

BEACON INVESTMENT MANAGEMENT

THE FRIDAY BRIEF

Distributed to our clients and friends weekly

<http://www.beaconinvest.com>

Toll Free 888-621-5885

Friday April 10, 2009

The Fourth Dimension

In the process of investing we spend a great deal of time in linear thinking. We measure, we weigh, we time, and we project. We draw lots of lines as we make our assertions and projections. The regulatory agencies require us to disclaim that past results do not guarantee future results, but we all, to various degrees, subscribe to that very notion. The multi-billion dollar marketing machine we'll simply call Wall Street spends millions of dollars a day drawing lines which analyze, dissect, compare, measure, and highlight past results. There is an implication that the more colorful and complicated these reports are the better equipped we are to decide their appropriateness for the future.

Wall Street spends billions of dollars trying to bring linearity to vast amounts of historical data. It is a tempting idea indeed that the right algorithms are out there waiting to be discovered which can bring order to seemingly random data; finding a line which perfectly explains and fits the chaotic rhythms of past events. Once explained that line could be extended into the abyss we call the future to predict events and highlight opportunities with near certainty.

Now let's move to the second dimension – width. In the investment framework, risk is the second dimension. Risk adds width or wiggle to our investment performance line. Risk is the degree of movement above or below our projected investment line. Wouldn't it be wonderful to find an investment that provides an attractive return without the unseemly wiggles of risk? Such promises abound, yet the wiggles invariably destroy our elegant straight projected investment line, as well as our investment course for that matter.

The wider the wiggles deviate from our original straight line, the more we tend to behave irrationally, which brings us to the third dimension – that of heights and depths. In the 3D world of investing we must be on guard against our emotions. When we find ourselves far below our line we can give over to fear and paralysis; too stuck to take advantage of extraordinary values. When we find ourselves high above our original course we may become mesmerized by an exuberance of greed, believing the 'new paradigm' has re-drawn original course much more steeply and ever upward.

Now let's continue our journey into the fourth dimension – that of time. Time has much to do with our investments. The miracle of compounding is most affected by it. Performance is reported over many slices of it; whether days, months, quarters, or years. We assume that the longer the track record is for any investment or advisor the more confidence we can have adding it to our portfolio.

In fact, track record benchmarking is the approach that most people, institutions, and their advisors use to build their portfolios. Some take it a step further and analyze the risk of the investment (the width of its wiggles) to determine its appropriateness for their risk tolerance. Once they have thoroughly analyzed the past for each option and made their

choices they commit the investments to their portfolios and hope their richly reported and analyzed track records will continue to deliver as they have in the past.

But time plays an even greater role in the investment process, yet this aspect is largely ignored by investors and their advisors. While the world measures time as a commodity; uniformly and indifferently, to us as individuals time represents the sum of our lives; our past and our future hopes and dreams. We hope that our portfolios will successfully meet the funding requirements of major milestone events and periods in our lives. Yet we manage them with a commodity approach. We chase the best returns and accept the same risk as everyone else. We know the market is risky and that there will be times it declines, but we largely trust to luck that it will not be down when we need to draw from our investments. In essence our plans do not address the risk we intuitively know is there, we simply ignore it.

Your investment plan, whether written or rolling around *the* recesses of your mind like a pinball, consists primarily of events and periods you will need to fund with your portfolio. They will cost specific amounts of money and occur at specific times which can be planned. Your ability to fund them will depend upon the assets and income available at the time. Unfortunately as you project your plan you cannot know when stock market risk will rear its ugly head. Now this risk is not the commodity variety of risk the industry warns of, but moreover a very personal form of risk, the kind of risk that hits you, your plan at exactly the wrong time. All those colorful performance and risk reports mean little when you find yourselves amidst a major market decline at just the wrong time.

Risk, specifically stock market risk is a certain evil. It is the unwelcome, yet ever present companion of return. As we reach for greater returns we must almost certainly embrace a commensurate rise in risk. But we need not be held hostage to risk. There are ways to plan for it, to address it head on as part of a uniquely tailored investment plan.

To this end we construct an investment plan comprised of your unique priorities, goals, assets, and cash flows. We use a sophisticated software process known as Wealthcare® which employs Monte Carlo simulation. The analysis stress-tests your plan over thousands of 'virtual lifetimes,' and uses many more thousands of scenarios drawn from historical and statistically possible returns to determine the probability of your plan's success. Knowing your priorities, we test various scenarios to achieve a high likelihood that you will accomplish many, if not all of your goals with as little risk and financial sacrifice to current lifestyle as possible. We maximize what you want to accomplish while minimizing what you don't - risk, saving, or working longer.

We strive to balance your priorities in a way that achieves greater than a 75% chance of success and less than 90%. Quite simply we recognize that your current lifestyle should be considered in the planning process. Why invest more or take more risk than is required to meet your objectives? Are you investing to satisfy your unique investment requirements or those of your advisor and Wall Street? Without Wealthcare® how can you know for sure?