The Investor's Conundrum

By: Robert Klosterman, CEO & Chief Investment Officer

When people think of investing, they often are focused on the rate of return or performance of a particular investment idea or strategy. Unfortunately investors are easily misled when focusing on the return earned over a period of time, since it is only one factor in the reason to forego spending money currently to consume it at a later date.

While it is intuitive that the more money you earn the more you can consume later, it too often misses the point of the reason that we save and invest, to have more money to consume later. Coming of age in the 50's and 60's the paradigm of retirement was very different than in today's world of increasing lifespans and therefore much longer years in retirement.

In fact, retirement is a relatively new concept. The age of 62 was institutionalized in the 1880's in Germany. The then Chancellor, Otto von Bismarck, felt that people who had reached the age of 65 should be able to not work. It is important to keep in mind that was when male life expectancies were approximately 47 years of age. 18 years past life expectancy. Today that would equate to age 96. (78+18=96). Retirement was not envisioned as a decades long proposition.

In my book, The Four Horsemen of the Investor's Apocalypse, I identify four levels that stand in the way of investors meeting their long-term financial security goals and dreams. They are Inflation, Volatility, Sea of Sameness and Global disruptions and dislocations. What gets lost in the shuffle is the real people's use

of their portfolios and the impact of that usage is paramount in how a portfolios performance plays out.

Inflation and volatility often take the lead in an attempt to ravage real peoples portfolios. Inflation, while subdued in the past few years stay plays an insidious role in impacting the need a portfolio needs to meet over time. For example, even assuming a 2% inflation rate, a $100,000 annual income need grows to $155, 796 buy the end of 15 years. A 55% increase! Over 20 years the need grows to $180,611 or an 80%+ increase in the need.

Inflation points out the need to offset inflation. Unfortunately, that objective is nearly impossible to meet with fixed income investments such as bank accounts, CD's and Bonds. History has shown with overwhelming evidence that renting your money out via fixed income vehicles will do little other than reduce the expectation of the fluctuation or volatility of a portfolio. Combine this with an expectation that interest rates are at a 30+ year low and show obvious signs of increasing that will impact the value of bonds in a negative fashion.

Yet an even more destructive force to be met is the impact of volatility on meeting those needs. With an increasing income need over the years, the impact of account values declining during difficult times in the markets can be especially destructive. Virtually all investments show an illustration of performance over time. For the most part, they do not take into consideration the impact of deposits and withdrawals of capital. They are a point-to-point reflection of what happened without consideration how real people use their capital. In other words, the investment industry assumes you are a "rip Van Winkle" investor who puts their money in and does not do anything with it until you wake up at some point in the future and are amazed that things have turned out the way they did. Unfortunately, that is not a reflection of the real world that all of us live in.

	Spending	Portfolios: S&P 500	Portfolios: 80% S&P 500 - 20% Barclays Aggregate Bond Index	Portfolios: Diversified with Alternatives
12/31/1999		$2,000,000	$2,000,000	$2,000,000
12/31/2000	$80,000	$1,737,893	$1,814,147	$1,784,905
12/31/2001	$81,881	$1,449,471	$1,584,425	$1,581,731
12/31/2002	$84,483	$1,044,652	$1,238,580	$1,359,782
12/31/2003	$86,746	$1,257,559	$1,440,957	$1,635,662
12/31/2004	$90,264	$1,304,107	$1,488,147	$1,771,093
12/31/2005	$94,070	$1,274,140	$1,459,754	$1,871,981
12/31/2006	$97,212	$1,377,962	$1,558,045	$2,110,192
12/31/2007	$101,957	$1,351,748	$1,546,284	$2,239,957
12/31/2008	$102,867	$745,228	$973,015	$1,446,367
12/31/2009	$106,489	$835,833	$1,081,064	$1,672,990
12/31/2010	$108,933	$852,705	$1,115,869	$1,767,136
12/31/2011	$113,032	$755,201	$1,036,286	$1,601,568
12/31/2012	$115,904	$760,080	$1,060,661	$1,671,835
12/31/2013	$118,572	$887,932	$1,203,835	$1,788,593
12/31/2014	$120,417	$889,070	$1,229,061	$1,758,826
12/31/2015	$122,259	$779,325	$1,122,040	$1,607,567
12/31/2016	$125,774	$733,136	$1,092,607	$1,561,536
Annualized Mean Return		4.47%	4.62%	4.59%
Annualized Standard Deviation		15.03%	11.99%	10.91%

Note the column entitled "spending" that the amount rises each year due to the impact of inflation. As mentioned above the amount grows in spite of the growth or decline in portfolio value. This is based on the assumption it is safe to withdraw a 4% if the initial portfolio value of $2,000,000 and adjust for inflation. In the next column, entitled S&P 500, the strategy is assumed to be the S&P 500 index, gross of fees. This is actual index, not an index fund or ETF. To invest one would incur some costs not identified in this analysis. In other words, advantage S&P 500. Note how the ending value at the end of 2016 is $733,136 or about 37% of the original $2,000,000 due to the withdrawals taken. If a person retired at 65 they would now be 82 years of age. Note also the return of 4.47%% and the measure of volatility or Standard Deviation of 15.03%

Now move to the next column. It is a mix of 80% S&P 500 and 20% of the Barclay's Aggregate Bond index; still gross of fees it is important to compare the return and volatility of this column

to the S&P 500 alone column. The difference is not the rate of return. The real difference is the fluctuation or measurement of volatility of the portfolio. There is 49% more capital available due to reducing the level of volatility. Volatility matters a great deal!

Yet, the investor is faced with a dilemma. Bond interest rates are at low levels and the interest rates are likely to move up. This is bad for bonds since it causes volatility and depreciation in value What can an investor do to protect themselves against the evil force of volatility in their portfolios? After all, they saved/invested to use the portfolio not hoard the capital. The good news is that investing is not limited to just US Large Cap Stocks, Bonds and Cash as investment choice. In fact the world is full of relevant and helpful investments such as real estate, alternative forms of lending, managed futures and many others. Investments that also have records of safety and relative performance that can further round out portfolio to meet the needs of real people's needs to achieve and preserve their goals and dreams.

Often, referred to as "alternative investments", make it sound as if they are a monolithic assets class but they are not. There are multiple assets classes that are included in the broad-brush term of alternatives. Yet, is there some value in including these non-traditional types of investing in a portfolio. White Oaks believes firmly the answer is. Yes! Note in the final column that includes a mixture of alternatives in a portfolio. (see notes at end) Note, the reduced standard deviation or volatility of the portfolio and the amount of capital preserved over the same time period. The final column even has a slightly lower return than the 80/20 mix in the middle strategy it has massively more capital preserved (113% more than S&P 500 and 43% more than the 80/20 mix) due to the lessened volatility. Clearly, increasing the availability of tools in a portfolio has a dramatic impact.

The numbers in the final column are all based on indexes of the alternative classes not the performance of strategies employed at White Oaks. While actual results might be better, I felt the purpose of the paper is to demonstrate how the reduction of volatility is vital in meeting and preserving financial goals and dreams. Actual performance of actual investments historical records can be obtained on request by accredited investors.

In summary, investors, in order to preserve their resources and maintain their ability to live the life they envisioned, need to consider all the tools available to them, not just the one that are most familiar. The rules for retirement have change dramatically via increased lifespans and the impact of inflation over these longer time frames.

Important Notes:

• Assume a $2 million portfolio on 12/31/1999 and spending that is $80,000 in 2000, which grows each year by inflation plus 80bps.

• Spending reduces amount of portfolio by the full annual amount on the last day of the year after the market closes.

• The S&P 500, 80% S&P 500 - 20% Barclays Aggregate Bond Index, and Flexible Fund columns show the growth of a portfolio invested as such inclusive of spending.

• The S&P 500 and the 80/20 Benchmark are gross of management fees and trading costs.

• The "Diversified with Alternatives" is net of management fees, custodial fees, and legal fees. It is net of trading costs within the different funds that are used and gross of trading costs between funds that are used. The annualized management fee is 0.90% and the custodial and legal fees are 0.07%. These are deducted at the end of each month.

• All portfolios, with multiple components, are continuously rebalanced (i.e. 80% S&P 500 - 20% Barclays Aggregate Bond Index and "Diversified with Alternatives").

• "Diversified with Alternatives" is not the actual results of the Alternative Fund; it is actually the results of a back-tested portfolio that consistently maintains an allocation that is similar to the target allocation of the Alternative Fund as of the end of 2014. Please see separate table for more details on the back-tested allocation that is called "Diversified with Alternatives" in this table.

About the Author

Robert Klosterman, CFP® is Founder, CEO and Chief Investment Officer of White Oaks Investment Management, Inc. and Founder of White Oaks Wealth Advisors, Inc. Bob has been a Certified Financial Planner licensee since 1989. He has a clear vision for the future having worked in financial planning since 1975, and feels a strong need to provide people with expert and independent wealth advisory services. As a Certified Financial Planner and certificate holder for Family Wealth Advising, Bob's expertise and guidance have helped to fuel the steady growth of the firm. Today, White Oaks Wealth Advisors boasts a talented staff of advisory professionals, hand-picked for their financial planning and wealth management knowledge as well as their dedication to client service.

"My mission is to serve our clients through the combined expertise of our advisory team. I want to use my experience to really impact the lives of the people who place their trust in us."

Bob's leadership within the firm's Advisory Committee regularly encourages fresh thinking and new approaches that provide clients with innovative wealth management solutions in the areas of economic and investment market analysis, stock option strategies and wealth transfer techniques.