

# in | Context

WEALTH STRATEGY FROM A DIFFERENT PERSPECTIVE



## PATIENCE IS A NECESSARY INGREDIENT OF GENIUS

The last two weeks of September tested the resolve of investors, no matter how many bear markets they may have previously experienced.

This quarter, investors watched while long-standing financial institutions merged, filed for bankruptcy or sought bailouts from the U.S. government. But smart investors know that each down market must be borne with the same equanimity.

Some investors spent time searching for a way to protect their portfolios, and many responded when their emotions demanded that they do something. Prudent investors have been staying the course because the possibility of negative events was already incorporated into their investment plan.

While it may be easy to argue now that the collapse of Lehman Brothers or the acquisition of Merrill Lynch was inevitable, for most investors, the events came as a surprise. The subsequent Wall Street roller-coaster ride may have temporarily caused investors to forget a few important facts about the market.

**Myth #1:** Bad news results in falling stock prices.

**Fact:** What matters is not whether news is good or bad, but whether it is better or worse than expected.

For example, there are instances almost daily of companies reporting losses and their stock prices rising because the loss was not as bad as expected. So, if housing prices were to fall another 5 percent, but the market anticipated that they would fall another 10 percent, all else equal, stocks will rise on that news.

**Myth #2:** Information is knowledge that can be used to gain excess returns.

**Fact:** Unless someone could have forecasted all of the above events, that information is basically irrelevant. The reason is that once the information becomes public knowledge, it is instantly reflected in current prices. Thus, one cannot benefit from it. Even news regarding the bailout plan has been incorporated into prices.

*continued on page 2...*

## SHELF LIFE

"In day-to-day life the past often seems obvious even when we could not have predicted it. It's why weather forecasters can tell you the reasons why three days ago the cold front moved like this ... but the same forecasters are much less successful at knowing how the fronts will behave three days hence."

Leonard Mlodinow, *The Drunkard's Walk: How Randomness Rules Our Lives*, 2008



CYPRESS ASSET MANAGEMENT

## WHAT NOW?

We are in the middle of one of the worst economic and financial markets ever seen. As prudent investors, we would like to know what we should do now.

Longtime clients will not be surprised with the following advice. Do nothing. Passive investing is easy to follow when the market moves steadily higher. The true value of passive investing shows itself in times of turbulence — either rapid gains or rapid losses in the financial markets.

Most of the time, our reason is stronger than our emotions. However, emotions are much more volatile than reason. This is why the rare exceptions are caused by strong bull or bear markets — when things are white hot, greed or fear will pull us one way or another when reason tells us to stay put.

For some clients, at such times it may be best not to even worry about rebalancing or loss harvesting. Both are important parts of a well-designed plan and should be done if possible. However, if the very fact of thinking about our portfolios and having to make decisions in the middle of the storm is likely to cause us to overreact, perhaps we should leave them alone for now. Not rebalancing or harvesting losses is certainly less harmful than making big changes based solely on emotions.

# IS IT DIFFERENT THIS TIME?

By Weston J. Wellington

In recent days, we've seen a number of prominent financial firms on the brink of collapse. Clearly, there are many things to worry about: real-estate-loan losses, oil prices and an economic slowdown both here and abroad. It's possible that some of these problems may be of greater magnitude than we have faced in many years. What should investors do at a time like this?

Some might say that these recent events are so unprecedented that they call into question the wisdom of maintaining any long-run strategic exposure to stocks. Nothing could be further from the truth. Instead, these events offer a ringing endorsement of the best way to deal with uncertainty: broad diversification and a consistent portfolio strategy, including the appropriate amount of high-quality fixed income needed to reduce overall portfolio risk to an acceptable level.

For those with concentrated positions, especially employees with large holdings of company stock, these events have inflicted serious damage. *The Wall Street Journal* estimated that the 24,000 employees of Lehman Brothers have seen \$10 billion in personal wealth evaporate as the value of Lehman shares collapsed. Many longtime employees of once great companies such as Fannie Mae, Freddie Mac, AIG, WaMu and Wachovia have experienced similar losses.

For well-diversified investors, the financial damage associated with all of the aforementioned firms has been minimal since the combined weight represents an insignificant percentage of a globally diversified portfolio. Four or five years from now, these investors may have a difficult time remembering what happened and when.

Time and again, the sensation is — when described by the investment press — that somehow this time is different, and things will never be the same again. But since risk and expected return are related — those two forces have always been with us and always will be with us — in that sense, nothing is different at all. There may be different prices that people are willing to pay, but the fundamental system remains unchanged.

History offers abundant evidence that market economies are resilient. The key issue for investors is to make sure their financial future does not get derailed by events at a handful of firms, and that their portfolios are properly positioned to capture the rewards the markets have to offer when the next up cycle begins.

Weston J. Wellington is vice president of Dimensional Fund Advisors (DFA). He joined DFA in 1995 and has more than three decades of experience in the investment industry. He holds a bachelor's degree in history from Yale University.

*continued from page 1...*

**Myth #3:** Markets are backward, not forward, looking.

**Fact:** On average during recessions, stocks have not gone down. They have actually outperformed Treasury bills by more than 2 percent, gaining an average of 7.4 percent in the 11 post-World War II recessions. To benefit from the knowledge about the timing of a recession, one would have to forecast it well ahead of time. The problem is that the U.S. government often cannot declare that a recession has begun until as much as a year afterward.

Warren Buffett is acknowledged as one of the greatest investors of all time. During this crisis, he has been buying, not selling. In September, he made major investments in three companies: GE (\$3 billion), Goldman Sachs (\$5 billion) and Constellation Energy Group

(\$5 billion). Investors can learn from Buffett, who has always kept his head while those around him were losing theirs.

These are times that test the patience and discipline of all investors, even those who have weathered previous storms. The hard truth is that investors must accept the fact that we cannot know when things will go from bad to good. That is the nature of equity investing. There are risks. If there were no risks, then stocks would provide the same low returns that safe fixed income investments do.

What we do know is that the strategy most likely to allow investors to achieve their goals is to have the discipline to adhere to their plan. As Benjamin Disraeli said: "Patience is a necessary ingredient of genius."



## Five Things to Consider When Transferring Wealth

By Marilyn Wechter

### **Prepare your children for money management early with allowances, budgets and responsibilities.**

By giving your children the opportunity to learn to deal with and be responsible for money early in their lives, you provide a template for managing their later wealth and inheritances.

### **Make sure that you and your heirs are on the same page.**

Do they understand your core values and what your wishes are for your money?

### **Know what kinds of legal instruments best accomplish your intended goals.**

Meet with your advisor to learn about the various ways of passing on your wealth. Understand how these work legally and understand their psychological implications.

### **Have a family meeting with your adult children to talk about your plans and wishes — hear their feedback.**

Discussing your estate plans with your heirs while you're still alive provides everyone with the opportunity to voice their feelings. This lessens the likelihood for confusion or hurt feelings. It also gives everyone a chance to confront and understand the family dynamics at play.

### **Think about what you want your legacy to be and how you want your money to be used.**

What are the values you want passed on? Reflect on how this money can help accomplish those goals.

Marilyn Wechter, psychotherapist and wealth counselor, has been in private practice in St. Louis for 28 years working with adolescents, adults, families and couples. In addition, she works with estate lawyers and planners, investment advisors and executive coaches. She has taught courses on normal and abnormal development at Washington University in St. Louis, and courses on images of women in film from a cultural and psychological perspective at Webster University.



CYPRESS ASSET MANAGEMENT

Cypress Asset Management  
4814 N. Prospect Road  
Peoria Heights, IL 61616

phone | 309.679.9146  
fax | 309.679.9147  
web | www.cyporam.com