# Investment Management

Investment management is a critical component in the financial planning process. A basic understanding in the beginning increases satisfaction with future portfolio performance through good and bad markets.

It is our belief that proper investment management is about making unbiased, well-informed financial decisions and minimizing costly mistakes. There should be a reason and a process behind decisions, rather than hunches, emotions or media hype. We take an evidence-based analytical approach, infused with a solid dose of common sense.

This document is designed to clarify how we view investment management while working with you and to address some of the questions and concerns that may arise. The objective is to explain what we do, how we do it, and why we do it.

# Investment Philosophy

Saving and investing is important to protect your current life and prepare for the future. For many people this is the most important part of financial planning services. Our philosophy aligns with client goals in the following ways:

## Prudent Management of Risk

It's an unavoidable truth that all investing involves some degree of risk. Many people focus strictly on short-term fluctuations in value (market risk), but keeping up with rising prices (inflation risk) over time is equally important. Our task is to help clients achieve their objectives while taking no more risk than necessary. All funds are placed at a large independent custodian to provide ease of management and safekeeping for our clients.

## Sound and Justifiable Approach

All investment decision-making should hold up to the most current academic studies, empirical data and every-day common sense. Our investment strategy is an "evidence-based" approach incorporating decades of rigorous peer-reviewed research from top universities and practitioners. There will always be a well-thought out reason and rationale behind everything we do.

### Focus on Costs and Tax-Efficiency

Taxes and expenses have an unquestionable impact on investment results. They also happen to be two areas where we have considerable control. As a result, we focus on both intently and strive to minimize their effect. After all, it is your "net" returns which you keep, so our goal is mutually aligned with yours.

### Asset Allocation and Diversification

Investing would be quite simple with perfect foresight –simply pick the single investment that will do best in the future. Unfortunately, we all know it's not that easy. The future is unknowable, and should be treated as such. There are many possible outcomes, several of which are difficult to imagine today. A portfolio should be structured to withstand whatever the future might bring, and proper asset allocation and diversification are the logical ways to approach an uncertain world.

### Long-Term Focus

We are not market timers or short-term traders, and we make no attempt to predict market tops or bottoms (or even direction). Consider how often forecasts miss the mark in sports, weather and politics – financial markets arguably have as many (or more) variables impacting results, and the likelihood of consistently guessing outcomes and predicting changes is exceedingly low. We believe the best strategy is a disciplined approach to take advantage of the benefits that accrue to patient investors over time.

### Valuation Matters

Markets can (and do) drift away from a reasonable estimate of long-term "fair value," and the risk / return tradeoff can become distorted. When this happens, maintaining a static allocation to an asset class just isn't logical. Our approach is based on valuation sensitivity – focusing on the long-term investment opportunity available for each asset class, and we will adjust exposures when warranted.

## Investment Process

### When you become a client

One of the first steps in your investment process is moving what accounts we can to an independent or qualified custodian so your assets are with a large, secure, third-party financial institution. Our firm has an institutional relationship with Charles Schwab to provide this service. Through this relationship we are able to provide our clients with a variety of investment choices and avoid some unnecessary account fees that are often assessed at other custodians. We are not employed by Schwab and we are not compensated in any way by Schwab. Schwab is the facilitator for transactions, safekeeping, and statement reporting of your investment holdings.

Some accounts may not be able to move to Schwab (e.g. workplace 401k plans, children's 529 plans, annuities you may have purchased in the past). We still manage these accounts, either directly or indirectly, and include them in your overall portfolio allocation. We do this by using technology to evaluate and choose the best options available in these plans, and round out your entire portfolio with investments held in your other accounts.

## Your Investment Policy

Before investing your accounts, we work with you to determine an appropriate asset allocation for your situation. Asset allocation is the combination of investment classes with varying degrees of risk that make up your portfolio and it has a major impact on long-term investment results.

To determine an allocation, we incorporate your personal preferences, overall financial plan, time horizon, ability to save, and general conversations on your investment history and background. These components give us insight into your ability to take risk, both financially and emotionally. We formalize this in an Investment Policy Statement (IPS), which provides the framework for how investments will be managed.

## Types of Investments

The asset classes included in your portfolio will generally be a combination of equities (stocks), fixed income (bonds), and alternatives (real estate, natural resources, commodities, etc.). Each of these classes has different, inherent levels of risk.

> ***Equities*** are more commonly known as "stocks" and represent ownership in publicly traded companies, and for certain clients, private equity (ownership in privately owned companies) may be recommended for a minority of your holdings. On the scale of risk, equities are on the higher end. We like to use a combination of low cost, passive "funds," along with some actively traded strategies to fill this category. There are internal costs associated with funds, and we look at these carefully. An advantage of funds is that they provide low-cost diversification, which limits exposure to any one company, industry or sector of the economy.
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> ***Fixed Income*** includes all forms of interest-paying investments. The most common fixed income asset is a bond. A bond is a "debt security," a loan to a company or

government entity. The borrower agrees to repay the investor over a defined period of time, with
the investor receiving interest as compensation for loaning the money. On the scale of risk, bonds are generally on the lower end (provided the borrower is credit worthy). We use individual bonds for cash flow purposes as well as bond funds for liquidity. Cash and bank certificates of deposit also fall in the fixed income category, as they generally pay interest at regular intervals.

***Alternatives*** include real estate, private equity & credit, natural resources, commodities, and various strategies with the goal to hedge other investments you may own. These types of investments have risk and return characteristics that are varied and in some cases may run as high as equities, while in others may be more conservative. Their liquidity is often less than publicly traded stocks, bonds, and money market funds, so we recommend only placing an amount of your portfolio into these securities that you are comfortable having semi-liquid or illiquid. We use the same sort of due diligence and stewardship in selecting alternative investments as we do in choosing traditional strategies.

## Asset Location

We consider tax consequences when determining the types of investments and the accounts in which they are held (asset location), as well as any time sales are made.

***Taxable accounts*** are generally invested in equities and (if beneficial to you) municipal bonds (federally tax- exempt). For individuals in lower tax brackets (with less tax sensitivity) taxable bonds may be used.

***Roth IRAs*** are often considered to be an account that will be used well into the future for cash flow needs. Generally having the longest time horizon of all your accounts, this will often be invested more aggressively relative to other accounts. In other words, this type of account may hold more stocks and alternative assets, and you will see more fluctuation relative to your other accounts.

***Traditional IRAs*** and other tax deferred accounts tend to be more flexible in terms of the investments held within them. Since there are no tax considerations for investment gains, we generally use this as the place to round out your investment portfolio.

It’s important to keep in mind that all of your accounts are individual parts of the whole portfolio. You may hold aggressive investments in one type of account and safer investments in another, resulting in much different rates of return in each type of account.

## Implementation and Ongoing Investment Management

After your current investments transfer over to our management, we will gradually shift your portfolio to match the target asset allocation of your Investment Policy Statement (IPS) and will continue to monitor compliance with your IPS.

It is important to make any adjustments and investing decisions in a tax-efficient manner and with an eye toward transaction costs. For certain accounts it may take longer to transition to avoid generating unnecessary fees or tax consequences.

While managing your accounts, we are always monitoring the allocation to determine when you benefit from asset rebalancing, intended to bring your overall portfolio mix into compliance with your Investment Policy Statement (IPS) target asset allocation. Transaction costs and tax implications are taken into consideration prior to making any investment changes. When significant balances are held outside of our authority, we may need your assistance in rebalancing those accounts. If you are not able to help us make adjustments, your overall portfolio mix may drift outside of your Investment Policy Statement (IPS) target asset allocation. Periodic rebalancing helps to maintain an appropriate level of risk and allocation between the asset classes.

The level of cash in your portfolio will vary as bonds mature, dividends and interest are paid, and other investments are sold. Cash is valuable for funding withdrawals and rebalancing a portfolio without being forced to sell other assets. In addition, the stability of cash tends to smooth out portfolio volatility, making it a better diversifier for stock market risk than any other defensive holding. We view cash as a unique and important asset class, and a modest allocation of a few percentage points is reasonable and beneficial.

## Keeping you Informed

You will receive regular statements from Schwab for each of your accounts. You will also have electronic access to performance and return information provided by software we use to reconcile and track your portfolio performance.

We provide access to an online financial portal that gives an overview of all your investment accounts and the financial plan in place to achieve your goals. It provides an overall, consolidated picture of your accounts, values, asset allocation, transactions, etc. plus a snapshot of your total net worth (including accounts, assets, and liabilities outside of our purview).

We recommend meeting with you on an semi-annual basis or upon your request to discuss your investments, including evaluation of your underlying portfolio assets, asset allocation, current market conditions, and investment results to ensure investment strategy and expectations remain aligned with your stated goals and objectives.

## *Summary*

Every one of our client relationships is built upon a diversified investment approach which targets a particular balance of return and risk customized for your needs. We seek to coordinate, organize and optimize all details around your financial picture. We're committed to understanding you and your family as if you are part of our own—and staying in tune with the happenings of your life. In fact, throughout our entire relationship, we'll continually only recommend strategies we would use for our family, friends and our personal finances. We figure if it's good enough for our family, it should also work well for yours.

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