

Section VII. Wealth Cycle Management
Chapter 17. Orchestrating Your Resources

*We cannot seek or attain health, wealth,
learning, justice, or kindness in general.
Action is always specific, concrete,
individualized, and unique.”*

-Benjamin Jowett

Key Points

- A wealth blueprint documents the plan
- Risk tolerances shape wealth strategies
- Ultimately cash flows must be matched

Chapter Overview

This orchestration chapter summarizes a planning and execution process by bringing together individual bias, economic resource, risk, and wealth flow issues discussed in the previous *Lifetime Wealth Flow Guide* chapters. The very knowledgeable reader may skip the past chapters and find a complete wealth flow process with documentations suggestions in this chapter. Yet facets of objectives, risks, strategies, and tactics will be missed. The 19th century Oxford Professor, Benjamin Jowett instructs us to consider our biases and objectives. Then specifically seek to attain cherished health, wealth, or other ideals. Plan and monitor.

An Investment Policy Statement (institutional IPS) or Investment Advisory Agreement (advisor IAA) is a planning document customized in the framework of previously analyzed factors. It is developed here as a personal wealth blueprint. A good process can withstand the changes of a very uncertain life.

A balanced process, which will be outlined, is needed to execute a plan for portfolio construction, strategies, and tactical adjustments. Prudence and perseverance are virtues that support development of a unique useful personal wealth flow process. Simple rules will be suggested to grow, accumulate, preserve, and distribute wealth throughout a life cycle. The long term process should be simple. Yet it takes more effort than most people are willing to make. It is not easy. Post investment transactions analysis is also needed to make adjustments. Knowing one's behaviors and developing improved capacities are more valuable than trying to find profitable strategies or copying tactics with unknown risks. Understanding a wealth flow process is valuable even if you employ financial or wealth advisers.

A Personal Economic Wealth Blueprint

A personal wealth proposal should address the following issues in a lifetime wealth perspective:

- Personal behavior biases and risk tolerance
- Expected objectives and related strategies
- Investment resource cash in and out flows

Personal behavior biases effect wealth flows

Either you or your wealth planner needs to understand your investment behavior biases in order to know and adjust for your risk tolerance. For many people childhood behavior reviews are a useful place to start. Both emotional and cognitive (rational) biases are evident in most people prior to high school and often don't change through life.

Savers manage to have something left over at the end of the week and are naturally more disciplined than those, who look to others for gifts or loans. Cultures (e.g. United States) often encourage overconsumption (discourage savings) by government loan guarantees, credit dependency programs, and lenient bankruptcy penalties. Even the natural saver behavior bias may be lost, when overwhelmed by the cognitive short cut behavior (follow the crowd – if they can have instant gratification, why can't I?). Non savers (over spenders) have a serious handicap. They fail to convert human capital and subsequent financial capital into savings wealth seed money. Succinctly, it takes saved money to make money.

The “follow the crowd” behavior bias may also be an emotional bias looking for acceptance. It is an immature behavior; but dependency on conformity with others (safety in numbers) is a common bias.

The most common emotional bias identified by economic behavioral psychologists is a tendency to avoid taking losses. This prospect or reference based tendency may be due to hoping to get even on a losing investment or an inability to admit an error. A related tendency is to avoid taking a sure loss, even if a scenario analysis indicates a higher probability to suffer a larger expected loss by holding a declining value asset.

For most people, holding falling priced assets postpones the analysis of a strategic or tactical error, reduces portfolio returns, and precludes the opportunity to move the proceeds from a losing to a profitable asset. Markets are impersonal. They don't care what price you paid for an asset.

Seeking balanced behaviors

Behavior biases often jump between emotional extremes. Fear and greed may jump between holding risk-free and risky assets. A consistent fearful low risk tolerance leads to a strict wealth preservation strategy. Behavior that vacillates between fear and greed is dangerous. It is highly stressful and unprofitable. The probabilities are high that declining undervalued assets will be sold for fear that they will fall further in price. Likewise overvalued assets will be held due to greed that momentum will lead a greater fool to pay a higher price for them.

Prudence is the antidote to thoughtfully dial in from the extremes. Undervalued assets in fearful directionless markets may be bought and overvalued assets in overextended markets may be sold incrementally after good cognitive analysis. There are no guarantees for developing a prudent balanced emotion process. It takes effort and perseverance to know how to find value that is likely to soon be recognized by the market. Yet, balance allows the high risk tolerant investor to take calculated risks and grow wealth.

Cognitive biases are generally short cut behaviors that fail to recognize personal physical limitations or oversimplify critical factors that influence asset pricing. Sometimes senses offer faulty data. Other times, representativeness causes us to attribute the wrong causal factor for an asset's valuation. A few successes attributed to a wrong primary factor can lead to misplaced overconfidence. Unrecognized good luck also adds noise and leads to overconfidence.

Leading and Lagging Behaviors and Tactics

Asset markets reflect behavior biases that should be thought about. Market participants tend to correctly observe short or intermediate term price momentum, which leads asset fundamental valuations. The best speculators use tactics to earn higher profits than asset buy and hold strategies by riding momentum trends. Commodity prices may quickly reflect weather related supply factors in the face of inelastic demand. The challenge is to correctly guess when the trend changes and cash out after prices over shoot operational values. The duration of asset over/under valuation swings are very difficult for the best speculators to estimate. Small growth stocks can also present momentum opportunities that skillful portfolio manager tactics can exploit by leading or buying ahead of a change in a fundamental valuation.

At the other end of the behavior spectrum is the slowly rising cautious market advance that lags a fundamental value price. A so called "Wall of Worry" causes market prices to lag fundamental values. Volatility may drop to low levels as prices rise in small steps. The key is to watch for daily or weekly distribution of market price and volume characteristics. A flow of funds analysis may indicate that most of the cautious buyers have made purchases and the market price has approximately reached the fundamental price.

In the short or intermediate term, a speculator may profitably lead a volatile market for a while, but ultimately give back profits as market prices return to fundamentals. An investor may also hold small asset profits in a slow moving lagging market, but ultimately gain normal profits as the market price catches up to fundamentals. Aggressive or cautious tactics can be profitable under different conditions. Promoters of both tactical growth and value tactics can find support for their biases through back testing past data.

What is your risk tolerance?

An individual must find and analyze his/her own behavior biases. (Chapter 4) Then a compatible risk tolerance can be identified. Generally, a high risk tolerance indicates the capability to aggressively own volatile equity assets and sell them at either limited (stop) loss points or full value gains. A moderate risk tolerance shows the ability to own modestly volatile dividend paying equity assets. A low risk tolerance suggests a preference for investment quality debt (bond) assets that have a sizeable probability to provide modest positive returns if held more than a year.

A wealth blueprint should state the basis for a risk tolerance that truly reflects personal emotional and cognitive behavior biases. High risk behaviors imply that a household needs low risk strategies to achieve long term objectives.

The biases "I hate to lose and will hold a loser until I break even (prospect)" and "I am going to make profits like the big guys (greed)" are high risk behaviors. High risk, high expected return assets suffer losses and at times go bankrupt (worthless). Big guy profits are publicized, but losses also occur. A passive investor must define small wealth accumulation objectives, if he/she plans to hold losing assets until they break even. Either personal risky biases must be reduced or a trusted advisor must be employed to invest and accumulate wealth at well matched strategies.

Two highest impact negative personal emotional and cognitive behaviors are suggested to be stated in a wealth blueprint. Noting extreme related emotions such as greed and fear or overconfident trend following and apathetic retreating after losses are vital insights. They can be controlled with cognitive efforts and acquired habits to limit the bias swings. Briefly listing controlling actions (mechanical stop loss criteria and holding assets with historic low risks) as well as high impact biases are suggested as part of the process. Personal risk tolerances should be stated and a path to grow higher risk tolerance habits may be included in the wealth blueprint.

Goals and objectives

State quantified objectives (Chapter 5) in your personal wealth blueprint. The general long term objectives for distributing accumulated wealth are simple. Post working career household (retirement) spending and gifting (family inter-generational legacies or specified causes) are primary wealth uses. Goals should translate into quantified objectives, which can be monitored and measured periodically (annually or quarterly) to see if they are being met.

A measurable objective should be absolutely stated. Yet, analysis reviews should note relative conditions in periodic performance appraisal reviews, which are filed with the wealth blueprint. An aggressive household in their mid 30's may set an objective of doubling investment wealth every 9 years. Using the rule of 72 (rate of return X years of compounding) an 8% annual return is implied. The household may assume a long term 20th century annual 3½% inflation rate. Thus, an annual 4½% real portfolio return is expected and predominantly equity assets are required. The objective translates into a wealth accumulation strategy.

Alternatively, during retirement a low risk tolerant household may select a wealth preservation strategy. It may focus on matching near term (e.g. 5 year) cash flow spending plans with low risk investment cash flows. Those are annuities, social security payments, certificates of deposits that mature during specified quarters and low volatility bond like assets with 5 years or less to maturity.

Strategies to meet personal objectives

The process of defining strategies follows an analysis of personal risk tolerance and objectives. A critical factor (Chapter 6) is time

horizon. Both the wealth accumulation (earnings/saving) period and the distribution period (retirement life expectancy) are prime considerations in setting up strategies. A common rule is that long time horizon objectives can rationally accept higher risk investment portfolio strategies. A corollary is that younger households have more human capital (potential earnings/savings) to make direct financial wealth additions and smooth out (reduce risk) the total financial wealth annual growth consistency.

Strategies should be carefully matched to risk tolerances and objectives. A long time horizon household may rationally accept a heavily weighted equity assets portfolio. However, if its risk tolerance is low, then the household is likely to abandon the strategy, when a normal recession occurs and most asset class prices decline about 25%. A scenario with potentially high stress and finally "throwing in the towel" near low points in equity market prices implies a poorly conceived approach. Alternatively, a household may spend well within its means and save a significant portion of upper income earnings. A relatively low risk annuity or bond weighted portfolio strategy may achieve their retirement spending and gifting objectives. The volatility of their returns can be expected to be much lower than a heavily equity weighted portfolio. Reduced portfolio volatility and presumably lower stress, while achieving modest material wealth flows, may be a good personal strategy decision.

A few Greek symbols worth thinking about

A personal wealth blueprint should be aware of the quantitative elements of investment portfolio risk. Those are the historic asset volatility (σ) and the correlation (ρ) of asset price movements. σ reflects the historic movement of asset prices about their averages and is the more important concept for most households. If low σ assets are held, then most people need not be concerned if their ρ 's all move the same in response to an economic surprise. They usually feel that their short term bonds and CD's are little affected and that intermediate term bonds will be held to maturity, so that the principle will be paid in full.

ρ is a more complex variable, because most equity assets and some high credit risk bond assets tend to move together during macro-economic stress (recession). In other words, the investment portfolio asset to asset ρ 's may be acceptably low during most scenarios and

smooth out the portfolio σ . Yet they rise during economic stress and most portfolio asset prices generally fall together. A carefully constructed portfolio should be designed to avoid that. The simplest way to reduce portfolio asset correlations (ρ 's) is to sell a portion of volatile (σ) assets and remain partly in cash during the uncertain periods of economic stress.

Performance benchmarks provide perspective

A vibrant economy has good investment return and poor return years. A mature perspective is to avoid greedy behavior biases; that is looking to compound a recent good 15% return year with subsequent similar returns. A benchmark provides a good reference to notice how much better or worse than expected was a recent portfolio performance review. A wealth blueprint should include asset benchmarks, such as index mutual funds or exchange traded funds (ETFs) that are used for measuring performance against a buy & hold core index funds strategy. For instance, a 10% recent annual return may exceed a long term expected 8% return, but lag behind a portfolio benchmark 14% recent return. Lagging a benchmark by a few % in a given year may be acceptable, but it indicates volatility and long term risk. Table 1 shows benchmarks for an example securities portfolio in a TBD year with related similar asset weights. (Note real estate is not included in the example portfolio. Home equity adds to the total household portfolio.)

Table 1. Example: Portfolio Benchmarks

Asset Class	Security	Weight (%)	Return (%)
S&P 500 large stocks	VFIX	20	A
Russell 2000 small stocks	RUT	10	B
Foreign Developed stocks	EFA	20	C
Foreign Emerging stocks	EEM	10	D
US Invest Grade 5 year bonds	VFICX	20	E
US GNMA short term bonds	VFIJX	20	F

An annual performance review should measure portfolio returns versus benchmarks, where a personal portfolio holds similar asset class weights. A 100% core portfolio strategy discussed in previous chapters would include all index funds and show less than 1.0% annual return difference from the benchmark due to small tracking errors, expense costs, and taxes on

distributions in taxable accounts. An annuity may be considered a bond like low risk investment grade security that provides annual cash flow returns as a percentage of contract face value. If satellite strategy (Chapter 15, 16) actively managed funds or individual securities (stocks, bonds, commodities, and alternative assets) are held, their relative benchmarks are asset class index mutual funds or ETFs similar to Table 1. The variation from benchmarks will normally be greatest for satellite actively managed assets by a fund manager or yourself. An investor or adviser must take into account how much an asset varies from annual benchmarks and what is an appropriate response.

Following the cash flow

A final factor to consider in a wealth blueprint is cash flow. Both net cash flows into the investment account during the wealth accumulation period and net cash outflows from the wealth account during the distribution period are important. The cash inflow during the accumulation period is primarily from savings; but also from retained investment distributions. Savings is simply converted human capital into income that is not spent on consumption. Those, who spend modestly and save significantly are flexible and have a large advantage toward using low risk strategies to achieve retirement spending and gifting objectives. Also think about the change from working life spending to retirement spending. A household that spent \$80,000 annually while working will be much more comfortable cutting retirement spending by 12½% to \$70,000 than a household that spent \$160,000 annually and must cut retirement spending 56¼% to \$70,000. Steady cash savings inflows for young households are excellent buffers to equity market volatility. For example, a young couple may be saving through a 401K plan at an annual rate of \$20,000, mostly invested in equities, and have a beginning year balance of \$50,000. A declining equities market may result in a beginning year account value fall to a year end value of \$40,000. Yet, their added \$20,000 savings results in a net account increase of \$10,000 to \$60,000. There is a good probability that the following year will earn greater than normal returns and their total account value will rise sizably. Consistent savings and investing during up and down markets in the wealth accumulation period is dollar cost averaging. As the household grows older, they can also control the volatility of account by holding a greater portion of dividend

paying equities and interest paying bonds. Steady cash inflows smooth out total investment account value changes. The wealth blueprint during the accumulation period should list planned savings and investment account contributions. Understanding the total investment portfolio structure reduces potential stress during market meltdowns.

The wealth distribution phase is more complex due to simultaneous cash inflows and outflows. During the post-working career retirement period it is suggested that the wealth blueprint be focused on matching low risk cash inflows to cash outflows. That is acting like a pension fund, which does asset/liability cash flow matching (ALM) during multiple time periods. Multiple objectives, such as retirement spending and gifting should be given priorities. If retirement spending is the higher priority, it should be based on the lowest risk assets to make sure spending resources are available. Time horizons are critical, when there is no working income to buffer investment account declines. At age 65, a household with a 30 year time horizon may have more flexibility to grow cash flows needed for the last planned 10 years of spending than the first 10 years of retirement spending. It is suggested that the first 5 years of planned retirement spending cash inflows be fully matched with low risk asset cash outflows, such as Social Security payments, annuity payments, certificates of deposits maturing quarterly as needed, and high quality bond interest or blue chip stock dividends. If gifts are the secondary objective, then they can be reduced in amount to make up for a short fall of retirement spending cash inflows. As households grow older it is suggested to increase the number of matched cash flow years. Therefore, at age 80, or the last 15 years of expected life all expected retirement spending and other gifting cash inflows should be matched. During the last years of life, the goal should be reduce financial stress to near zero!

The wealth cash flow blueprint is suggested to be simple with a focus on steady savings cash inflows and appropriate investing during the accumulation phase. The wealth cash flow blueprint should focus on cash in/out flow matching and reducing risk with time during the distribution phase. That is multifaceted and encourages the concept of seeking more pension and annuity low risk cash flows during retirement.

Wealth Blueprint Construction Document

Name

Total Financial Assets (\$)

Estimated Human Capital (\$) (potential income for savings)

Estimated Total Annual Savings Amount (\$)

Time Horizons (years of wealth accumulation and years of wealth distribution)

Personal behavior biases analysis

Communication with own self or with a trusted confidant (advisor) aids understanding behavior biases. More specifically consider the following emotional and cognitive bias questions to know and clearly state your wealth risk tolerance.

The following five emotional influence factors provide risk taking clues.

1. Reasons to end a losing transaction and percent loss? prospect
2. View of individual assets objectives vs. total portfolio assets joint objectives? partitioning
3. When lose sleep regarding wealth (overwhelming stress)? fear boundary
4. What scenario causes extreme confidence? greed boundary
5. Reaction to taking a loss? (apathy/determination to recover) perseverance

Smaller loss limits, more partitioning, limited fear and greed ranges, and less determination to learn from losses imply a low risk tolerance.

The following three cognitive influence factors offer rational risk taking clues.

1. How representative is a single investment factor to profitable investors or investments?
2. Primary source of valuable asset information?
3. Time spent to understand/decide on an investment transaction (buy/sell)?

Less than 3 representative factors, primary investment source information from non regulated marketing parties, and less than 3 hours spent on qualitative/quantitative valuations imply an oversimplified rational short cut process. That implies a low risk tolerance.

There is good news. If you understand your behavior biases, then you can build a cognitive improvement process or find trusted help. Consider cognitive questions 2 and 3. Regulated cumbersome qualitative and quantitative financial reports provide generally accurate financial, operational, and strategic information. Added time spent fine tuning good habits overcomes emotional and cognitive negative biases and tilts probabilities positive. Better behaviors support potentially more profitable risk taking. Yet, the simple concepts require extra effort.

How do you view market?

- Looking for price/profit patterns and trying to buy ahead of others? (momentum growth)
- Waiting for positive operating fundamentals prior to buying assets? (under priced value)

Your view of participation in market asset ownership gives an idea of required risk tolerance. A momentum focused speculator must have a high risk tolerance and many disciplined tactics to be profitable. An operating values centered investor will likely want periodic distributions (dividends, interest) and employ a strategy for buying relatively high book value assets with catalysts to increase market value.

Risk Tolerance Assessment

Understanding behavior biases and approaches to participating in market asset ownership together help quantifying your risk tolerance. Three suggested **risk tolerances** from which to **select** and **state** for your wealth blueprint follow.

1. Low risk tolerance (Conservative)
Less than 3% portfolio loss from last review value or less than 10% asset decline from most recent weekend peak
2. Moderate risk tolerance (Mid range)
Less than 10% portfolio loss from last review period or less than 15% asset decline from most recent weekend peak
3. High risk tolerance (Aggressive)
Less than 15% portfolio loss from last review period or less than 25% asset decline from most recent weekend peak

State your risk tolerance, critical behavior biases, and improvement plan

Goals/Objectives

Economic wealth pays for qualitative goals, as well as quantified objectives. The objectives may suggest a lower risk tolerance than behavior

biases potentially allow. Cash flow requirements, to be later noted, may also be involved. Select and **state** general **objectives** from the following:

- Retirement spending
- Family legacy estate or gifts to others

The blueprint should also **state** the **priority of multiple objectives** and if secondary priority funding is postponed during difficult times. Other objectives may also be specified for shorter time duration accrual and distribution purposes, such as a child’s education or home equity down payment.

Strategy Process

Risk tolerance, time horizons within an objective’s accumulation and distribution phase, current financial capital, and human capital are suggested factors to establish in preparation for constructing an appropriate wealth strategy.

Low risk tolerance, short objective time horizons, and limited human capital normally corroborate a **low risk wealth preservation strategy**. That means an asset portfolio of high quality, bond like assets or annuities that match certain near term needed spending cash in flows with certain budgeted cash distributions (spending). Wealth preservation strategies do not usually have resources to also support family legacies and other significant gift programs. An example of a Wealth Preservation strategy portfolio for a retired household age 68 weighed in terms of periodic cash flows with a 25 year longevity time horizon is shown in Table 2.

Table 2. Wealth Preservation Strategy Portfolio

Asset Class	Security	Weight (%)
Social security payments	US gov	20
US Invest Grade 5 year bonds	VFICX	20
US GNMA short term bonds	VFIJX	20
Fixed income annuity/pension	contract	15
S&P 500 large stocks fund	VFINX	15
Global Utilities stocks ETF	JXI	10

The example wealth preservation portfolio gives a retired household a diversified cash flow portfolio, which is weighed with 75% bond like assets. The 25% equity weight is made up of US and global blue chip stocks, which annually yield approximately 2.5% and provide the potential for above inflation rate price appreciation. The key point is that the wealth preservation strategy is focused on low risk cash flows with limited annual rebalancing of stock to bond assets.

A **high risk wealth accumulation strategy** at the aggressive end of the spectrum requires high risk tolerances, normally entrepreneurial attitudes, long objective time horizons, and significant human capital. The strategy is equity growth focused. Private businesses with competitive strengths or operational management arrangements are the entrepreneur’s asset portfolio for potentially high return opportunities in high stakes decision situations. Business liquidity is important to withstand normal losses during economic hard times.

Those, who do not own businesses, may still pursue **wealth accumulation strategies**, if they have the above mentioned attributes. Strategies focus on investment portfolios of diversified (Chapter 12) growing equity assets and regular savings during long time horizons to control volatility. The equity weighted portfolios adjust wealth processes to find a well suited core and satellite portfolio strategy. A young (mid 30’s) household that wants to learn and invest without advisors may start by constructing a 50% core and 50% satellite assets portfolio. The satellite portfolio may include actively managed funds and individually owned stocks, as well as bond funds for flexibility. An example follows as a Table 3 Wealth Accumulation strategy portfolio.

Table 3. Wealth Accumulation Strategy Portfolio

Asset Class	Security	Weight (%)
Core Assets		
S&P 500 large stocks	VFINX	10
Russell 2000 small stocks	RUT	10
Foreign Developed stocks	EFA	10
Foreign Emerging stocks	EEM	10
US GNMA short term bonds	VFIJX	10
Satellite Assets		
Johnson & Johnson stock	JNJ	10
Small company growth stock	?	10
Small company growth fund	?	10
Limited partnership – gas	?	10
US GNMA short term bonds	VFIJX	10

The example wealth accumulation portfolio gives a low experienced household a diversified portfolio of assets to monitor and adjust with time. The performance of the blue chip stock, Johnson & Johnson, can be periodically compared to the benchmark S&P 500 blue chip stock index fund. The performance of the small company growth stock and Small/Mid size company active fund can be compared to the core Russell 2000 small stock index ETF. The limited partnership provides experience in commodity related investments. Finally, the

GNMA bond funds add low volatility assets, which may be used for other asset purchases in either the core or satellite portfolios. The strategy will likely **include periodic rebalancing criteria** with different asset classes. The key point is that the wealth accumulation strategy provides a learning experience and knowledge about managing equity risks and potential returns. Even if the satellite assets do not perform as well as the benchmark core assets, the household has used a diversified wealth accumulation strategy and is better prepared to work with an advisor, if desired in the future. **Select and state your wealth strategy.**

Savings, Spending, and Rebalancing

All wealth strategies require systematic monitoring related to personal factor changes, portfolio performance, and risk taking. A change in time horizons due to a life shortening condition may abruptly **change** wealth accumulation to wealth preservation **strategies**. An unexpected increase in earnings due to a business competitive advantage or promotion to a corporate executive position allows flexibility to rethink a wealth accumulation strategy. Savings may be increased, a gifting objective may be added, or portfolio risk taking may be changed.

Savings, spending, and risk taking are habits that do not change much over time for most households. That is important. They are **personal decisions** that **control the volatility** of annual **wealth accumulation** toward a terminal value or spending withdrawal rate at the start of the distribution period. An annual 10% or 15% savings rate in a tax deferred saving plan or conversely spending only 85% of after-tax income adds resources to the wealth accumulation account. In economic recessions, when equity assets decline in value, the savings purchases more assets at relatively lower prices. A strategy should remain aware of human capital available for future savings. When human capital buffers decrease as a working career nears completion, risk taking should decline for everyone, except those have more economic resources than they plan to possibly spend in their lifetime.

Rebalancing is a simple, systematic part of the strategic process, which most people do not complete. It is a periodic (usually annual) portfolio adjustment. Rebalancing changes portfolio asset proportions that exceed asset

portfolio weight thresholds at the end of a period. Risk is reduced by selling assets that are judged to be generally over valued. Portfolio equity risk may also be reduced in preparation for a transition from wealth accumulation to lower risk portfolio wealth distribution.

Table 4 shows an example portfolio for a 50 year old household with a diversified portfolio goal of 60% stocks, 40% bonds, a 20% weight adjustment threshold, and a 1% annual reduction in equities. The Emerging Market stocks ETF at 13% end of period portfolio weight is the only asset that exceeds the 20% threshold change criteria. The Foreign Developed EAFE stock EFA increased up to the 20% weight threshold limit. Yet, the age 51 household 59% stocks and 39% bonds reduced age related risk criteria is also considered in rebalancing portfolio weights.

Table 4. Example: Portfolio Rebalancing

Asset Class	Security	Weight Age 50 Goal (%)	Weight Actual (%)	Weight Age 51 Adj. (%)
S&P 500 stocks	VFINX	20	18	20
Russell 2000 stocks	RUT	10	9	9
Foreign EAFE stocks	EFA	20	24	20
Emerge Mkt stocks	EEM	10	13	10
US 5 year bonds	VFICX	20	18	21
US GNMA bonds	VFIJX	20	18	20

Notice that the EEM and EFA stock fund weights are decreased, the portfolio bond VFICX and VFIJX fund weights are increased, and the VFINX stock weight is increased. A part of the possibly overvalued foreign stocks are reduced. **State your strategic rebalancing criteria.**

Wealth Blueprint Cash Flows

Accumulating enough resources to spend self reliantly during the retirement wealth distribution period is the primary objective of most people. Consistent savings cash flows provide the seed money for well selected investments to grow and accumulate value during a working career. Savings provide the chance to buy undervalued assets after they fall during an economic decline. The purchased investments in tax deferred savings plans or

corporate pension plan contributions reflect both accumulation and distribution period risk tolerances. Purchasing corporate lifetime cash flows in the form of pension or annuity selections indicates low risk retirement distribution preferences. Conversely, purchasing equity and debt assets in savings plans indicate a hands-on distribution approach with possible moderate or high risk tolerances.

The wealth blueprint distribution phase often includes complex retirement asset (annuity and investment withdrawal cash inflows) and liability (retirement spending and gift cash outflows) matching. The investment withdrawal decision may be simplified by purchasing all low risk annuity cash flows to match planned retirement spending budgets. If retirement spending cash inflows come from investment resources, then the withdrawal rate should reflect one’s retirement longevity time horizon. A 30 year time horizon at nearly no risk can be funded with $1/30 = 3.33\%$ withdrawal rate from an account that invests in laddered maturity government bonds whose returns cover income taxes. The assumption is that cash flow covers one’s spending rate. (Specifically, \$3,000,000 retirement low risk asset account should support an inflation adjusted \$100,000 after tax spending rate liability.) Most people need to take some investment risks during retirement. It is suggested to match sets of retirement years in your wealth blueprint with assets available at the start of retirement (Chapter 13). Table 5 is repeated below.

Age	65	72	80+
Matched yrs Risk-Free Cash flows	5	10	15-
Yrs. Risky Cash flows	25	13	0

Table 5. Matched years of risk free cash flows

The first 5 years of retirement spending are matched with risk free cash flows. As analyzed (Chapter 13) moderate to low investment risk taking is shown with future cash flow resources between age 65 and 80. The investment plan is expected to grow 24 years of retirement resources to the total 30 years of planned retirement spending. Table 5 shows that 10 years of risk free cash flow are matched with planned retirement spending at age 72 and all cash flows are matched at age 80 (assuming life to age 95.) The net effect of analysis conservatively

assuming equity returns lower than the past 80 years is: a 4.17% withdrawal rate can be expected with the discussed scenario analysis. (Specifically, with prudent risk taking about \$2,400,000 of resources are needed to match 30 years of retirement spending at a \$100,000 annual rate.) Cash flow analysis is highly time horizon dependent. A 15 years time horizon requires less initial retirement resources, but all cash flows are suggested to be matched with risk free resources. (You no doubt see the picture; \$1,500,000 of resources should be available to match 15 years of retirement spending at a \$100,000 annual rate or a 6.67% withdrawal rate). Based on your retirement spending and gifting needs and time horizon, **state** your **annual cash inflows** and investment resources **withdrawal rate** (if annuity cash inflows do not match all of your retirement spending needs.)

The wealth blueprint strategic process is necessary but not sufficient. Things change both personally and in investment markets. Tactics provide the flexibility to adjust for personal changes, ideally invest in undervalued assets with higher expected returns, and most ideally avoid part of market asset price corrections that inevitably come with economic dislocations (recessions, credit crashes, and wars) and high uncertainty.

Monitoring & Tactical Process Adjustments

The suggested annual attachment to the strategic the outlined wealth blueprint document is a **monitoring document** (economic wealth score card.) Monitoring asset operations, macro-economic outlook, and markets provides data to find if assets are under or out performing. Tactics may either be able to reduce over valued risks or take under valued opportunities. Previously discussed benchmarks provide relative comparisons between your asset performance and that of the relevant market. An individual with all core passive index funds can monitor and make the comparison as infrequently as semi-annually. Asset valuation changes should be within 1% of the benchmarks. Note the tactical monitoring differs from annual strategic rebalancing. It notices if an extreme problem exists with the asset. A quarterly monitoring review is suggested for portfolio actively managed assets. The active manager may have a strategy that is not working in the market place. For instance, if a mutual fund's performance lags behind the benchmark by 15% in a quarter, more investigation is needed. You may accept a

quarter of under performance, if a prior quarter's out performance exceeded 15%. Yet, the added volatility should be accounted for. Individually owned stocks and bonds entail an added set of specific asset risks, so that at least end of week price monitoring is suggested. Without going into details, small capitalization stocks are much more volatile than large blue chip stocks. Diversification (Chapter 12) is necessary to control volatile asset risks.

Stop loss point settings and over valued **profit taking** points are market price related **tactics**. Various types of asset past performance price and volume charts are available. A favored type should be used to monitor market price changes of individual asset securities. Specific charts and settings are personal decisions. The investor, whose goal is to hold assets an average of 3 years, will use different charts and settings than a speculator, whose goal is to hold assets 2 months and ideally take 10% transaction profits from the market. It is suggested to remember that a 50% gain is needed to compensate for a 33% loss. For most investors, it is sensible to take a loss at about 15% unless there is a good understanding that the asset is undervalued and very likely to recover within 6 months. **State monitoring plan frequency. State stop loss and take gain tactics.**

Reduce noise

It is best to focus clearly on facts during financial uncertainty. Many established **market experts** have poor investment records. They often confuse facts with twisted reasoning. **Ignore them and find a personal method** to review actual asset operational and market data. Read the business/finance section market data tables or charts. Analysis is difficult. Errors are made. Yet more can be learned from analysis of personal transactions than being entertained by Jim Cramer's emotional advice.

Macroeconomic response tactic – Yield Curve

Wealth preservation tactics (Chapter 16) were previously analyzed. A few key tactics are highlighted. The Interest Rate Trouble Tactic focuses on the relationship between short term (3 months or 2 years) and long term (10 year) Treasury security interest rates. Normally, time duration risk results in a positive yield curve (long term rates higher than short term rates). When the FRB causes a negative inverted yield curve (short term rates higher than long term rates), it is responding to a macroeconomic issue

by trying to slow down the economy with more expensive money. That is a warning of future economic and asset valuation problems. It is a significant factor in the Commerce Board's reasonably accurate monthly Leading Economic Indicator (LEI). The warning may be very early, such the Feb. 2006 **inverted yield curve** prior to the Oct. 2007 general equity markets peak. The related wealth preservation **equity asset tactic is to reduce growth focused or over valued actively managed assets**. The reciprocal LEI related tactic (Chapter 16) is also suggested when appropriate.

Market response tactic –Uncertainty

The anticipated uncertainty tactic is based on measuring and estimating the amount of market asset price volatility. The U.S. stock market's volatility or uncertainty can be measured by the VIX (an index of implied volatility measured by the weighted prices of S&P 500 (SPY) put and call options over the past 30 trading days). Historically, it has risen significantly above a normal level around 20 during sharp market declines. During a volatile period, an asset that is more than 20% overvalued is vulnerable to a large correction. When potential asset buyers get scared and stop trading, prices decline quickly. The related suggested wealth preservation **equity asset tactic** is to **sell ½ positions in actively managed assets** that are estimated to be **more than 20% over valued** when the **VIX measures above 27 for more than 5 trading days**. The reciprocal tactic is purchase undervalued assets when the VIX settles below 24 for more than 5 trading days. The tactic avoided past sharp market declines, but it also failed to participate in the euphoric 1999 stock market advance.

Portfolio Management tactical decisions

The concept of a riskometer (Chapter 14) was developed with an eye on remaining within comfortable personal risk (speed) limits. The idea is to recognize that aggressive risk wealth strategies in search of above market returns hold volatile assets. Even if behavior biases can deal with the price changes, many varied tactics are needed to control the high risks.

The investor will monitor both operational and asset market price information to set stop loss and gain take away points. The data emphasis for the growth stock investor, who tends to hold assets that are overvalued and more volatile, is market prices. Tactics focus on market prices and volume. The value investor, who is more

likely to buy bond and equity assets that are under valued, pay dividends, and less volatile tends to be more cash flow oriented. Tactics focus on the quality of the cash flows, as well as market price warning thresholds. The short term oriented speculator tends to concentrate on asset market price and volume data. His/her tactics try to recognize price patterns and generally go with the momentum flow.

The previously discussed Greek quantitative symbols, σ and ρ , should be monitored quarterly. They are usually calculated based on 3 years worth of monthly price data. The volatility (σ) measure is more specific for an asset than the VIX. When an asset's σ rises more than 20% above its normal reading and its benchmark, it is making large price moves. That may indicate over valuation. A tactic is to sell part of highly volatile assets and reduce the total portfolio σ to your desired comfort level. The correlations between asset price movements (ρ 's) are a trickier concept. ρ will increase for all equity pairs and the entire portfolio during a significant market decline. The change occurs coincidentally with the general market decline, so that there is little ρ warning of troubled waters. The direct tactic for reducing total portfolio volatility is selling assets and thus including a portfolio asset (cash) with nearly zero correlation with other assets. The indirect portfolio volatility reduction tactic for certain assets that may not be sold (for many reasons) currently is to purchase a put (sell) option nominally equal in exercise price to the held asset price. The put option $\rho = -1$ relative to the protected asset. It approximately offsets the price change impact of the held asset (for a premium charge) prior to expiration.

State macroeconomic, market, portfolio management or other tactic planned to adjust wealth strategy risks to tolerable levels

Monitoring cash flows

Working life **savings** and **retirement spending budget** cash in and out flows should be monitored. They are **certain actions** to follow a documented plan. If all retirement spending sources are **annuities** or nearly **risk free** bond like interest **distributions**, then cash flows are **matched** and **no tactics** are needed.

Yet the **cash flows** are **not matched if risky equity returns are required** for part of the planned spending. In that case, the build up of a

retirement account **buffer is desirable**. The net **present value** of retirement **annuities (pensions)** and **other retirement spending sources** should be **monitored annually versus planned target values**. **If a buffer** increases due to investment returns above plan or otherwise remains **positive**, then **no tactical actions are required**. However, **if planned forecasted cash flows lag behind plan**, then **tactical action is suggested**. **Increased savings** is the recommended solution to **eliminate any shortfalls**. Otherwise, **working past the planned retirement date** is recommended, so that **planned spending levels can be maintained beginning at the delayed start date of retirement**.

State if a buffer (added savings, added work prior to retirement or reduced spending) **is planned** if forecasted annuity or investment cash flows do not match retirement spending budgets.

Documentation

The described wealth blueprint document is more difficult to develop than an institutional IPS or a client IAA because it is not a “fill in the blank” record. Soul searching is needed to understand personal behavior biases and decide what level of risk can be comfortably handled.

Effort is needed to write simple complete statements down on paper. After monitoring and analyzing investment transactions, personal behaviors will be better understood and the wealth blueprint risk tolerance statement may be revised. That disciplined process is too difficult for most households. Yet the risk tolerance statement is a foundation for selecting a wealth strategy that can withstand the volatility of a selected portfolio of investment assets.

The wealth strategy statement should not change. Yet the tactics statement may change as market knowledge increases. This allows the wealth blueprint to remain reasonably stable and become more valuable with use. If an advisor is used at some time the wealth blueprint, as well as annual monitoring record, are excellent communication tools. They should directly lead to investment ideas that are compatible with your documented process.

A long term wealth flow process has been defined in practical concepts that are combined to deal with a dynamic world. It is a challenge to

use, but will tilt the odds in favor of achieving lifetime wealth objectives.

Summary

- Higher risk tolerances are based on balanced personal behaviors
- Wealth strategies must recognize risk tolerances, time horizons, economic resources, and savings rates
- Lower risk wealth strategies allow more flexibility to deal with personal change and asset value volatilities
- Tactics are support tools to reduce strategy risks at times of asset market uncertainties
- Low risk cash inflow matching to certain near term cash outflow spending needs minimizes financial stress
- Work to develop wealth buffers to compensate for inevitable random short fall periods
- Wealth blueprint statements and periodic wealth records build trust and confidence in your wealth flow management process