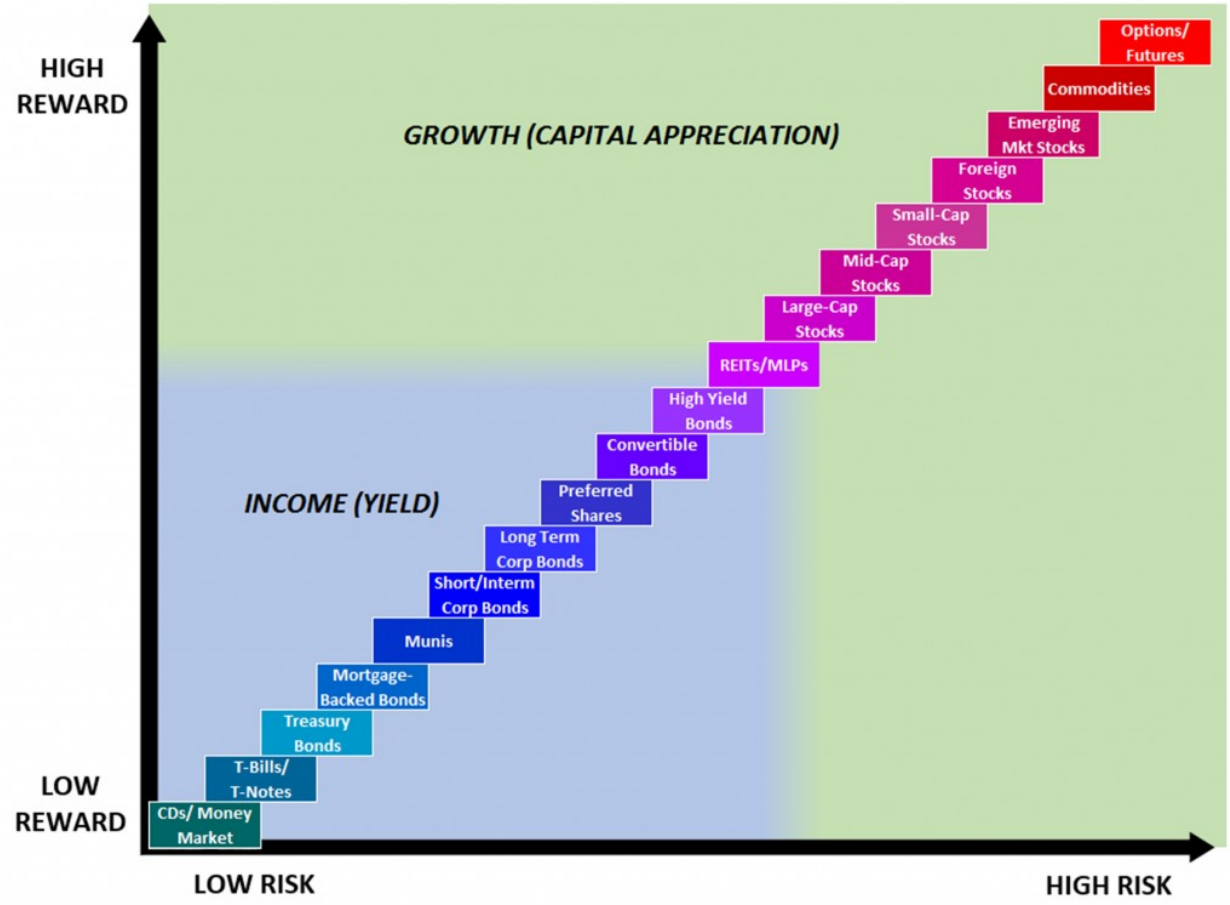
SPECIAL REPORT

6 Gilly Flower Street
Ladera Ranch, CA 92694
Phone: 949.600.6294
Fax: 949.600.6292
Email: info@mypacificpark.com
www.mypacificpark.com

Table of Contents

Investor Beliefs & Behaviors



The risk ladder above sits at the heart of Modern Portfolio Theory (MPT). What is MPT? In essence, it represents the "Don't put all of your eggs in one basket" rule of investing.

Unfortunately, many investors fail to realize that the risk ladder can, from time to time, get turned on its head. And that's when people get into trouble.

For a historical perspective, look no further than Senior Income Funds. They had been designed for retirees to provide price stability as well as a steady stream of income. And for several decades, they did just that… by investing in the relative safety of mortgage-backed bonds.

Then came the Financial Crisis of 2008. Real estate imploded clear across the country. And the idea of mortgages being a safe place to invest went out the bedroom window.

In fact, mortgage-backed securities were one of the worst performing asset classes in 2008. How bad was it? Despite mortgage-backed bonds existing on a low rung of the risk-reward ladder, ***Senior Income Funds lost as much as 80% in value!***

Theoretically, low-risk assets should not lose significant value. That said, only an adviser with a sell discipline is likely to execute an approach to minimize loss. With a process for managing risk, as well as a

fiduciary obligation to act in your best interest first, a proactive adviser will have a plan for when the risk ladder falls apart.

Buy & Hold

Modern Portfolio Theory (MPT) puts forth the idea that risk can be managed with a mix of major asset types. Specifically, you should place some of your eggs in the growth basket for stock price appreciation, other eggs in the bond basket for an income stream, and a few eggs in cash-like instruments for capital preservation. Then, sit back and relax.

That's the cult of "buy-n-hold" in a nutshell. Indeed, many investment professionals live in this house of worship because, well… laziness is bliss. (So is ignorance!)

If the risk ladder comes unglued, however, stocks may plummet. Bonds could also get killed. Clearly, few retirees in their 60s or 70s would be able to sit back and relax if their net worth fell 50% or more.

Additionally, most investors are not very good at holding onto everything through thin and thick. On the contrary. Most "buy high," chasing the hottest names because they fear missing out. And when stocks or bonds fall dramatically, the same folks "sell low" in a panic.

Buy & Hold works until it stops working. And it stops working when there are catastrophes large enough to change the course of our best laid plans. The tech bubble of 2000. The real estate bubble and financial collapse of 2008.

Can one argue that holding at all costs—buying diversified assets, holding those assets, hoping they do well—is sensible? Well, an investor would have to tune out every financial show, friend, account balance, as well as the moment. After all, the discipline of doing nothing is a lot like meditation.

Practically speaking, few people can master a monk-like meditation, let alone follow a Buy-Hold-n-Hope approach. Most human beings behave like humans; that is, we are swayed by our emotions, indecision, and the world at large.

Investing is Money (And Money is Emotional)

Studies have found that the brain activity of a person whose investments are making money is indistinguishable from the brain activity of a person who is high on cocaine. Researchers have also found that trading stimulates the same part of the brain that is associated with sexual desire. Without a doubt, it feels very good when your investments are profitable.

On the other side of the coin, when people lose money on their investments, the area of the brain linked to fear experiences immense arousal. Flashes of heat. Uncontrollable sweat. That sickening pit in the stomach. These are the physical manifestations of watching account balances tumble.

In fact, research has quantified the emotions associated with financial gain and loss, where the agony of losing money is three times more painful than the joy of gaining it is. It is comparable to the way we can recall frightful memories with far greater ease than we can remember pleasant memories.

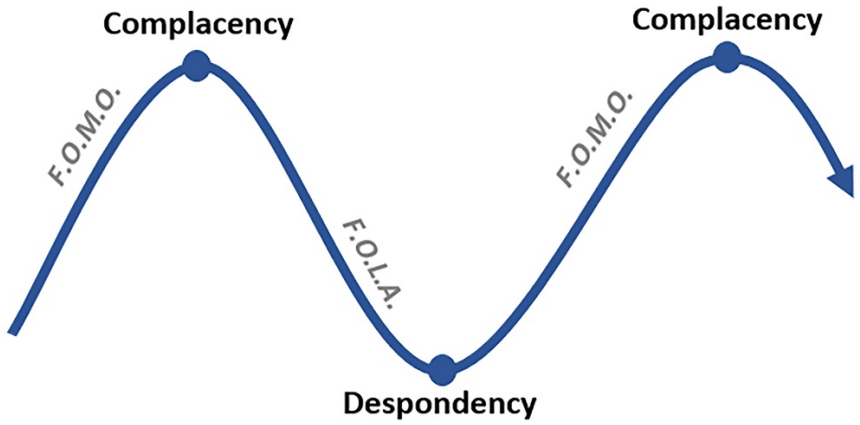
Not surprisingly, then, when people experience enough investing heartbreak, they may do anything to avoid getting burned again. Some leave financial markets for an extended period. Some quit forever.

Going forward, these folks are unable to build wealth for their futures. What is the old saying, “Once bitten, twice shy?”

Fear

Most people have made at least one disastrous investment decision. And that decision was almost certainly driven by fear.

Was it the Fear of Missing Out (“FOMO”) that caused so many folks to get in over their property heads at the height of the housing boom in 2006? Or was it the Fear of Losing it All (“FOLA”) that caused many retirees to swear off stocks at the depths of the stock collapse in the 2008-2009 bear?



Old school economics erroneously assumes that we are rational creatures. The assumption? People behave logically when they invest their hard-earned dollars. Yet that is just not the case.

We live in a world of instantaneous information. Real-time data are constantly streaming onto computer screens and smartphones.

Not surprisingly, the world of “right now” often spikes our adrenaline or alters our levels of serotonin, dopamine, and other mood-altering neurotransmitters.

Bottom line? Economics and behavioral psychology are now joined at the hip.

Investor Psychology

Investors often relate gut instinct with investment success. Unfortunately, whether you are relying on your own gut, a friend’s, or a professional’s, the feeling is not genuinely equivalent to insider knowledge.

In psychological terms, a gut instinct is an affect heuristic. It is a mental shortcut for the brain to deploy emotions, impulses, or rules of thumb. And we tend to use them in place of logic.

Unfortunately, investment decisions based on gut instinct often result in misguided moves. For example, let us assume that you were provided with every piece of timely information that is known on a particular company that you are interested in. You have fundamental data (e.g., P/E ratio, P/B ratio, DTI ratio, sales and revenue growth, inventory, etc.), technical information (e.g., trendlines, price patterns, MACB, RSI, etc.), corporate particulars (e.g., the CEO, board of directors, etc.), as well as analyst opinions. With the countless specifics at your disposal, how do you go about reaching a decision to invest?

Well, if you are like most people, you abstain. The amount of information overwhelms your nerves and causes your palms to sweat. Meanwhile, your anxiety might increase because some of the details paint conflicting pictures.

The cognitive dissonance could go something like this:

"According to these fundamentals, the stock is under-valued. However, this technical indicator supports the notion that the corporate shares are severely overbought. Yet, this analyst recently changed his opinion on the stock to a 'buy.' On the other hand, the CEO recently sold a large portion of her own shares, which suggests she believes her company's stock price is too high."

In the end, most people end up reaching into their subconscious toolbox without even realizing it. We may focus on a few bites of data to support the gut instinct.

The confirmation bias might go something like this:

"Well, the fundamentals surely don't lie, and that analyst who upgraded the stock to a 'buy' clearly sees the same bargain that I do."

This is a perfect example of an affect heuristic. And frankly, everybody is guilty of it.

Another mental shortcut, the social proof heuristic, involves seeking comfort in the herd. By witnessing others pour into an investment – like Tesla or Bitcoin or GameStop – our minds build a compelling case to join the ranks.

This bandwagon-like behavior was remarkably prevalent during the dot-com boom and subsequent bust in 2000. Similarly, the behavior set the stage for home-flipping and highly leveraged real estate purchases prior to the credit crisis in 2008.

Here is a third mental shortcut: the representativeness heuristic. This occurs when we perceive similarities between a past and present event, and then expect outcomes to be similar.

Indeed, many investors find comfort in past performance figures. Just because an investment soared over the previous five years, or even the previous 10 years, it does not mean one should expect similar results over the next month, year, or decade. As the popular disclaimer goes, "Past performance does not guarantee future results."

Nevertheless, an over-reliance on past performance is one of the most prevalent missteps. And the slip-up demonstrates how our subconscious can convert complex decisions into so-called "no-brainers."

Perhaps the psychological concept with the most influence on the way we behave is known as "framing." It describes how people's perception of information depends upon how that information is presented to them.

For example, let's revisit a time when the term "dot-com" couldn't be spoken without a cash register ringing in our collective heads. Just about every day came with a new IPO doubling out of the gate. It was the late 1990s, and people believed that the late 1990s represented a "NEW Economy."

There's more. Many tech stocks had been doubling in a matter of months. Media moguls screamed "BUY, BUY, BUY!" on the television. And on top of it all, young guns ridiculed the stars from yesteryear, pointing the finger at doddering old fools like Warren Buffett. (Yes, that Warren Buffett!)

At the time, it did not matter what a company did to turn a profit. In fact, some companies didn't even need to earn a dime. What was needed? The fanatical endorsement of professionals, pundits, and gurus.

It was easy for investors to fall victim to the framing that had shaped their investing lives. How easy? In February of 2000, the all-knowing bulldog from CNBC and former hedge fund manager, Jim Cramer, dished up his "Winners of the New World." Here is a peak of the stocks on Cramer's list:

1. 724 Solutions
2. Ariba
3. Digital Island
4. Exodus
5. InfoSpace
6. Inktomi
7. Mercury Interactive
8. Sonera
9. Verisign
10. Veritas Software

The March 2000 issue of Smart Money was equally adept at framing the wondrous NEW economy. Readers rejoiced at the byline, "What's next for the market's hottest sector—and how to profit from it."

Here is the list of those 15 Great Tech Stocks:

1. ADC Telecommunications
2. Applied Materials
3. Ariba
4. Cisco Systems
5. Hyperion Solutions
6. JDS Uniphase
7. LSI Logic
8. Lucent Technologies
9. Parametric Technology
10. PMC-Sierra
11. Powerwave Technologies
12. RF Micro Devices
13. Sanmina Corp
14. Taiwan Semiconductor Mfg
15. Veritas Software

Smart Money was an immensely popular and widely distributed financial magazine. Meanwhile, Jim Cramer was a consistent presence across a wide variety of media. Who were you to question the experts? Who were you to tell your neighbor that his get-rich quick portfolio was likely to crash? Of course Jim Cramer knew better. Of course Smart Money was smart advice.

The NASDAQ 100, a benchmark commonly employed to gauge the technology sector, lost 50% of its value in 2000 alone. Nevertheless, many investors rationalized their way into holding onto their lofty dreams; still others convinced themselves to buy into the weakness.

The NASDAQ 100 did not stop after being cut in HALF. From the March 2000 peak to the October 2002 trough, the NASDAQ 100 fell 83%. How bad is that? An investor would require an eye-popping 487%... just to breakeven!

It took 17 years as well as a plethora of changes to the NASDAQ 100 index itself to be made whole. That's if you invested in the Nasdaq 100 (QQQ).

Yet, what happened if you went with Jim Cramer's stock advice? Of the stocks he recommended, VeriSign is the only one today with a certificate worth more than the paper it is printed on.

Could you have fared better by running with the Smart Money bulls? Nope. Their list of 15 great tech stocks would have eviscerated your principal, as well as your desire to invest in stocks ever again.

As if Smart Money did not push you into tech stocks at the worst possible month (March 2000), they advocated abandoning the stock market near the worst possible moment as well (September 2002). If one could receive an award for untimely investment advice, Smart Money would have won a Nobel Prize.

The Average Investor

Imagine having inherited $500,000 at the start of the year 2000. Since this was an unplanned financial windfall, and since stocks had been rocking throughout the 1990s, you invest your $500,000 into SPY, an S&P 500 index fund.

Can you guess what your inheritance would have been worth at the end of the decade? $1,000,000? $1,500,000? Try $452,000.

That's right. You did not double your money. You did not make a cool "mil" buying and holding stocks. After 10 long years, your inheritance eroded.

It gets worse. Twice during the 2000-2009 span, you would have had to watch your $500,000 fall to $250,000. Your investment would have been slashed in HALF, first in 2002 and then again in 2009.

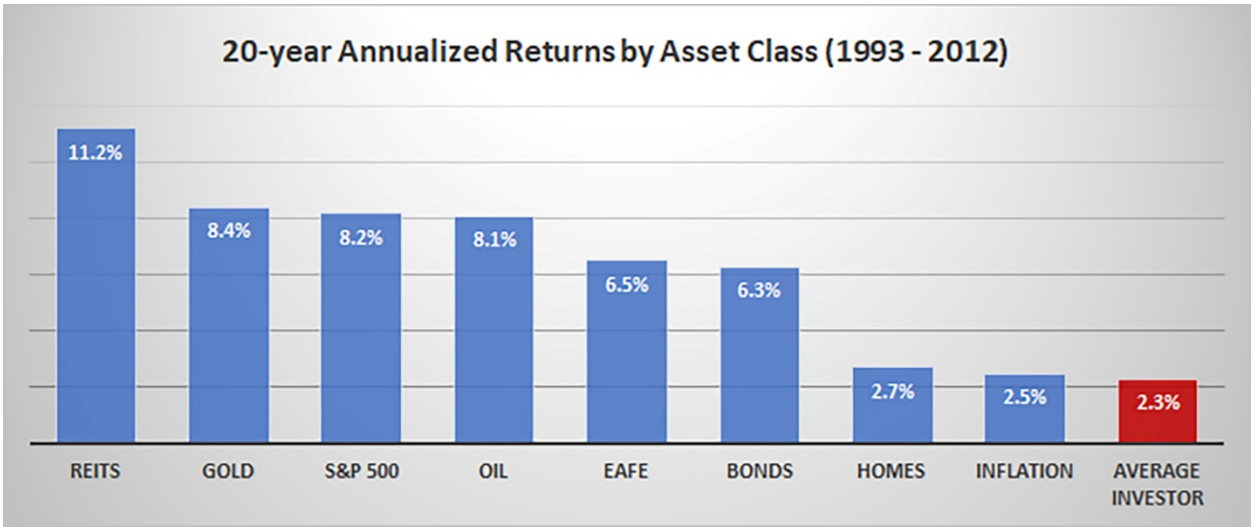
Now, what if by chance, your brother-in-law offers some advice for the next decade. He advocates a more conservative approach that involves greater balance. Would you be happy if after just four years (2010-2013) his guidance turned the $452,000 into $600,000?

Doubtful. And here's why...

Had you left the $452,000 in the S&P 500's SPY in 2010, the $452,000 would have grown to $813,000 by year-end 2013. Chances are, you would find yourself feeling frustrated. You may even have had some choice words for your brother-in-law.

Ironically enough, the money moves in the above scenario are quite typical. How can one tell? The annualized investment returns for average investors show that these folks are making poor decisions.

For example, researchers analyzed a 20-year period in which they compared the annualized performance of the average investor against the annualized performance of seven different asset classes. Not surprisingly, the average investor underperformed every asset class in the study. Worse yet, the average investor did not even keep pace with inflation.



Indexes used are as follows: REITs: NAREIT Equity REIT Index, Gold: USD/troy oz., Oil: WTI Index, EAFE: MSCI EAFE, Bonds: Barclays Capital U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Inflation: CPI. The average investor return is based on an analysis which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Source: J.P. Morgan and DALBAR Inc.

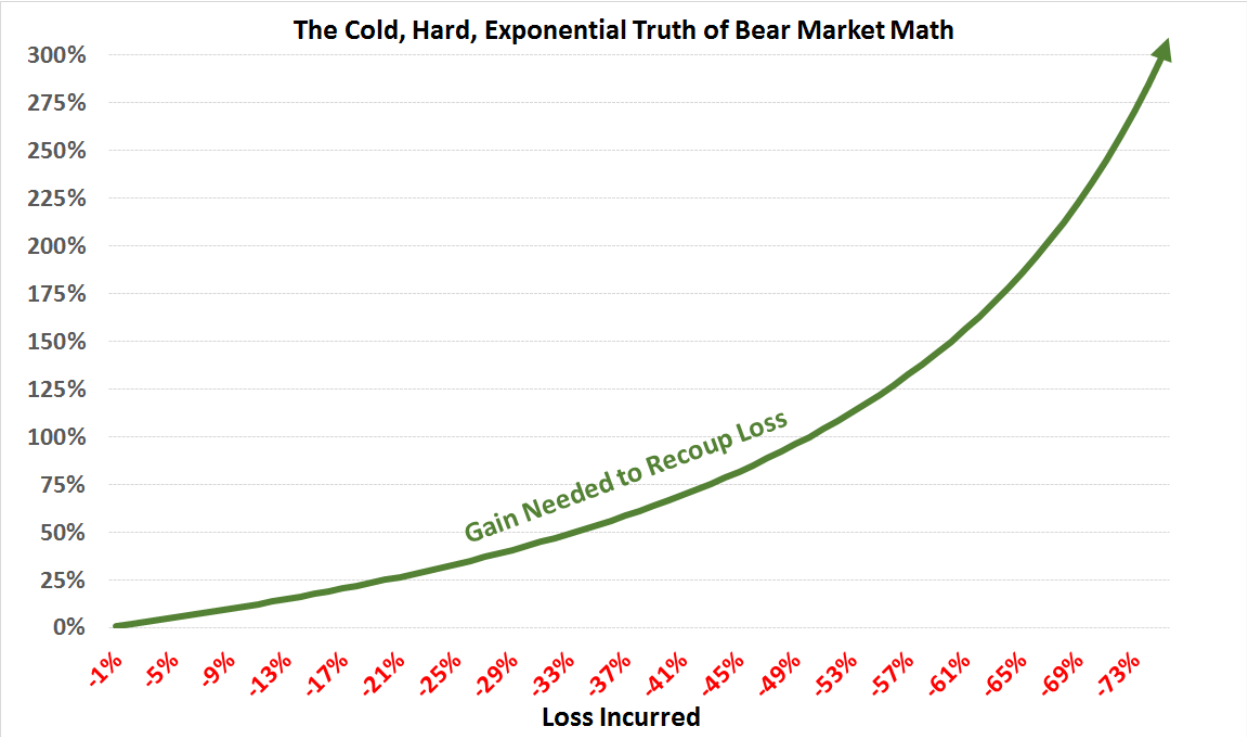
Are there things that you can do to avoid becoming an "average investor?" Absolutely. The first step is to recognize the mistakes that typical investors make.

The Math of Investing

Here is one of the most common mistakes that the average investor makes. They assume that an investment which is down 10% merely needs 10% to recover.

Unfortunately, that's not the math of investing. The cold, hard truth? Bear market math is exponential.

For instance, if you lose 10% in a broad-based index fund like the S&P 500's SPY, you will need 11.1% to break even. (What's the big deal? Why are we even sweating it?)



Let us continue.

If you lost 25% on an investment last year, then make 25% in the second year, your 2-year return is not 0%. It is -6%. Why? Because a 25% loss requires a 33% gain to get back to the starting gate.

If you lose 50%, you need 100% to revisit the flatline. And sadly, 50% losses requiring 100% gains may take 5, 7, even 10 years to come back from.

Remember Jim Cramer's *Winners of the New World* portfolio? It lost 98%, requiring an astounding 5400% gain to get back to an inflation-adjusted breakeven point. In essence, the more you lose, the more your gains need to be exponentially higher to recover lost principal and lost time.

Quantifying Time

When (not if) the next stock bear mauls investor portfolios, anyone lacking a sell discipline will be tragically ill-prepared. Valuable time (and money) will be lost.

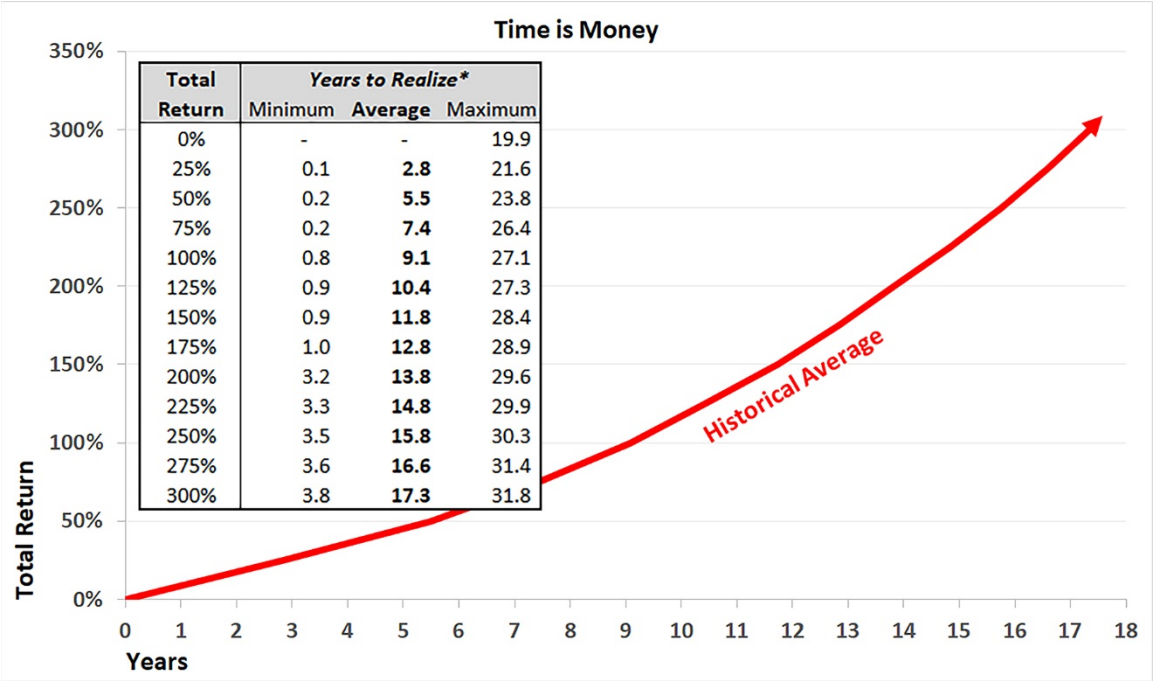
Indeed, *time is money.* Truer words have rarely been spoken.

Cliché notwithstanding, if one allows investments to languish or lose significant financial ground, there may not be enough time to make up that ground. This is particularly accurate for those who no longer earn income from traditional work.

Many stock bears in history have removed years, even decades from investor well-being. Financial. Emotional. Even physical.

Think about it. If losing time and money is stressful, and if stress is a silent killer, can you really afford to hold-n-hope through a severe bear storm? Or would it be preferable to employ an approach that seeks to minimize titanic losses?

You may have heard that, on average, the stock market doubles every seven years. Adjusted for inflation, however, the historical average moves up to 9.1 years. (See the chart below.)



Total Return	Years to Realize* Minimum	Average	Maximum
0%	-	-	19.9
25%	0.1	**2.8**	21.6
50%	0.2	**5.5**	23.8
75%	0.2	**7.4**	26.4
100%	0.8	**9.1**	27.1
125%	0.9	**10.4**	27.3
150%	0.9	**11.8**	28.4
175%	1.0	**12.8**	28.9
200%	3.2	**13.8**	29.6
225%	3.3	**14.8**	29.9
250%	3.5	**15.8**	30.3
275%	3.6	**16.6**	31.4
300%	3.8	**17.3**	31.8

*1926 to 2013 inflation-adjusted, large cap (S&P 500) total return data provided by Morningstar.

Losing the purchasing power of your dollars (a.k.a. inflation) is only one concern when it comes to the growth of money over time. Another? Average returns exist across an exceptionally wide range of potential outcomes.

Granted, on average, an inflation-adjusted total return of 100% clocks in at nine years. Then again, it could take as little as 10 months. Or it can drag out over the course of 27 years.

27 years? Simply put, that might result in a near-retiree or retiree running out of money and time.

Looking at the chart again, one notices that there have been long periods of 0% inflation-adjusted returns. In fact, there have been times when no inflation-adjusted dollars had been made after 20 years.

Two decades in the market with nothing to show for it? That would be catastrophic for many folks.

Here are just a few modern-day examples:

- The Shanghai Composite (China) reached 6,124 on 10/16/2007. More than 13 years later (March 2021) it is trading near 3,500. That is roughly down 43% from a high.
- The Nikkei 225 Index (Japan) reached 38,957.44 on 12/31/1989. More than 31 years later (March 2021) it trades around 29000. That's down roughly 26% from its peak 31 years ago.

- The NASDAQ 100 Index reached 4,704.73 on 3/27/2000. It took 17 years to put those lows in the rearview mirror. (And it would have taken much longer if the index components hadn't changed dramatically from what they were in 2000!)

Stock market devastation is more frequent than many assume. Since the turn of the century alone, the S&P 500 had been cut by more than HALF twice.

How comfortable would you be losing 50% of the value of the money you have invested in stocks? Because it will happen again.

More importantly, when it happens again, an investor will need time to recover his/her capital. Maybe it will be 10 months. Maybe it will be nine years. Or maybe it will require 27 years to get back to the starting gate.

It follows that a smart approach to the uncertainty is to have a specific discipline that seeks to minimize the losses that occur in stock bears. In that manner, one is more likely to shorten the recovery time as well as go on to pursue impressive price appreciation.

Volatility & Futility

One of the most infamous periods in American history is the Great Depression. And it probably comes as no surprise to learn that a 20-year period with 0% inflation-adjusted stock returns occurred in the Great Depression.

The specific time frame? Inflation-adjusted, stock prices went nowhere from September of 1929 to July of 1949.

Of course, you do not have to be a history buff to deduce that the stock market did not move sideways for two decades. On the contrary. The span started with a monstrous bear market descent of 79%. Stocks then rallied for a 575% gain off the bottom. That was followed by a bearish loss of roughly 30%.

A whole lot of volatility, to be sure. The two-decade period also represents futility for those who just held on to portfolios for the entire ride.

Now, here is a mathematical exercise worth highlighting. What if an active risk manager implemented an unemotional process that limited market exposure by half? On the upside and the downside?

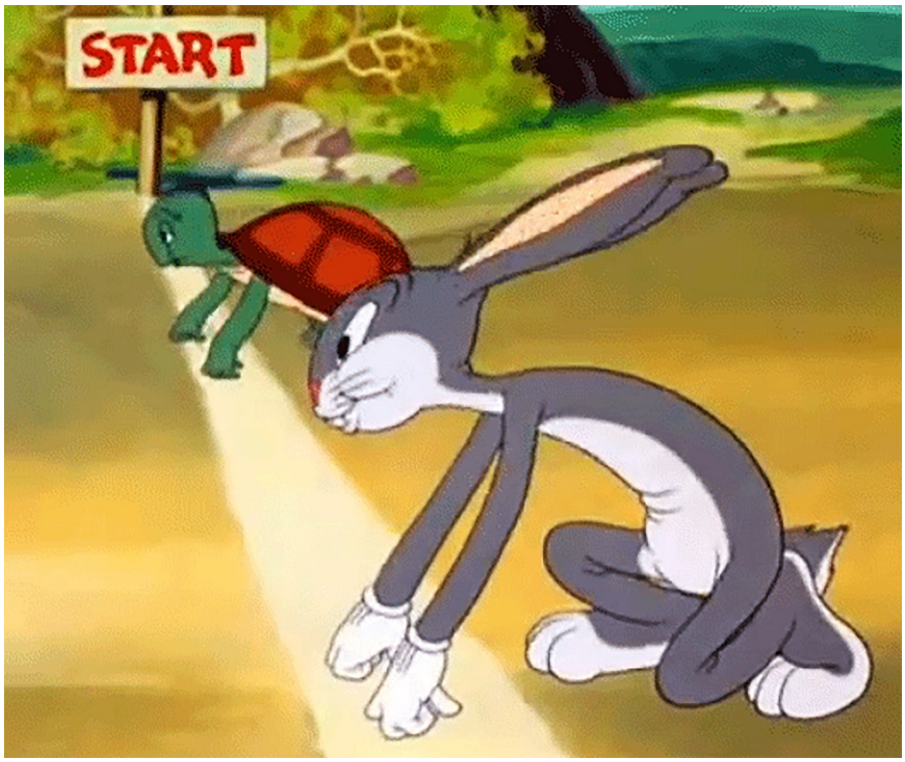
In other words, instead of 79% losses out of the Great Depression's gate, the investor experienced roughly 40% price depreciation. Instead of the 575% gain that occurred off the bottom, the increase was half as palatable at 288%. And finally, the investor witnessed a 15% decline rather than a 30% haircut.

While hold-n-hopers from September of 1929 to July of 1949 experienced an inflation-adjusted result of 0%, the risk-conscious investor described above would have garnered a 100% inflation-adjusted return. Double the money even with the Great Depression. The math shows that losing half as much on the downside was far more influential on the outcome than having only earned half as much on the upside.

The take-home here is twofold. First, implementing a process for losing less in bad markets is paramount. Second? Even dreadfully futile periods provide opportunity, though you will not be able to simply hold-n-hope throughout those awful times.

Keep in mind, you will never be able to sidestep a bear market in its entirety. Yet, having a process that focuses on losing less in downward trending markets is likely to improve your financial outcomes.

The Secrets of Investment Success



The tale of the Tortoise and the Hare has been taught at a very early age to many generations. Still, most investors forget the lessons from childhood, often opting for flashier paths that promise enormous fortune.

When it comes to our money, are we compelled to behave in an irrational manner? Are the negative influences from peers and the financial media too great to ignore?

We are constantly bombarded with “get rich” publications, TV shows about making “mad” amounts of money, as well as industry profiles that crown individuals with mystical stock picking skills. Sadly, though, the quest for a quick and easy path to wealth typically ends in disappointment, if not disaster.

Stock Market Gurus

We can all agree that one correct assessment does not a genius make. Likewise, making an incorrect assessment does not seal one’s fate as an imbecile. Intelligent people are just as capable of making bad decisions as foolish people are.

When it comes to the peculiar world of investing, some people may provide the perfect analysis and still come up on the wrong side of a trade. Meanwhile, others may get it right despite extremely faulty reasoning.

Yet, the outcome (not the reasoning) is how the media convince the public who the superstar pickers are. Should you really care who the best portfolio manager was last year?

Bill Miller was once considered the world's premier stock market guru. He co-managed Legg Mason Capital Management's Value Trust Fund (LMVTX) from its inception in 1982. Over the years, Mr. Miller and his team received numerous honors for their performance record and distinct investment style, which focused on a detailed understanding of businesses and their intrinsic value.

Mr. Miller was ranked among the top 30 most influential people in investing when he was named a member of the "Power 30" by Smart Money. He was also named "The Greatest Money Manager of the 1990's" by Money Magazine and named Morningstar's 1998 "Domestic Equity Manager of the Year." In 1999, he was selected as the "Fund Manager of the Decade" by Morningstar.com. In 1999, Barron's named him to its "All-Century Investment Team" while BusinessWeek called him a "hero of value investing."

In 2007, LMVTX became the largest stock mutual fund in the world. With 15 consecutive years of beating the S&P 500, it seemed that Mr. Miller could do no wrong. In June of 2007, LMVTX was hitting fresh all-time highs, just as scores of hopefuls piled in. After all, why wouldn't you want a stock market guru with awards galore at the helm of your portfolio? It's a no-brainer, right?

With a recession beginning to take shape in the 2nd half of 2007, not everyone believed that it would lead to an epic meltdown in the financial system. In fact, Bill Miller decided to invest even more heavily in banks and other financial services firms. The "stock market guru" was not able to predict the financial collapse nor the depth of declines in the shares of major financial institutions.

From June of 2007 to March of 2009, Bill Miller's fund plummeted 73%. In less than two years, LMVTX wiped out more than a decade's worth of returns. Not only did LMVTX fail to beat the market in 2008, but it also underperformed the Lipper Average for Large-Cap Value funds over 1, 3, 5, 10 and 15 years.

NEXT!!!

The world of finance did not waste any time finding a new stock market guru on the other side of Bill Miller's trade. His name? John Paulson.

Mr. Paulson made a fortune from the collapse of the mortgage-backed securities that were at the heart of the 2008-2009 Financial Crisis. His bet to short subprime mortgages in 2007 has been called one of the greatest trades ever. At the time, every financial source was touting his clairvoyant portfolio management capabilities.

The popularity associated with having made the "greatest trade ever" allowed Mr. Paulson to grow a miniscule, one-employee, $2 million hedge fund, Paulson & Co. Inc., into the fourth-largest hedge fund in the world; $2 million swelled to an astonishing $36 billion in investor assets under management. Books and movies were written about him.

Undoubtedly, Mr. Paulson's 2007 bet against subprime was nothing short of a home run. Shortly thereafter, though, Paulson's performance was less like Hank Aaron and more like infamous strike-out artists. In 2011, John Paulson earned the dubious title "worst performing fund manager." Popular stock market benchmarks may only have been flat that year, yet Paulson's Advantage Plus Fund experienced a horrendous -52.5% drop. Unprecedented!

Surely the guru with the greatest trade ever could do better in 2012, right? Despite S&P 500 index funds earning more than 15% in 2012, Mr. Paulson's flagship Advantage Plus Fund was near the bottom in performance yet again, logging a pitiful -19%. The droves of investors who had hopped on the Paulson bandwagon suddenly found themselves down 62% from the top… in just two years! Buy-n-hold believers in Paulson began 2013 needing 163% just to break even.

Americans need their heroes. And some portfolio managers seem to have it all—media recognition, awards, past performance. But when a "guru" does not have a plan to minimize losses, it's the buy-hold-n-hopers who lose.

Gains Guaranteed?

Outside of cheating, there is no such thing. If somebody tells you otherwise, run away. Run far away.

Risk Management

Investment success hinges on a very important concept: risk management. And the simplest way to explain risk management is by comparing it to a relatable necessity, insurance.

Southern Californians, for instance, have grown accustomed to frequent tremors and ground rumblings associated with living near active fault lines. Should they possess earthquake insurance on the homes that they own?

Granted, there have only been two major seismic events in Southern California over the last 40 years. There was the Whittier Narrows in October of 1987, and the Northridge Quake in January of 1994. Both were memorable. And yet, neither were particularly troublesome for residents in Orange County.

I say "not particularly troublesome" with an ironic grin. Southern California homeowners who dutifully pay earthquake premiums feel like they are throwing away hard-earned money. The deductibles are extremely high. And the "Big One" never seems to come to fruition. (Complacency can be a killer.)

In other words, four decades have passed with little more distress than a smattering of phone conversations. ("Did you feel that?")

Insurance is one of those things that we can only appreciate in circumstances of grave misfortune. Ironically, though, we purchase insurance with the hope that we will never actually need it!

So why waste hundreds of dollars to renew an earthquake policy? Some insurances are necessary evils. Others can be viewed as overkill or unnecessary.

Yet a residence typically represents a family's largest asset. It is better to pay premiums year after year after year, even with the possibility that there will be no "benefit," than to experience a total loss of equity because you did not protect the value from catastrophe.

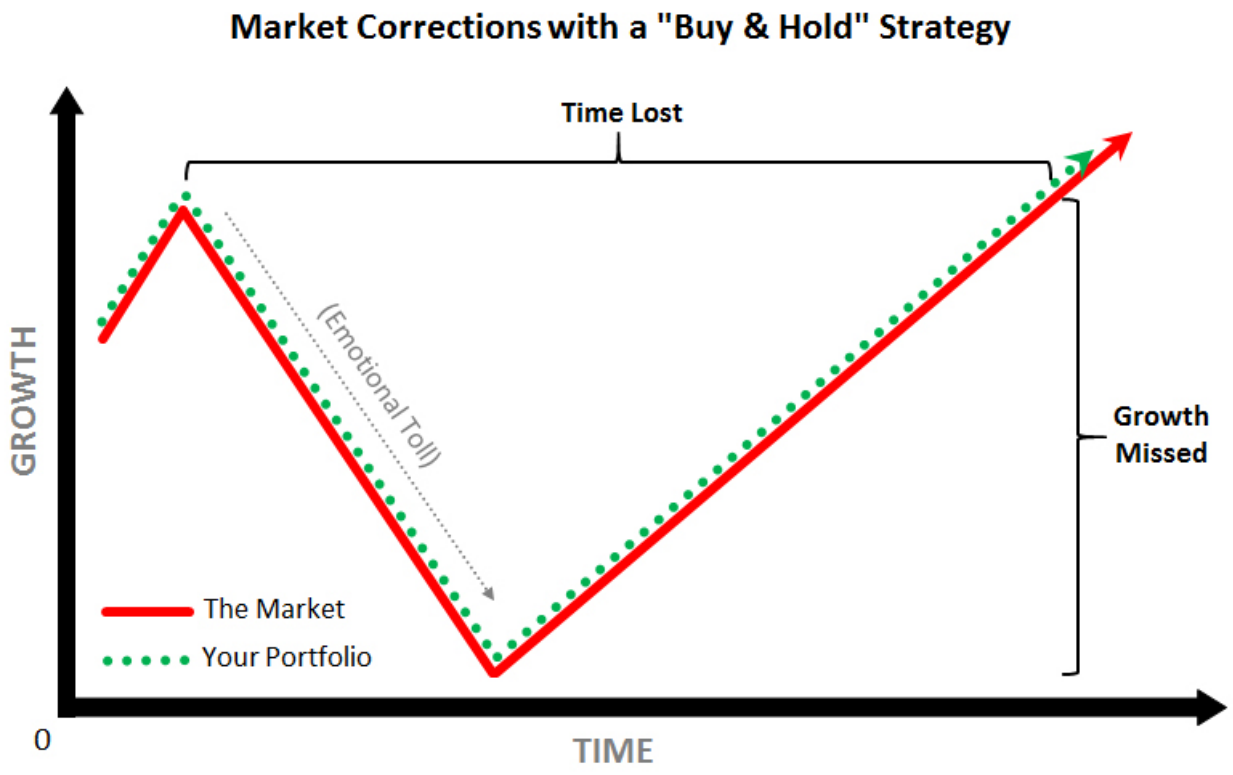
An earthquake insurance premium represents a small loss that provides a California homeowner with the peace of mind that there will never be a massive, life-altering loss. Avoiding the possibility of a cataclysmic loss brought on by an earthquake is worthwhile, even if nothing happens in the state for another 40 years.

Just as your home needs protection from the risks that could severely damage or destroy it, so too does your investment portfolio. And yet, very few investors have an actual risk management plan in place to protect their financial future.

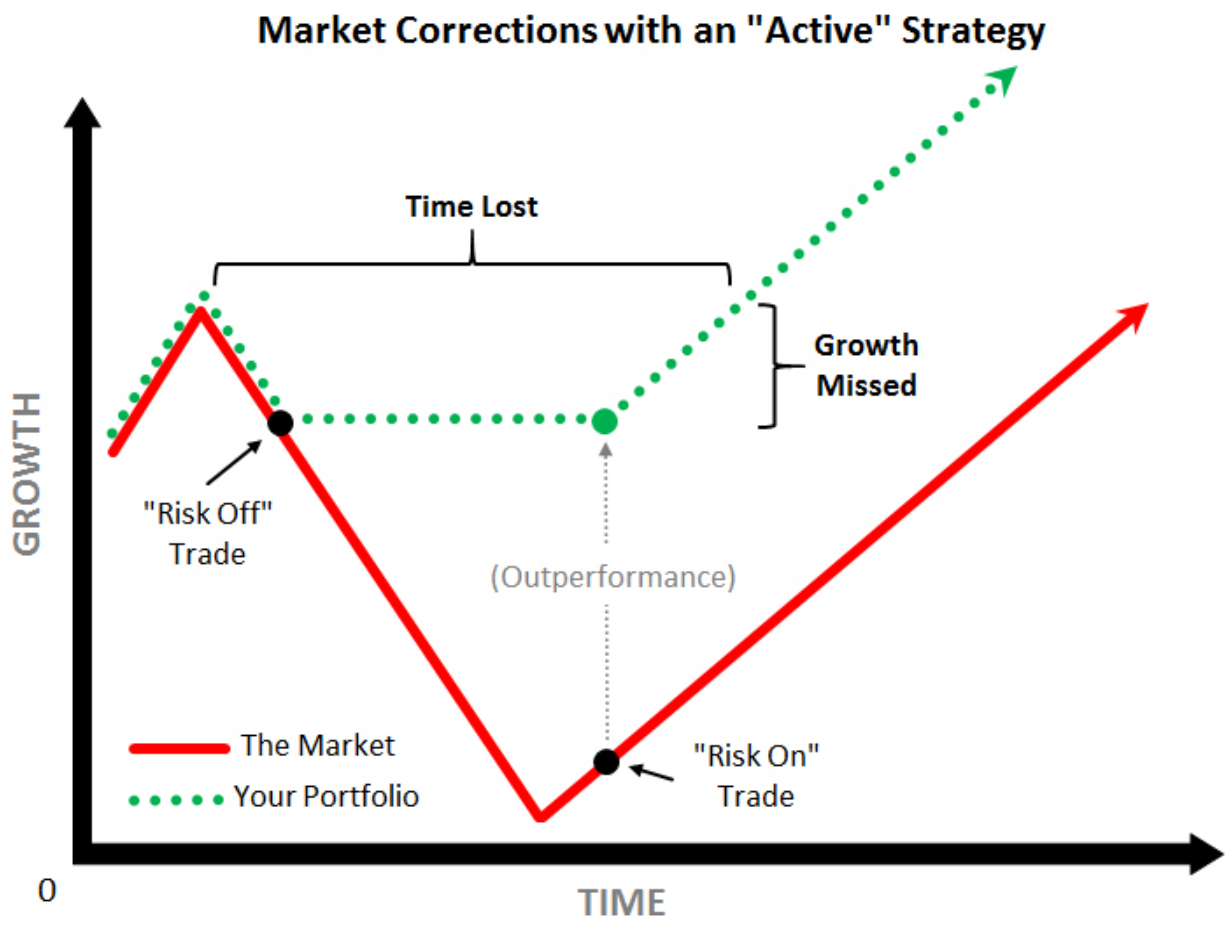
The Mechanics of Active Management

Achieving better performance does not necessarily mean you have to take on more risk. It simply means that you must lose less on the downside. This mathematic fact is at the heart of what is known as a risk-adjusted return. In our opinion, active risk management is the way to improve your risk-adjusted return.

Below is a two-part representation of the mechanical differences between “buy-n-hold” and active management:



Without an active component to help you minimize declines, you are at the mercy of the markets. You might squander away precious time and money. Also, the emotional toll that comes with watching your investments fall is immeasurable.



In contrast, a sell discipline can save you time and money. It can also help you avoid the emotional toll of riding markets down to the bottom. Additionally, one has the potential to enhance his/her risk-adjusted returns by lessening the extent of bearish price declines.

Tactical Asset Allocation

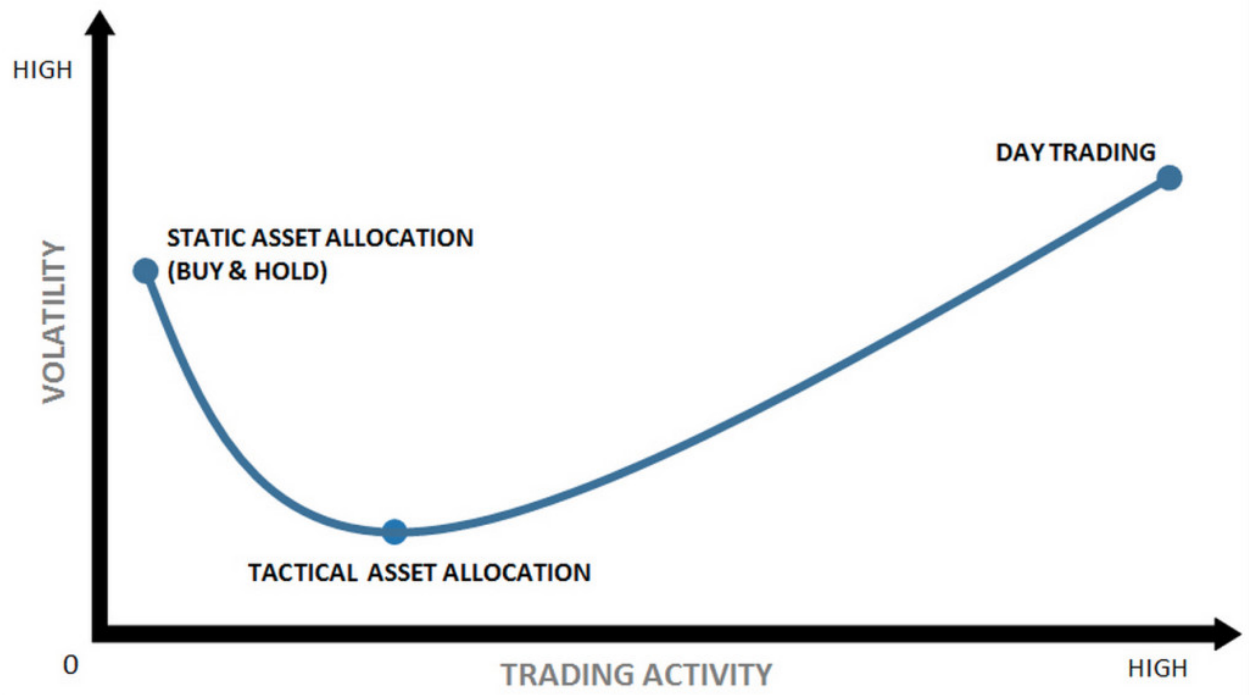
A well-rounded investment strategy is as important as a flight plan is to a pilot. Without planning for weather, traffic, instrument and mechanical failures, a pilot would have limited control over the potential outcomes of a trip.

We are not just talking about a late arrival. In the worst circumstances, a pilot and his/her plane might not make it to a destination at all.

When it comes to managing portfolio risk, you need to have a clear idea of the strategies available to you. Non-correlated assets. Stop-limit trade orders. Trend-following. Ultimately, the appropriateness of the risk management tool comes down to specific goals and standard of living requirements.

Indeed, some strategies require very little time and energy to implement, though they may not be as effective at sidestepping the bulk of bear market selloffs. Conversely, other approaches may limit one's exposure to downturns, yet they may also require more time, energy, and discipline.

Below is a graphical representation of our interpretation of the investment strategy spectrum:



Static asset allocation (a.k.a. "buy & hold") sits at the far left of the investment strategy spectrum. It is a popular approach because there is little to do. In essence, you select a mix of "diversified" assets, then place your faith in the markets over time.

From a theoretical perspective, plenty of evidence supports a do-nothing, hold-n-hope approach. However, when catastrophe hits, it becomes more difficult to stand by and "do nothing." Worse yet, the recovery time from deep selloffs may not make financial sense.

On the other side of the spectrum? Day trading. Many like to brag about the "mad money" that they have made on hot stocks and tech that typically exist in smaller accounts. Yet, most people see this type of investing activity for what it truly is: gambling. Few would "bet the farm" on get-rich hopes and dreams.

Keep in mind, many things that exist on the furthest ends of a spectrum tend to be problematic. Sensible risk managers seek a happy medium.

Our happy medium is "tactical asset allocation."

With tactical asset allocation, one begins with a target asset mix. For instance, a moderate growth investor might expect a target of 70% equity (stock)/30% income (bond).

The target mix will stay intact in low-risk environments. In essence, you hold the mix for as long as the environment remains favorable, whether that is five years, two years, six months, or six weeks.

Eventually, though, things will change. Things may change very quickly, or a long period of time may pass in between. Regardless, one must be disciplined enough to adapt to the shifting landscape.

When identifiable risks outweigh the prospective reward of participating at the targeted asset mix, one can downshift. An investor who might otherwise target a mix of 70% equity (stock)/30% income (bond) could have 40% equity (stock), 25% income (bond) and 35% is the safety of cash.

Our investment process identifies environments that are more favorable for risk as well as less favorable. We do so by employing unemotional data and technical trends.

(For more on the specifics of our tactical asset allocation, please visit THE SPECIFICS OF AVOIDING BIG LOSSES at our website.)