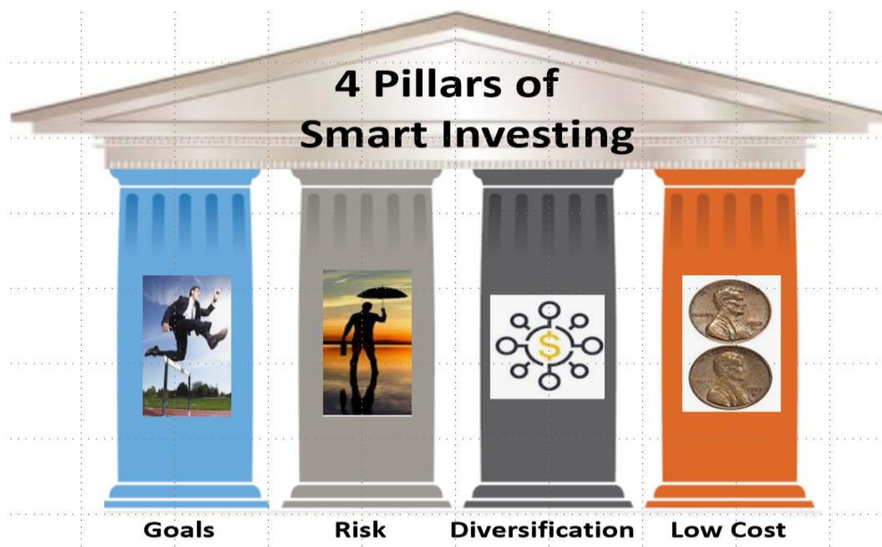
Four Pillars of Smart Investing
Game-changing Tools That Prevent Stupid Mistakes.

- It was easy to be "smart" in the past decade. It will be easy to be "stupid" in this current decade. Smart investors make smart asset allocation decisions.
- 78 million Baby Boomers need to get smart right away, before it's too late. Many are currently stupid investors.
- If you use an advisor, it's smart to trust but verify. 60/40 is stupid.

Stupid is as stupid does. Forrest Gump
Everyone is stupid. Only on different subjects. Will Rogers



The critical step in smart investing is realizing what matters most. By focusing on this most important aspect, smart investors spend their time, energy and money wisely, and avoid distractions that take their eyes off the prize of reaching goals. Saving "enough" is the most important action an investor can take. The second most important action is investing it wisely, but this is a distant second. "Save and protect" is a smart mantra.

If you've saved enough, it may be best to simply be safe, and protect it. Importantly, there comes a time in most lives when whatever you've saved must be "enough" because it's all you'll ever have. For those who don't have a defined benefit pension, that time is when you leave the workforce and begin retirement.

Saving enough is not an investment decision; it's a behavioral goal. In the following we provide guidance on wisely investing whatever you have saved, with the perspective that it will have to be "enough" by necessity when you enter retirement.

Asset allocation is the most important investment decision. It [explains 100% of investment performance] -- yes, all of it. Getting asset allocation "right" is the smartest investment thing you can do. It's much more important than security selection. Stock picking might be [more fun], but picking the very best securities doesn't matter nearly as much as your asset allocation. We discuss smart asset allocation in this article.

The following periodic chart demonstrates the importance of asset allocation. In 2018 everything lost and in 2019 everything won. The average spread between the best and worst performing asset classes is 32% each year. Importantly for investor memory and behavior, everything except commodities won over the past decade.

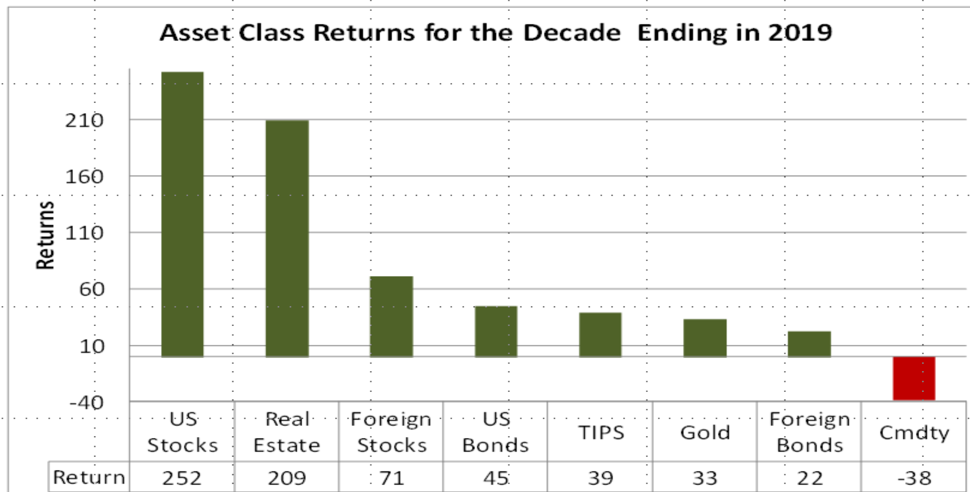
2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	10 Years
REITs 28.4%	TIPS 13.3%	EM 19.1%	Small Cap 41.0%	REITs 30.4%	REITs 2.4%	Small Cap 26.6%	EM 37.3%	Cash 1.7%	Large Cap 31.2%	Large Cap 13.4%
Small Cap 27.2%	REITs 8.6%	Int'l Stocks 18.8%	Mid Cap 35.2%	Large Cap 13.5%	Large Cap 1.3%	Mid Cap 20.5%	Int'l Stocks 25.1%	Bonds 0.1%	REITs 28.9%	Small Cap 13.3%
Mid Cap 26.3%	Bonds 7.7%	REITs 17.6%	Large Cap 32.3%	Mid Cap 9.4%	Bonds 0.5%	Comdty 12.9%	Large Cap 21.7%	TIPS -1.4%	Mid Cap 25.8%	Mid Cap 12.4%
EM 16.5%	Large Cap 1.9%	Large Cap 16.0%	Int'l Stocks 21.4%	Bonds 6.0%	Cash -0.1%	Large Cap 12.0%	Mid Cap 15.9%	Large Cap -4.6%	Small Cap 22.6%	REITs 12.0%
Comdty 16.2%	Small Cap 1.1%	Small Cap 15.7%	**EW 10.7%**	Small Cap 5.5%	Int'l Stocks -1.0%	EM 10.9%	Small Cap 13.1%	REITs -6.0%	Int'l Stocks 22.0%	**EW 6.4%**
Large Cap 15.1%	Cash 0.0%	Mid Cap 15.2%	REITs 2.3%	**EW 4.0%**	TIPS -1.8%	**EW 10.0%**	**EW 12.6%**	**EW -7.2%**	EM 18.2%	Int'l Stocks 5.4%
EW 15.0%	**EW -1.4%**	**EW 11.0%**	Cash -0.1%	TIPS 3.6%	Small Cap -1.8%	REITs 8.6%	REITs 4.9%	Small Cap -8.6%	**EW 17.5%**	Bonds 3.6%
Int'l Stocks 8.2%	Mid Cap -1.5%	TIPS 6.4%	Bonds -2.0%	Cash -0.1%	Mid Cap -2.5%	TIPS 4.7%	Bonds 3.6%	Mid Cap -11.3%	Bonds 8.5%	TIPS 3.2%
Bonds 6.4%	Int'l Stocks -12.3%	Bonds 3.8%	EM -3.7%	EM -3.9%	**EW -4.7%**	Bonds 2.4%	TIPS 2.9%	Comdty -13.1%	TIPS 8.4%	EM 2.9%
TIPS 6.1%	Comdty -14.0%	Cash 0.0%	TIPS -8.5%	Int'l Stocks -6.2%	EM -16.2%	Int'l Stocks 1.4%	Comdty 0.7%	Int'l Stocks -13.8%	Comdty 7.6%	Cash 0.4%
Cash 0.0%	EM -18.8%	Comdty -2.1%	Comdty -11.1%	Comdty -18.6%	Comdty -28.2%	Cash 0.1%	Cash 0.7%	EM -15.3%	Cash 2.0%	Comdty -6.0%

Funds: EEM, VNQ, MDY, SLY, SPY, EFA, TIP, AGG, DJP, BIL

(EW = an equal-weighted portfolio of every asset class listed here)

Focusing on the past decade in the next graph, asset allocation has been important, and it will likely be even more important in the next decade. Portfolios with high allocations to US stocks and real estate performed far better in the past decade than those that held

commodities. Since most US investors hold US stocks and real estate, they can view themselves as "smart" in the past decade, but the next decade is going to be much more challenging for reasons we discuss in this article. For some, the recent good times are all they have experienced, but it will not go on forever.



Fortunately there are tools for intelligent investing that develop smart asset allocation. The best tools are easy to use and, most importantly, manage risk in the Risk Zone that spans the 5 years before and after retirement when savings are at their peak, making losses most damaging. Investors can use these tools in their 401(k)s, their Individual Retirement Accounts (IRAs), and their personal accounts.

There are 78 million Baby Boomers in the Risk Zone who would be stupid to not use these game-changing tools. Most Boomers are making a stupid mistake by not protecting themselves in the Risk Zone. They are on average 60% in equities and 40% in long term bonds, an allocation that lost 30% in 2008.

As discussed in the next section, smart asset allocation is challenging, but can be accomplished with the right tools.

4 Pillars of Smart Investing

Asset allocation is the first pillar of smart investing. It's designed to achieve objectives with an acceptable likelihood. Allocations are adjusted in response to successes and

failures in this achievement. Plus goals change through time. This financial navigation is dynamic and challenging.

Asset allocation decisions are risk decisions. You need to take a certain amount of investment risk in order to earn the return you need to achieve your objectives. Dr. Frank Sortino, father of Post-modern Portfolio Theory (PMPT), calls this target return the Minimal Acceptable Return (MAR). This risk decision is called "risk preference" or "risk necessity." It should not be confused with market timing, another separate motivation for modifying risk. The risk preference pillar needs to be conditioned on three more pillars:

- Do you have the risk capacity for this level of risk?
- What is the smartest way to take this risk?
- How can you take this risk at the lowest cost?

There are circumstances when you simply should not take the risk it requires to achieve your objectives because you don't have the risk capacity. In particular, there's a time in everyone's life when risk capacity is very low because the stakes are as high as they will ever be. You cannot afford to lose your lifetime savings at this critical juncture in your life, warranting its title as the "Risk Zone" that spans the 5-10 years before and after retirement.

Losses in the Risk Zone can devastate retirement lifestyle and reduce the length of time that savings last, even if markets subsequently recover. Sequence of Return Risk is the source of this Risk of Ruin. Even the wealthy should protect themselves in the Risk Zone because they too have plans that can be ruined, and heirs who could inherit less. The rich can be devastated too; after all, they have a lot to lose. In the U.S. there are 78 million baby boomers in the Risk Zone, most of whom are taking way too much risk.

Smart asset allocation is tailored to achieve your goals, unless you cannot tolerate the required risk, especially in the Risk Zone. If you use an investment advisor, you are most likely invested in a model portfolio, but most models fail to recognize age and the Risk Zone, recklessly striving for an MAR regardless of risk capacity. Fortunately, there are better models. Recognizing your capacity is the second pillar.

As for the third pillar, the smartest way to take risk when you're young is to be as diversified as possible: global stocks and bonds, real estate, commodities, etc. Then as

you enter the Risk Zone, the smartest way to control risk is with safe assets, like Treasury Bills. Dr. William F. Sharpe won a Nobel Prize for his revolutionary discovery, called the Capital Market Line. The smartest way to control risk is not to add more bonds; it's to blend a broadly diversified world basket of risky assets with safe assets. Diversification and smart risk control provide the best returns for the risk taken over time.

And the fourth pillar -- being cost conscience -- is simply common sense. Costs reduce returns. Interestingly, the desire to diversify and to keep costs low has recently driven investors to passive index investing, especially in Exchange-Traded Funds (ETFs). Investors are "getting it."

The smartest asset allocation integrates risk willingness with risk capacity, primarily age. Ignoring risk capacity is stupid because it exposes investors to catastrophic risk at precisely the wrong time. Retirements are not ruined by investment losses. They're ruined by big investment losses at the wrong time, namely during the transition from working life to retirement. This is not market timing, although current economic conditions reinforce the need to defend now in the Risk Zone. We are likely to suffer a major market correction sometime in the next decade, and those in the Risk Zone will be impacted the most.

Beyond the Risk Zone, retirees are best served by re-risking in order to extend the life of investments. This is contrary to the old rule of thumb that advocates "100 minus your age" in equities. Groundbreaking research by Dr. Wade Pfau and Michael Kitces has revolutionized optimal investing in retirement.

The good news is that today there is financial engineering designed to not lose money and to provide the highest returns for the risk that is taken. Better investing through science.

Why the next decade will suffer a major market correction

We can expect certain things to happen in the next decade. FOMO (Fear Of Missing Out) has

been a primary driver of recent stock market gains, but that will eventually morph into FOBO (Fear Of Bad Outcomes). Baby Boomers born between 1946 and 1964 will be passing through the Risk Zone for the next 15 years, during which the odds are not good for dodging a market setback. The only question is how bad the next correction will be.

We've just completed one of the best decades in history , and are currently enjoying the longest stock market recovery. This has led to sky high prices, which means the US stock market is extraordinarily expensive. At the same time, the world is facing a debt crisis and socioeconomic pressures are threatening the world, especially with China, Iran and North Korea. It's a scary time.

According to Capital Market Consultants, Inc, the US economic outlook at the end of 2019 is precarious:

No one has an accurate crystal ball, but we do have a formula that always works for forecasting returns. It's currently forecasting a 46% loss if P/E ratios fall from their current lofty 30 down to their historical 15 level. The following table shows the ranges of possible returns in 2020. As you can see, P/E is the primary driver of returns; its primary determinant is human behavior. If P/Es remain at their current 30 level, the return in 2020 will be 8%, but that would require prices to remain extraordinarily high.

	Earnings Growth								
End P/E	-4	-2	0	2	4	6	8	14	24
10	-67	-66	-65	-65	-64	-63	-63	-61	-57
15	-51	-50	-49	-48	-47	-46	-45	-42	-37
20	-35	-33	-32	-31	-29	-28	-27	-23	-16
25	-19	-17	-15	-14	-12	-10	-9	-3	5
30	-3	-1	2	4	6	8	10	16	26
35	14	16	18	21	23	25	28	35	46

Exacerbating lofty stock market prices, per capita world debt has surged to over $200,000, due in large part to quantitative easing that has simply put off the inevitable global recession. The US is in even worse shape than you think. The world economy is running on the fumes of delusory borrowed money, playing an outlandish game that will not end well. We owe each other money that won't be paid in today's dollars. That's why crypto currencies were invented. Fiat money only works if we all agree to honor it; otherwise it's just pieces of paper. US currencies were debased in 1971, when they were taken off of the gold standard and replaced by "In God We Trust." Now debasing means printing money, or monetizing the debt. Lenders lose when borrowers control payment values.

The World Debt Crisis manifests itself in a variety of problematic ways, as shown in the following:

In his outlook for 2020 Lawrence Fuller, publisher of the ***Portfolio Architect***, says:

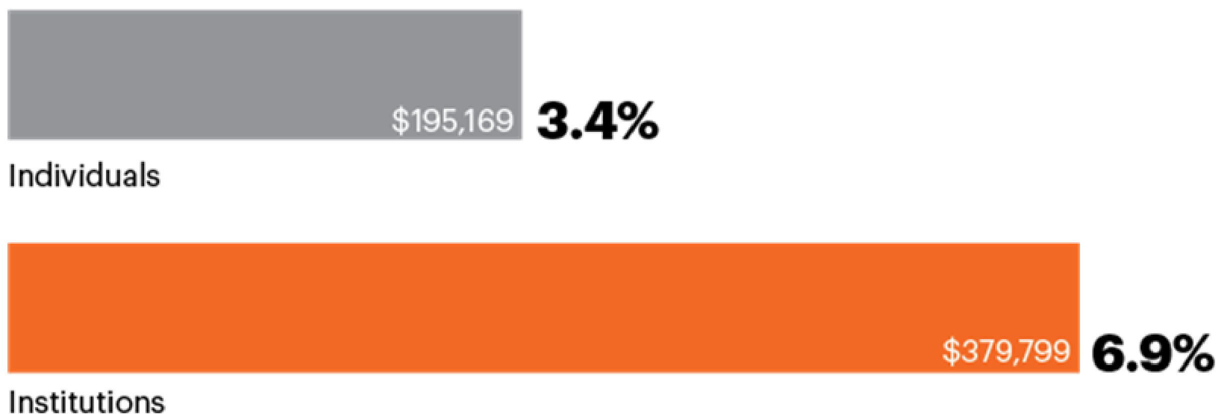
> *My greatest concern for the year ahead is that the Fed has fueled a surge in financial markets that is now so far divorced from economic fundamentals that an inevitable reversion to the mean will reverse this wealth effect. The subsequent collapse in confidence will come at a time when our debt-laden economy is barely growing. The Fed will have minimal firepower to address the next downturn with monetary stimulus. The federal government will be equally impotent considering it just implemented a massive tax cut and faces $1 trillion deficits.*

Similarly, industry expert Lance Roberts, Managing Partner of **RIA Pro**, warns:

> *With debt levels rising globally, economic growth on the long end of the cycle, earnings growth weak, valuations high, and potential risk of a recession, the uncertainty of retirement plans has risen markedly. This lends itself to the problem of individuals having to spend a bulk of their "retirement" continuing to work*
>
> *Yes, not only should you worry about bear markets, you should worry about them a lot.*

Smart institutional quality investing in the current decade

Individual investors can learn from institutions, with their substantial resources and research. According to FS Investments, institutional investors have performed far better than individuals in the past 2 decades:



Target date funds (TDFs), at $2 trillion and growing, are the biggest deal in institutional investing. Individuals can benefit by following the disciplines incorporated in TDFs. Smart investing begins with an assessment of your financial well-being, like taking this self-assessment quiz, with its guidelines on what to do next. From there, you can make your own investment decisions, or it might be best to hire an advisor. Either way, smart investors will use game-changing asset allocation tools that follow TDF glidepaths.

Investors can use free asset allocation models available on several websites, but you get what you pay for: these tools do not use TDF disciplines. There are better models that manage risk in the Risk Zone and follow the patented Safe Landing Glide Path that has been used successfully for more than a decade in the SMART Target Date Fund Index. Its primary objective is to not lose money, especially in the Risk Zone. Here's how SMART performed in the past 3 tests of its primary objective.

Calendar Year	Fund Year	SMART Return	TDF Industry Return
2008	2010	-4	-24
2011	2010	8	0
2018	2020	-1	-4

Importantly, SMART has won by not losing, earning returns comparable to the industry, but with less risk.

"Don't stop thinking about tomorrow" by Fleetwood Mac is a song we should all be singing at this precarious time. The tectonic plates of investing are shifting and we need to be prepared. One group in particular is in serious danger, namely baby boomers.

Conclusion

The smartest investors spend their time, energy and money on what matters most, namely asset allocation. Getting this critical decision right is not easy. Attempts to improve performance results beyond policy returns typically fail, undermining achievement of your goals. Stock selection and market timing are unproductive at best and typically counterproductive. You can win the performance game but fail to achieve your goals.

Smart asset allocation integrates risk willingness with risk capacity, and is broadly diversified and low cost. The good news is that there are tools to be smart, and they are

easy to use and inexpensive. These tools bring the wisdom and disciplines of target date funds (TDFs) to the masses. 401(k) plans have invested more than $2 trillion in TDFs, and growing. According to a recent study by the Wharton School "**the adoption of low-cost target-date funds may enhance retirement wealth by as much as 50% over a 30-year horizon.**"

Stupidity in the next decade could be very costly, especially to Baby Boomers who should not be gambling their lifetime savings. You may want to work with an investment advisor during this critical time in your life, but you should verify his/her competence by using these tools. Unfortunately the "60/40 stock/bond Rule" is alive and well, and stupid. Trust but verify.

More Information

To learn more, please visit the following:

- Video interview on Facebook or YouTube
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- Get help from an advisor
- Smart investing Infographic
- PPT Presentation
- Do-it-yourself Library
- Free eBook
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