

Don't Let External Factors Force You to Commit Strategy Errors

Written by Michael Alexenko, CFA
Friday, 06 June 2014 00:00

Despite the Federal Reserve's manipulation of the bond and stock markets through the distortion of interest rates investors and potential retirees cannot mistakenly assume that the rules of correct portfolio management have been repealed. Diversification, asset allocation and risk tolerance remain critically important to building a portfolio that is tailored to the specific needs of each individual investor.

In 2009 then Fed chairman Ben Bernanke wanted to force people out of savings accounts and certificates of deposit and into riskier assets and he was successful. There probably always are a percentage of retirees that plan to stash their retirement funds in wrongly perceived risk free bank savings vehicles. The problem with this plan is that it violates the rules of long term investing that require diversification and asset allocation. That's why the Fed's policies became and remain particularly punishing for them, because without reasonable diversification of their money the investors have suffered extreme loss of interest income. These savers learned the tough lesson that a cash account is not a risk free investment.

Just because the investment markets are warped by the Fed doesn't mean that an investor who needed and desired 35% invested in risk assets and the balance in capital preserving bonds and cash should now have 100% invested in stocks and 0% in bonds because she fears that interest rates will rise and make her bonds drop in value. An investment strategy doesn't become obsolete and unworkable because of exogenous events. Because an authentic strategy has flexibility in order to allow the investor to take a little more or less risk depending on informed evaluation of market conditions. For example if an investor with a 65% targeted allocation to bonds fears that rising interest rates will wreak havoc on her bond values she should then, by an equal amount, increase the percentage of her holdings to short term bonds and decrease her long term bonds. That will lower the sensitivity her bonds have to changes in interest rates.

Too frequently inexperienced investors view decisions in their portfolios as all or nothing actions. If they own a stock that has had strong gains they make their decision about selling more complicated by considering only the option to sell all of it or nothing. In the same way people are now contemplating whether they should own any bonds at all because the Fed's abuses will become inflationary and bond values are destined to collapse. That's been the dominant belief for the last 5 and ½ years and it hasn't turned out to be a very good one as bonds have delivered good total returns.

Don't let the markets dictate your investments actions and don't be persuaded by media noise

Don't Let External Factors Force You to Commit Strategy Errors

Written by Michael Alexenko, CFA

Friday, 06 June 2014 00:00

that claims you need to disregard disciplined investing because things have suddenly become different.