

## **10 Principles for Happier Investing**

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# **#1** Holding Gains is Easier than Recovering Losses!

- Higher portfolio returns require greater risks
- Manage portfolio risk first; investment return second
- Investment gains and losses multiply instead of add

Initial Year Gain/Loss	<b>Reauired for Recoverv</b>
100%	-50%
80%	-44%
60%	-38%
40%	-29%
20%	-17%
10%	-9%
5%	-5%
0%	0%
-5%	5%
-10%	11%
-20%	25%
-40%	67%
-60%	150%
-80%	400%
-100%	Infinite



# **#2** Higher Volatility Brings Lower Long-Term Returns!

- Start with \$10,000.
- Invest for 15 years.
- Choose the best performance.

	A	B	<u>C</u>	D
Starting Investment	\$10,000	\$10,000	\$10,000	\$10,000
Year 1	30%	20%	30%	8%
Year 2	-15%	20%	30%	8%
Year 3	30%	-20%	30%	8%
Year 4	-15%	20%	-50%	8%
Year 5	30%	20%	30%	8%
Year 6	-15%	-20%	30%	8%
Year 7	30%	20%	30%	8%
Year 8	-15%	20%	-50%	8%
Year 9	30%	-20%	30%	8%
Year 10	-15%	20%	30%	8%
Year 11	30%	20%	30%	8%
Year 12	-15%	-20%	-50%	8%
Year 13	30%	20%	30%	8%
Year 14	-15%	20%	30%	8%
Year 15	30%	-20%	30%	8%



# **#2** Higher Volatility Brings Lower Long-Term Returns!

- Slow, but steady wins!
- Highest average return does not always produce the best compounded return.

	A	B	<u>C</u>	D
Starting Investment	\$10,000	\$10,000	\$10,000	\$10,000
Year 1	30%	20%	30%	8%
Year 2	-15%	20%	30%	8%
Year 3	30%	-20%	30%	8%
Year 4	-15%	20%	-50%	8%
Year 5	30%	20%	30%	8%
Year 6	-15%	-20%	30%	8%
Year 7	30%	20%	30%	8%
Year 8	-15%	20%	-50%	8%
Year 9	30%	-20%	30%	8%
Year 10	-15%	20%	30%	8%
Year 11	30%	20%	30%	8%
Year 12	-15%	-20%	-50%	8%
Year 13	30%	20%	30%	8%
Year 14	-15%	20%	30%	8%
Year 15	30%	-20%	30%	8%
Average Return	9.0%	6.7%	14.0%	8.0%
Ending Value	\$26,150	\$20,289	\$29,123	\$31,722
<b>Compounded Return</b>	6.6%	4.8%	7.4%	8.0%

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## **#3** Balance to Reduce Volatility & Deliver Consistent Performance!

- Long-term returns of investment securities are remarkably consistent over most time periods.
  - Stocks returned +11.6% per year, 1946-2001<sup>1</sup>
  - ▶ LT Govt. Bonds returned +5.5% per year, 1946-2001<sup>1</sup>
  - Gold returned +3.9% per year, 1946-2001<sup>1</sup>
- Bonds reduce volatility and help stabilize the portfolio.

U.S. Stocks (S&P 500 Index <sup>2</sup> )	U.S. Bonds (Lehman Index <sup>3</sup> )	Standard Deviation	Annual Return (1977-2001)
100%	0%	15.15%	13.74%
70%	30%	11.30%	12.57%
50%	50%	9.01%	11.67%
30%	70%	7.19%	10.69%
0%	100%	6.26%	9.05%

<sup>1</sup> Jeremy J. Siegel – University of Pennsylvania

<sup>2</sup> An unmanaged index of common stocks frequently used as a general measure of stock market performance. The index assumes reinvestment of distributions and does not account for fees or taxes.

<sup>3</sup> An unmanaged index of U.S. fixed income securities.

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#### **#4** Defending Downside is More Valuable than Risking for Upside!

- Gain consequences:
  - Feel good
  - Occasionally spend a little more
  - > Minimal impact on lifestyle!
- Loss consequences:
  - Reduce spending
  - Increase saving
  - > Significant changes in lifestyle!



## **#5** Invest, Don't Speculate!

	INVESTING	SPECULATING
OBJECTIVE	Achieve financial goals within acceptable risk parameters.	Entertainment and profit.
PROCESS	Research and analysis – economy, industry, and company.	"Lucky numbers", random selection, or horoscopes.
SUCCESS FACTORS	Experience, knowledge, discipline, and hard work.	Gamesmanship.
RESULTS	Partly predictable.	Unpredictable.



## **#6** Exploit Market Inefficiencies!

- Market overreactions create opportunities
  - Excessive upside moves can be sold
  - Excessive downside moves can be bought
- Constant vigilance and fast action are required
  - News and announcements
  - Rumors



## **#7** It's Time, Not Timing that Produces Winners!

#### WORST-DAY INVESTMENTS (market highs)

Date of Market High*	Investment	Value on 12/31^	
12/2/86 8/25/87 10/21/88 10/9/89 7/16/90 12/31/91 6/1/92 12/29/93 1/31/94 12/13/95 12/27/96 8/6/97 11/23/98 12/31/99 1/14/00	\$10,000 10,000 10,000 10,000 10,000 10,000 10,000 10,000 10,000 10,000 10,000 10,000 10,000 10,000	<ul> <li>9,615</li> <li>17,567</li> <li>30,346</li> <li>49,834</li> <li>57,405</li> <li>84,819</li> <li>101,950</li> <li>122,158</li> <li>133,633</li> <li>193,636</li> <li>247,817</li> <li>340,568</li> <li>448,079</li> <li>552,238</li> <li>511,050</li> </ul>	
Annual Return = +15.9%			

\* Based on Dow Jones Industrial Avg. ^ Assumes S&P 500 Composite

#### BEST-DAY INVESTMENTS (market lows)

Date of		Value		
Market Low*	Investment	on 12/31^		
1/22/86	\$10,000	\$ 12,316		
10/19/87	10,000	24,041		
1/20/88	10,000	39,872		
1/3/89	10,000	65,741		
10/11/90	10,000	74,976		
1/9/91	10,000	111,537		
10/9/92	10,000	130,919		
1/20/93	10,000	155,118		
4/4/94	10,000	167,920		
1/30/95	10,000	244,271		
1/10/96	10,000	312,857		
4/11/97	10,000	430,411		
8/31/98	10,000	566,103		
1/22/99	10,000	697,205		
3/7/00	10,000	643,549		
Annual return = +18.7%				

\* Based on Dow Jones Industrial Avg. ^ Assumes S&P 500 Composite

"Nobody buys at the low and sells at the high except liars." Bernard Baruch

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### **#8** Gains are Possible; Expenses & Taxes are Certain!

- Mutual Fund Sales Charges up to 5.75%
- Transaction Costs (mutual funds average 1.0% per year)
  - Commissions
  - Bid/ask spread
  - Market impact

Management Fees (mutual funds average 1.4% per year)

#### Taxes

- > Ordinary income interest and dividends
- Capital gains and losses timing is everything!
- Mutual funds pass through gains, but not losses



### **#9** Execution Matters!

- Monitoring and analysis of order books
  - Size
  - Patterns
- 25 to 50 cents per share savings can typically be achieved on each trade
  - Execution savings on 100 shares of a \$100 stock = up to \$50 per trade or 0.5% of trade value
  - Execution savings on 1000 shares of a \$10 stock = up to \$500 per trade or 5% of trade value
- Human judgment and experience are essential



### **#10** Buy Low, Sell High!

- Maintain your allocation discipline rebalance
- Sell appreciated asset classes, buy depreciated asset classes
- Rebalance with tax efficiency



## Summary

- 1. Holding Gains is Easier than Recovering Losses!
- 2. Higher Volatility Brings Lower Long-Term Returns!
- 3. Balance to Reduce Volatility & Deliver Consistent Performance!
- 4. Defending Downside is More Valuable than Risking for Upside!
- 5. Invest, Don't Speculate!
- 6. The Stock Market is Far from Efficient!
- 7. It's Time, Not Timing that Produces Winners!
- 8. Control Expenses & Taxes, Position for Gains!
- 9. Execution Matters!
- 10. Buy Low, Sell High!



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