



A Strategy for Volatility – Gaining Mastery and Tranquility

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"This is the true athlete – the person in rigorous training against false impressions. Remain firm, you who suffer, don't be kidnapped by your impressions! The struggle is great, the task divine – the gain mastery, freedom, happiness, and tranquility." –Epictetus

What strategy might we use to gain mastery over investing when we know that periodically markets will become volatile and violently shift direction? How do we gain freedom and tranquility in the domain of investing?

Having lived through many different markets, we have come to one conclusion: We know that we can't predict the direction of any market, whether it is stocks, interest rates or commodities.

The All-Bond Portfolio

To take the place of predictions as to the direction of markets, we developed another strategy, the All-Bond Portfolio, which we wish to share with you. This investment strategy is to create a cash flow produced by high-quality individual bonds to supplement or replace earned income. The cash flow generated by such a portfolio can lead to your financial independence.

The All-Bond Portfolio strategy is designed for investors who share the following profile:

They are conservative investors who are risk adverse. They may be risk adverse because they are nearing the end of their earned income stream, they have lost money in the last stock market crash, or they no longer wish to play in the casino of hope and fear.

The best case for our All-Bond Portfolio strategy is an investor who has “won the game”- meaning the investor can live on the cash flow produced from a portfolio of the highest quality individual bonds. However, financial independence can be achieved at many different income levels.

Is the All-Bond Portfolio Right for You?

This strategy is guided by the answers to the following questions:

First, what are your life and financial objectives?

Second, what is the “price” that you are willing to pay to achieve your objectives?

Third, what cash flow is attainable to satisfy your financial objectives?

Life and Financial Objectives

This is the hardest question because we are not asking about your hopes and desires. This question speaks to your current situation and what cash flow you can actually achieve with regard to your savings. For example, in January 2019, if you had \$1 million, you might be able to earn 3.5% tax-free or about \$35,000 per year in annual tax-free income, from a portfolio of the highest quality tax-free municipal bonds.

We all wish to have more, live better, and have enough for our children. We are asking you to define your minimum comfort level. If you want more, consider the next question –

What Price Are You Willing to Pay?

This question speaks to the level of risk that you are willing to take with your capital? There is no right answer to this question.

We believe that investors should take little risk with their capital. Our strategy is for investors who believe that preservation of their capital is the most important aspect of their investing profile. If one family member is willing to risk jointly held capital because of a desire for a more lavish lifestyle or is sucked into the vortex of ‘winning,’ the investor might consider the family impact if the risky investments don’t work out.

Might there be a family meeting regarding risk and reward? Could you clarify how each member of the family might be impacted in the downside case? Then ask again: Are you willing to pay the price?

Investing Around the Concept of Cash Flow

Traditional investing revolves around diversification and allocating your investable assets to all the major asset classes. The outcome is supposed to maximize your return and minimize your risk. However, we believe that when you invest in anything other than the highest quality individual bonds, you will increase your risk and your return will be unpredictable.

Our strategy is designed to protect your principal and generate a cash flow. Your cash flow can come from social security, fixed payment pensions or other assets. How do you supplement that with income from your capital?

Let's examine the possible cash flows from the major asset classes.

Dividends: Stocks often pay dividends. However, dividends may be cut or eliminated and stocks may decline in value impairing your capital.

Rents: Real estate pays rents. However, rents may be reduced or turn negative if expenses go up. The value of the real estate is variable and generally illiquid.

Cash Flow-No Principal: Annuities when annuitized may pay income for life, but you give up your principal and make the annuity company your heir.

Risk Assets: Securities can be sold to provide cash flow needs. In a rising market this strategy looks brilliant, but in a volatile or declining market, especially near the beginning of retirement, this might result in rapid depletion of your assets unless you are prepared to reduce your planned withdrawal rates.

If we reject these asset classes for one reason or another, we are left with--- drum roll – the highest quality individual bonds.

Conclusion

- The All-Bond Portfolio strategy is for investors who:
 - Believe that preservation of their capital is the most important aspect of their investing profile, and
 - Wish to rely upon predictable tax-free cash flow to fund their living expenses.

The highest quality individual bonds denominated in U.S. currency will provide the most reliable cash flow. While the value of individual bonds may vary, the coupons and thus the cash flows stay the same, unless there is a default. Historically, less than 1% of U. S. municipal bonds have defaulted.

Here are some of the benefits of holding high-quality individual bonds:

- Tax-free municipal bonds will provide a good return on an after-tax basis.
- Taxable bonds are suitable for your retirement accounts.
- No other transaction costs if you hold and do not trade.
- Self-liquidating asset, meaning they will turn into cash at the bond's face value when they are called by the issuer or come due on their due date.
- Enable you to sleep at night.

The question remaining is whether you can size your life style to live within the constraints of your cash flow? If so, you have gained mastery over the game of investing. You have also gained freedom from volatility and hopefully, happiness and tranquility. Financial independence is yours.

Epictetus would be proud of you.