ב"ה

ISRENET
ISRAEL RESOURCE NETWORK

Representing
The Financial Resource Network, Ltd.
in Israel

www.FinancialResource.Net, www.FRNIsrael.com
Box 31066, Jerusalem Israel
Phone: +972 2 622 3065
Fax: +972 2 624 5850
Info@IsReNet.com

Guerilla Investing:

Dealing with (investment) Losers

by F. Mark van Gelderen

Some Investors and even Portfolio Managers seem to love losers more than winners.

I regularly meet with Family Offices and individual investors who are seeking help but not willing to implement a change. They are frozen in place.

The problem often follows the same pattern. The portfolio's managers believe in Buy & Hold, Asset Allocation or similar theories that have left them with long-term underperforming elements as a result the last dozen year's rocky markets.

We suggest different strategies that have proven to do better, and were less volatile over the same time period. The response comes back, something like this:

"It makes sense and I really want to do it, but I need to wait until my current investments recover their losses before I can consider doing something new."

Such managers appear to be more in love with losers than with rational thinking. Somehow admitting to a loss is more painful or embarrassing than achieving results. Can one turn lemon investments into Lemonade?

Here are 8 concepts to be considered by anyone remotely close to this kind of situation and thinking. These suggestions are also a summary of basic investment principles.

1) Periodically analyze investments and move up-market.

The easiest example of this is looking at mutual funds. See how well Lipper, Morningstar or other recognized analytical agencies rate your funds. Then look at the top rated fund in each category and switch to the winner. Obviously the long-term winner is much more likely to recover that lost fortune faster, than sticking with a second rate manager.

With shares, it is relatively easy to find other companies in the same industry who are more successful and have a better chance of recovery than staying with a share that has underperformed for years. If you are using private asset managers, compare their returns with those that Morningstar and others publish for public funds. Make Upgrading part of your review process.

2) Convert to ETFs.

An even better idea for funds, stocks, bonds or private asset managers may be to find the leading Exchange Traded Fund that covers that industry or market sector, and switch to it instead of staying with your losers. This is much more of an almost no-brainer than most people realize.

The research shows, that few of today's individual fund managers should continue in business, as they rarely outperform their comparative benchmarks, the broad market or the indices of the individual sectors. Most ETFs give an almost exact return to their comparative benchmark index. Be an early adopter of this recent investment innovation. The next generation will almost certainly use ETFs predominantly, instead of today's fund based culture

3) Managers of Managers.

When we are sick we go to a doctor, who as often as not then sends us on to a specialist. When we need taxes done we get a proven accountant. Legal problems obviously need to be dealt by a lawyer. When we have investment questions we too often think we can figure it out ourselves or go to a stock broker or investment salesman. That makes little sense.

Unless you are a large enough organization capable of employing at least several top flight full-time analysts and associated staff, wouldn't it be best to go to someone with a proven public track record of both choosing great investments and in managing a portfolio along the lines you need?

We believe that the best choice for the core of most clients' portfolios, whether individuals, mid-size Family Offices or Pension Funds, are investments that are Funds of Funds. In effect you are paying for an expert to choose what to buy. This expert organization is good enough that it has a long-standing public fund that reflects its long-term track record, which is as good or better than buying most of the established traditional funds in the same market sector (as defined by the analytical firms). The proof of this strategy was shown in the recent market collapse. Managers of Managers generally did much better than most single manager funds, and recovered faster. An example of this for even small American equity investors is the RiverNorth Core Opportunity Fund, RNCOX; for British and Offshore investors there is the Miton Special Situations Fund. For Hedge Fund Investors, there are specialty houses with impressive records such as Aurum, Ashton, Gems, GAM and Stenham doing offshore based Funds of Hedge Funds. All these public managers do Managed Accounts for their larger clients.

Academic research shows that public fund managers generally do much better than private Asset Managers, Stock Brokers, or any other investment advisor category. In other words, for most, using anything other than the publicly proven best fund managers may mean you are either not concerned about reliable investment success or are under the influence of fast talkers. It is logical, most great managers will lead public funds, as that is where they can make the most money and get the most public recognition.

Use either a top manager or an ETF. The disadvantage of an ETF is that there is no one there to make alternative decisions when that sector, or the whole world, is out of favour or heading down. A Manager of Managers, or an ETF Portfolio Advisor, can decide, what to do for you and everyone else using him, with the flick of a single button or two. He may decide to sit in cash to weather the storm. Individual fund managers usually cannot sit in cash because of the restrictions put on them by their publicly stated objectives.

4) Use the losses as a tax benefit, and as a wake up call.

By moaning over one's losses instead of ending ownership, the manager may be losing the potential tax benefit. Losses provide a tax offset against profits. By doing nothing, one loses tax-planning opportunities.

Not analyzing why things went wrong is an indication that nobody is willing to determine whether the thinking and portfolio is up to date; meeting financial needs, estate planning, etc.

5) Diversification.

Loser portfolios may be examples of poorly diversified investment programs. Diversification is possibly the only real investment insurance that exists. Evaluate risk before becoming enamored with returns. Even the most conservative investments have a significant failure rate.

Consider all of the following as basics to a truly diversified program. Asset Classes, Currency risk, Country/Economic risks, Inflation, Tax Efficiency, Correlations between investments, and a significant list of other considerations, depending on the situation.

6) Dollar/Euro/Sterling Cost Averaging.

Timing is always an issue. The time is almost never exactly right to make major economic moves. According to all reports I have seen, no one can reliably predict the future! We never know whether we are reliably at a market high, or a low point.

It is statistically better not to throw the entire allocation into a new a position all at once. Splitting up money over time, even when diversifying among different types of assets, is the best way to invest. One of the most upsetting experiences is to unknowingly invest everything at the top of a market cycle (July 2008) and immediately experience a whopping loss. If there is enough money, always at least split it into 4 parts and invest each over intervals of at least 60 days.

7) <u>Dealing with counterparty risk</u>.

Look at this as the 'Madoff' issue. Those who lost their fortunes in scams probably not only did not deal with the previous points properly, but did not check out whether they had proper counterparties. Madoff, the investment manager, was his own broker, did not have an independent custodian for handling funds, and was not set up independently from his fund (the Fund was not separately incorporated and regulated). Plus, his operation did not have a proper auditor giving independent reports to the investors.

Even well recognized staid Banks and investment houses, like Barings and Lehman Brothers, periodically fail. Counterparty Risk falls into a unique category, especially within the realm of Diversification. Your Financial Advisors or qualified staff need to not only do proper initial Due Diligence, but also need to keep ears to the ground and noses in the air, to stay alert for any whiff of problems that might sink your assets due to problems associated with the administrators.

8) <u>Cutting Bait = Liberation</u>.

Having worked with numerous clients, this is the most surprising one of all. You might call this 'the morning after the hangover'. Once an investor has finally decided to cash in or replace their loser investments and are doing something more useful with their money, they feel liberated from their previous burden. It no longer is depressing, a burden and a distraction from the more important things in life. The investor was able to make a reasonably informed decision, feel again in control, and hopefully move on to bigger and better things.

One thing that is generally correct, and is the point of this article -- **Doing nothing is usually worse than doing something that is thoughtful**. No need to put one's head in the sand, there are many decent alternatives.

Yes, as the above list also shows, there are many potential areas where our financial objectives can go awry. Yet these guidelines are not rocket science, they are prudence and not difficult to follow, especially with the help of a decent Financial Advisor. There is no reason that any investor should be able to justify his situation as being the 'Biggest Loser'.

Mark van Gelderen is the manager of the Jerusalem office of the Financial Resource Network, that has been helping clients make financial decisions since 1992. Contact Mark to learn more, or to have a no-obligation initial consultation.
Mark@FinancialResource.Net

FiRN
Financial Resource Network Ltd.

F. Mark van Gelderen

Box 31066
Jerusalem 91008, Israel
Tel: 972-2-622-3065
Fax: 972-2-624-5850
mark@financialresource.net