Our Investment Guidelines

February 3, 2020

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These are the investment guidelines our firm uses. We invite you to adapt it and share it with your clients.

Every investment portfolio should have a significant allocation to bonds. Behind our belief in high-quality bonds as an appropriate investment for at least a portion of an individual investor's portfolio is a deep structure, which we call Richelson investment guidelines.

These guidelines have been of value to our clients over the years. They are designed to provide a framework to help you evaluate potential investments and determine which specific investments are appropriate to support your goals and level of risk.

Our seven guidelines are as follows:

1. Clarify your financial goals and life objectives.
2. If you can't afford the risk, don't play.
3. Don't lose money.
4. Evaluate the return on an investment on a risk-adjusted basis.
5. Understand the investment.
6. Understand the investment's liquidity.
7. Understand all tax aspects of the investment.

1. Clarify your financial goals and life objectives

List your financial needs, life objectives and values as specifically as possible. In short, what are your financial assets currently and what asset value do you hope to reach before retirement? What are your backup plans in the event that the unexpected happens and does not conform to your crystal ball? Fortunately, all we have to do is know the present and be satisfied each day that we have achieved our personal best. Tomorrow will take care of itself if we focus on today.

How do you decide how to invest for your future? Unfortunately, there is no way to know the future: Will the stock market be at an all-time high, or just suffered a severe, prolonged market drop? Will the real estate market be booming, or will the smaller, younger generations depress housing prices just when you want to sell?

2. If you can’t afford the risk, don’t play

Taking into account guideline 1, many investors get this wrong. They believe that they won’t get to their financial goal, and take on aggressive (risky) investments. While this might work if the investment gods are with you, a bear market might wreck your retirement plans. Is it better to risk what you have and possibly lose it in the hope of reaching your goal?

The return from an investment is proportionate to its risk. Unfortunately, there is no free lunch. If you are behind in your financial plan and don’t have enough investment assets to be able to sustain losses, don’t invest in risky assets.

Determine what percent of your investment portfolio you can afford to put at risk and what percent you will keep safe in high-quality bonds. For this reason, if you were 55, married and with children and saving for retirement in five to 10 years, consider a more conservative asset allocation to bonds than if you were 25 and single.

We repeat, if you can’t afford to take the risk, don’t play. If your stomach feels queasy and a headache is in the mix, your body is telling you that change is in order.

3. Don’t lose money

Easy to say, but not so easy to do in these uncertain times. How many among your family and friends have told you wonderful stories about their triumphs in the financial markets? Have you locked in your gains? You rarely hear about their losses.

Investors have a tendency to misremember the effect on their portfolios of market crashes. They tend to minimize what happened to them, believing somehow, they were able to sidestep a financial disaster that afflicted the similarly invested. This is called a “positive illusion” which may help you get through your day, but not help you make better investment decisions.

Compared to investors who win some and lose some, you will come out way ahead if you never lose money. The risk of a default on the highest quality bonds is historically very low.

4. Evaluate the return on an investment on a risk-adjusted basis

Guideline 4 is an extension and refinement of guideline 3.

With interest rates at low levels, many investors are investing in risk assets (e.g. stocks or junk bonds). Unfortunately, with the stock market at a record high, the hoped-for high return should be viewed on a risk-adjusted basis. You may want or need a higher return to reach your stated goals. However, if you risk-adjust the future returns, the future may not look so rosy and the costs too high.

As Jason Zweig reported, in 2000-2002 and 2007-2009, stock investors saw their holdings slashed in half twice. From 2000 to 2009, the S&P has a total negative return of 0.95%. "To end the decade barely below where they had started, investors had to endure a brutal battering along the way."[i] Pause and reflect on how you might feel if you have to live through a similar scenario over the next ten years.

5. Understand the investment

This guideline refers specifically to those investments that have potentially high returns, are simply explained to you by your broker or advisor, but take at least 50 pages to describe in writing. When you experience my eyes glaze over (MEGO), consider it a warning flag.

Before you make a significant investment, consider whether you understand its structure, risks, tax consequences, fees, and how and when can you get your money back (i.e., liquidity). We know this is asking a lot at a time when the industry is trying to make investing as simple as possible. However, reflect on the consequences of choosing what appears to be the easiest path.

6. Understand the investment's liquidity

Whether an investment is liquid depends upon the ease of selling it *at a fair price*. The concept of liquidity arises in times of uncertainty. The time that you most may want to sell your investment is when fear grips the market. Ask the question before you make the investment: Will it be liquid when I need to sell? During the crash of 2007-09, hedge funds put up gates preventing a sale at any price. Even some money market funds have gates and fees in stressful times. ETFs will not redeem your shares.

7. Understand all tax aspects of the investment

All returns should be viewed through a tax lens and evaluated on an after-tax return. It is only what you keep after your visit with Uncle Sam that counts. That is why savvy investors purchase high-quality, tax-exempt municipal bonds. They produce a consistent stream of after-tax income for consumption or reinvestment.

Conclusion

An investment should generate the largest after-tax economic return with the least risk of losing capital, the smallest investment costs and the least aggravation. We recommend individual, high quality tax-exempt municipal bonds for the share of your portfolio that you want to keep safe. Individual bonds come due and do not need to be sold. They provide income free of Federal income tax and possibly state and local tax as well. The default rate on high-quality municipal bonds is historically very low.

When you consider your life, what is the price tag for feelings of serenity, ease and well-being?

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[i] Jason Zweig. The Lesson Investors Will Probably Forget. *The Wall Street Journal.* p. R11.