And don't get upset and rush to change your investments when the normal ebb and flow and interest rates and stock market prices fill the media with fear.

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