Investment Principles, Strategies and Tactics

Not all investment principles are appropriate for all situations, but as a group provide useful guidelines in preparing investment strategies.

Sixteen principles, strategies and tactics:

1. Meet emergency and protection needs first.

2. Match investment instrument with investment objective (e.g., since IRAs accumulate interest tax-free until funds are withdrawn, an investor funding an IRA should seek the highest rate of return commensurate with the investor's risk preferences).

3. Equity investments require extended holding horizon:
   a. Investments in common stocks should have a planned holding period of at least three years.
   b. Real estate requires even longer planned holding periods.

4. Change with the times: careful investors watch economic, financial and security markets and restructure portfolios accordingly.
   a. Do not remain with a particular investment for sentimental reasons.

5. Beware of tax-savings rationale: many investments structured only on tax considerations have resulted in problems and losses for owners.
   a. Remember that tax laws can change year to year.

6. Understand the investment: a requirement for the client in order to avoid hidden consequences (e.g., risks in investing in new businesses).

7. Diversify the portfolio using a hierarchy:
   a. Narrow perspective at bottom of hierarchy is based on modern portfolio theory; about 20 carefully selected securities should be chosen in order to eliminate virtually all risks other than market risk.
   b. Further up the hierarchy, a broader diversification should include investments (e.g., real estate, precious metals) other than securities.
   c. A broad view of diversification, considering the client's occupation and pension plan, is used at the top of the hierarchy.

8. Recognize the role of intuition: economic and financial analyses alone are not always adequate (sometimes a hunch will prove profitable).

9. Expect mistakes: planner and client must realize that not all investments will produce as planned and must learn from mistakes.

10. Use a consistent pattern of investing: long-term results indicate that making investments on a regular basis is more important than when the investments are made.

11. Take advantage of the power of compounding: many investments provide reinvestment of current income. **Five examples** of compounding:
    a. Passbook savings accounts.
    b. Certificates of deposit.
    c. Mutual funds.
    d. Common stocks: corporations occasionally subsidize the purchase of common stocks by providing up to a 5% discount; often no brokerage charges are levied.
    e. **Zero coupon bonds:** bonds that do not make annual interest payments to the bondholder (e.g., U.S. Government Series EE bonds) and feature automatic compounding of interest over the bond's term.

12. Work with professionals: ensures that recommended investments are appropriate for client objectives.

13. Beware of high-pressure sales tactics.

14. Expect markets to overreact: allow time for the market to stabilize after overreaction to either good news or bad news and for longer-term trends to develop.

15. Avoid discretionary power by having client approve of any action taken by financial planner.

16. Apply the control process: once investments are selected, the performance of the investments must be monitored, then compare performance with targeted results.
    a. **Problem investment:** results when targeted results are not being achieved; action includes an immediate sell, or if future performance meets revised acceptable standards, retaining the investment for an additional period.

CAUSES OF INVESTMENT RISK

The Big Three	*The Modest Three*	*The Minor Three*
1. **Purchasing power (inflation) risk:** affects all fixed-dollar investments. 2. **Interest rate risk:** results in change in value of securities and/or income from the Securities. 3. **Market risk:** results from political, economic, demographic and social events.	1. **Business (default) risk:** results from consumer preference changes, Ineffective management, law changes or foreign competition. 2. **Liquidity risk:** the ability to convert an asset to cash quickly is a critical concern when evaluating appropriateness of investment assets for a client's emergency reserve. 3. **Marketability risk:** occurs when investment asset cannot be sold quickly at current price.	1. **Tax risk:** all investments have tax consequences relative to income and value appreciation 2. **Event risk:** possible occurrences can affect riskiness of specific investment. 3. **Additional commitment risk:** some investments require the owner to add Additional money into the Owner's investment at the occurrence of certain events.

FIVE REASONS INVESTMENT COMPANIES HAVE BECOME POPULAR
1. Each share in an investment company benefits from the pooled diversification of the entire portfolio. 2. Professional management provides better overall portfolio performance than individual investors can provide alone. 3. Many investors do not have time to select securities for a portfolio and prefer to delegate this responsibility. 4. The diversity of investment companies allows an investor to select a diversified portfolio that meets the investor's needs. 5. Fund management provides tax and record keeping.