Client's Corner

Three Steps to Successful Investing

EVERY ONCE IN A WHILE, IT'S USEFUL TO STEP BACK FROM THE permanent chaos of political, economic and market events, and ask ourselves the fundamental questions: what am I investing for, and how will I know whether I'm succeeding or not? How, indeed, does one even measure investment success?

The answers will be found not in today's headlines—and certainly not by attempting to predict tomorrow's. Nor will they be a function of whether the market's next 20% move is up or down. You see, the answers you're looking for can only be discovered by the light of your own personal financial situation. In practice, they'll depend on whether or not you are following—***in exactly this order***—the three fundamental steps to a genuinely successful lifetime of investing: **goals—plan—portfolio.**

This may be somewhat startling to investors who think successful investing is a function of whether or not their portfolio is outperforming some benchmark, or of getting in and out of the market opportunely. Considered properly, all portfolio issues are subordinate to the two vastly more important questions: (1) ***Have you set specific goals?*** And (2) ***Do you have a specific plan for achieving those goals in the time allotted?*** (for most of us, that will be our planned retirement date). The great thing about this is the realization that the most important variables in investment success are within your control—as opposed to economic and market variables, which are beyond your control.

Ask yourself: What am I investing for, and how will I know whether I'm succeeding or not?

Let's consider them in order:

GOALS. Under this heading, we have two critical questions to answer. First, ***what are we investing for?*** Most of us, I think, are accumulating capital for retirement, and beyond that for legacy. For the sake of focus, let's leave legacy out of the equation for the moment—because if we don't get retirement right, chances are there won't actually be any legacy. Thus the threshold financial issue in retirement is simply ***will we outlive our money, or will our money outlive us?***

The second and more specific question then becomes: ***how much is enough?*** That is, what will our income need in retirement be, and what capital sum might be expected to enable us to cover that income need, at an initial withdrawal rate of four to four and a half percent? Ideally, that withdrawal would rise as our cost of living rises, and we would also have funds set aside for emergencies.

This, then, is the essence of goal-setting: knowing what we're investing for, and having a fairly good idea of how much capital will be necessary to fund that goal. That should be very good information for the folks who'll ultimately read this little essay: ***without a clear, specific accumulation goal—and a sense of when you'll need to have reached it—nothing else matters much.*** As the immortal Yogi Berra said, "If you don't know where you're going, you might not get there."

PLAN. Then—but only then—the issue becomes making a ***written, date-specific, dollar-specific plan for accumulating that capital sum in the time allotted.*** Again, the issues are twofold: (1) how much must you regularly be putting away, and (2) at what assumed rate of return, to get you from where you are now to where your (inflation-adjusted) goals say you need to be by the time you retire. ***None of us were ever trained to do this.***

Which is why this is where—if he/she hasn't already—your financial advisor comes in. I suppose there are any number of software programs that might let you take a pretty good first cut at this, but in the end, I think you're going to want to be looking in someone's eyes as the exercise unfolds. There's just too much riding on it.

PORTFOLIO. The last piece of the puzzle is the portfolio you and your advisor choose to be the funding medium for your plan. The key phrase in that sentence is, of course, "funding medium." A portfolio isn't an end in itself, nor is beating a benchmark a financial goal. (Not running out of money in retirement is a financial goal—indeed, some of us see it as ***the*** financial goal.) ***The portfolio is simply a means to an end.***

This tells you that you're not going to be choosing a long-term portfolio based on some or another economic or financial outlook. You'll choose it based on ***what mix of assets has historically delivered the return you need over long time horizons.***

Will that same mix deliver its precise historical trendline return over your particular run-up to retirement? It doesn't seem likely: the randomness of equity returns being what it is, you may have to hunker down and practice greater-than-projected thrift to have a hope of achieving your goals. On the other hand, returns may outrun your target, such that you end up not having to invest as much money as you'd planned (unless, of course, you want to). This is yet another variable over which you have no control. What matters is that ***you always know where you are relative to where you expected to be***, and can adjust accordingly.

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Once again, then, the sequence of the three steps to long-term investment success must always be: **goals—plan—portfolio**. Take these steps out of their proper order—much less skip one altogether—and at some point you'll get to watch all the lights going out.

There is, however, one other point to be made here. It concerns the great reward we historically reap when we pursue a long-term plan of investing systematically toward a goal. Specifically, we get to experience perfectly normal equity market setbacks as opportunists rather than as victims.

There may be a more irrational investment policy than wanting the market to go up while you're still accumulating for retirement. But if there is, I don't know it. When you're beavering ahead, pursuing a multi-year investment plan, you want the market to go down the way the Boston Irish used to vote: early and often. The more shares you can get into the barn at fear-driven low prices, the more likely you are to reach your long-term goals.

If you haven't got these three steps in place, and in this order, you know what your next conversation with your financial advisor needs to be about. Hint: it isn't what the market is going to do next.