Investing & the Art of Waxing Proverbial

By LCDR Michael Wegman, USNR

"Don't put all your eggs in one basket" is one of many sayings I heard Grandmother repeat throughout my formative years growing up in North Carolina. Little did I know that I would one day rely on such simple ideals to guide my professional career. After a decade of helping people build and maintain investment and retirement portfolios, I have come to fully understand the value of what Grandma meant when she referred to those eggs and baskets. In the world of investing, it's called "asset allocation;" and in my mind, it remains the Holy Grail of financial planning concepts.

After the irrationally exuberant 1990's and bear market of 2000-2002, many investors are still licking their wounds and wondering what to do next. If you desire to make money this year and beyond and perhaps manage your risk a bit better than in previous years, it would help to set a goal of finding the right asset allocation for you. Here are my three specific rules to consider:

1. **Spread your risk around:** Regardless of your age, you should own a combination of stocks, bonds, money-market funds, and real estate. Your goals and your ability to stomach market fluctuations will determine the percentage of each of these assets you own. The extent to which you mix investment types within your portfolio is your "asset allocation," and that mixture needs to consider the risks associated with each type of investment.

   Equity (stock) investments are less stable in the short-term, as their value fluctuates daily because of the dynamic nature of share trading and supply and demand for shares. Statistics have shown, however, that over longer periods of time, quality stock investments outperform nearly every other type of investment out there. But remember, past performance cannot guarantee future results.

   While investments in bonds and cash equivalents such as money-market shares generally maintain more stable values in the short-term, they, too, come with their own risks brought about by inflation, currency exchange rates, and changes in interest rates.

   Younger investors with longer time horizons to accumulate wealth may want to consider greater allocations in stocks and stock mutual funds. Older investors approaching retirement may want to consider a strategy of asset protection with higher percentages of bonds and money-market funds.

   In nonretirement accounts where annual dividends and capital gains may create unwanted tax liabilities, a strategy of investing in municipal bonds and tax-deferred annuities or tax-efficient mutual funds may help considerably.

   In IRAs and company sponsored retirement plans where tax-efficiency is not an issue, you can consider leaning more toward investments such as sector funds, high-yield junk bond funds, real estate investment trusts, and international stock funds.

   To better understand asset allocation, consider a generic example: investor Smith allocates 60 percent of his 401(k) plan assets into stocks and 40 percent into bonds and fixed income investments. Provided his plan offers such diversity, the 60 percent stock portion should be divided between "growth" and "value" styles of small cap, mid cap, large cap, and international stock mutual funds. For the remaining 40 percent, a mixture of U.S. Government Treasury Bond funds, corporate bond funds, and money-market funds would be reasonable. A portfolio that contains a healthy mix of several different types of investments is less risky by design, spreading your money around in many different places ("eggs" and "baskets").

So why could this strategy work? Well, a diversified portfolio of many different types of investments generally represents a cross section of industry sectors of both domestic and international economies. In layman's terms, noncorrelated investments respond independently of each other, so only a portion of your money is subjected to the possible negative effects of changes within domestic and international stock & bond markets, currency rates, and short- & long-term interest rates.

The trick to insulating a portfolio from too much risk is to ensure that no single investment becomes the primary driving force within the portfolio. Most asset classes produce decent returns over time; but be patient, and "don't count your chicks before they're hatched." Asset allocation simply helps manage your risk in the meantime.

2. **Rebalance annually:** Once you have allocated your portfolio assets according to your age and risk tolerance, you should rebalance once each year back to the original allocation percentages. For example, returning to the fictitious Mr. Smith again: Suppose his 60/40 mix is now 71 percent stocks and 29 percent bonds following a year of decent stock market performance. While reviewing his portfolio, he notes that the small cap fund has grown from a 10 percent slice of his portfolio to 19 percent. To rebalance, Smith sells 9 percent of this fund to bring it back to the original 10 percent target value. As he reviews the other funds, Smith notices that two other funds are down slightly from their original percentage amounts, so he buys more of each until they are once again at the previous year's original allocation percentages.

Rebalancing causes good performing shares to be sold at higher share prices in order to purchase shares of poorer performing assets—selling high and buying low. Rebalancing has been a favorite tool of institutional money managers for many years, and its success is based on the premise that eventually every asset has its day in the sun. Owning as many shares as possible increases your return when that asset class has a good year.

3. **Forget market timing:** I recently read that if you were fully invested in the S&P 500 stock index every day for the past ten years (2600 days), EXCEPT for the twenty-five top performing days of market gains, your total return would be 3.0 percent instead of 13.0 percent. Short of having a crystal ball, nobody can pick when to get in and out of the markets based on odds like those, yet investors continue trying. There's a saying in the brokerage business: It's not TIMING the markets that's important, but rather time IN the markets!

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I agree. Long-term investors need to get in and stay in. Staying invested is a bit like learning to "roll with the punches."

The stock market research agency of Ibbotson and Associates recently reported a sad truth about investors and the markets since 1999. That year—the peak of the U.S. Stock Market climb—net dollars flowing INTO the markets hit a historical record high. Interestingly, just three years later at the 2002 market low, those same markets experienced record cash outflows! At record high levels of stock market performance, a record number of investors wanted in. When the markets cycled out-of-favor, investors threw in the towel and divested. That's historically how most investors behave: buying high and selling low.

"Don't throw the baby out with the bath water," was another of Grandma's favorite metaphors, and it's another one with a decent application on the subject of investing. All too often, investors, anxious to rid their portfolios of the bad that has occurred in recent years, will make radical sweeping changes that unfortunately also rid them of the potential good that is often right around the corner. After three dreadful years of poor domestic stock market performance, 2003 was a breath of fresh air; yet many disgusted investors missed it while sitting on the sidelines with their previously invested capital now sitting safely in a low-interest money-market account.

Now that the markets are once again in favor and approaching previous high levels, many of these investors are considering going back in. Don't "stay off the beaten path, when your chips are down." Instead, learn to leverage market volatility to your advantage by investing a small amount each month over a one- or two-year period until you are once again fully invested. Over time, as you buy shares all along the pricing curve, you may end up with an average share cost that will make your holdings much more valuable when it is time to sell.

Whether you choose to go it alone or with guidance from a professional, learn the discipline of risk management through asset allocation, and "seize the bull by the horns" by getting busy socking away funds for retirement, college, or that second home at the beach. You of all people have a vested interest in understanding that with wealth accumulation, your greatest resource remains time, and as Grandma also used to say—"it waits for no man."

Mutual Funds and Variable Annuities are sold by a prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information, can be obtained by calling your Financial Advisor. Read it carefully before you invest.

Asset allocation/investment timing does not eliminate the risk of fluctuating prices or uncertain returns. Stocks offer long-term growth potential but may fluctuate more and provide less current income than other investments. The value of small company stocks is generally more volatile than those of large company stocks. Investing in foreign securities presents certain unique risks not associated with domestic investments such as currency fluctuation and political and economic changes. This may result in greater share price volatility.

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CAN I BE FROCKED?

By CAPT Tom McAtee, USNR (Ret)

Soon, results of FY-05 promotion selection boards will start being approved and released. Upon the public release of selectees, the most frequently asked question is, "Can I be frocked?" Let's examine the current Navy frocking policy for Reservists.

MILPERSMAN 1420-020 spells out the Navy's policy on Reserve officer frocking. Prerequisites include:

1. Selection announced by ALNAV.
2. Senate confirmation announced by ALNAV for O-6 and above.
3. Serving in or ordered to a billet for the higher grade.
4. Meeting one or more of the following billet criteria (listed by priority):
   - Billet with title of CO.
   - Billet with title of XO, where XO fleets up to CO.
   - Billet in direct support of the President or Vice President.
   - Defense Attaché.
   - Formal school where higher grade is needed for admission.
   - Billets on the joint duty list.
   - Billet on staff of OSD.
   - Billet on staff of SECNAV.
   - Acquisition professional major program manager.
   - Billet with title of XO.
   - Billet with title of Officer in Charge.

If an officer meets the above prerequisites, then, the command may submit a letter of request to PERS-492 via the ECHELON 4 command to Navy Personnel Command, PERS-492; 5720 Integrity Drive; Millington, TN 38055. The request must include the following information:

1. Name/SSN/designator of officer to be frocked.
2. Grade to which frocking is desired.
3. Date Time Group (DTG) of ALNAV which announced the officer's selection for promotion.
4. DTG of ALNAV/NAVADMIN which announced Senate confirmation of the officer's selection (required only for 0-6 and above).
5. Command name, UIC, and mailing address.
6. Billet for the higher grade, which the officer occupies or ordered to. Include the title and Billet Sequence Code (BSC).

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7. Date frocking is requested to begin.
8. Brief justification paragraph.
9. Point of contact, telephone/name.

Frocking quotas are extremely limited and will be assigned based on relative merit. For further information, contact PERS-492 at (901) 874-4514.

National World War II Memorial Dedication – Sold Out Event

For those who will be in Washington over Memorial Day Weekend without tickets for the dedication, there will be a non-ticketed viewing area on the Mall that should accommodate about 10,000 individuals in seats and another 30,000 standing room attendees. This area will be located between 10th and 14th Streets, adjacent to the Smithsonian's WWII Reunion described in the opposite column of this page.

Live Televised Coverage

The History Channel and C-SPAN have both agreed to carry the dedication ceremony live from start to finish beginning at 2:00 p.m. EDT on Saturday, 29 May 2004.

Other Options for Those Without Tickets

The memorial should open to the public in mid-April 2004 and remain open through Friday, 28 May, so visitors may enjoy an early visit to the new memorial prior to the dedication weekend events.

Smithsonian WWII Reunion, May 27-30, 2004

Coinciding with the dedication ceremony will be the "Tribute to a Generation: National World War II Reunion," a major four-day event produced by the Smithsonian Institution's Center for Folklife and Cultural Heritage. Admission is free and tickets are not required. The Reunion will take place on the National Mall between 3rd and 7th Streets.

For more information on the National WWII Reunion, please visit: <http://www.folklife.si.edu/CFCH/wwwiioverview.htm>.

Science, Technology & Engineering (STE) Workshop 2004

The upcoming STE Conference in San Diego, CA, 20-22 May 2004, will be sponsored by the Naval Air Systems Command. The Naval Reserve Association is a co-sponsor on this conference. ***For more details about this conference, please visit: <www.navair.navy.mil/ste/>.***