

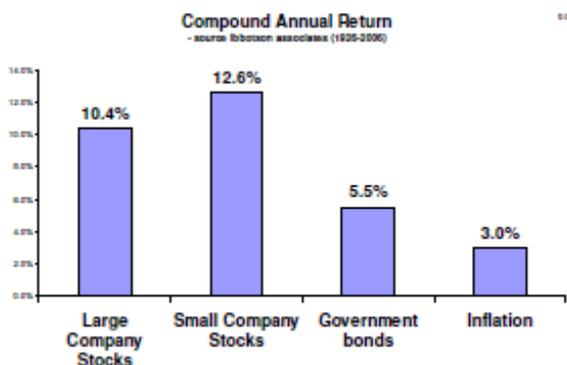
Should I recommend a “Conservative” Strategy to my Client?

August 23, 2006

Our professional colleagues, particularly accountants and estate planning attorneys, are often asked by their clients what “**is a safe way to invest**” their retirement assets or an inheritance.

The options appear simple at first glance. Your client can either get a low rate of return with little or no risk, or he can seek a higher return that will be subject to risk in the form of volatility and possible loss of principal.

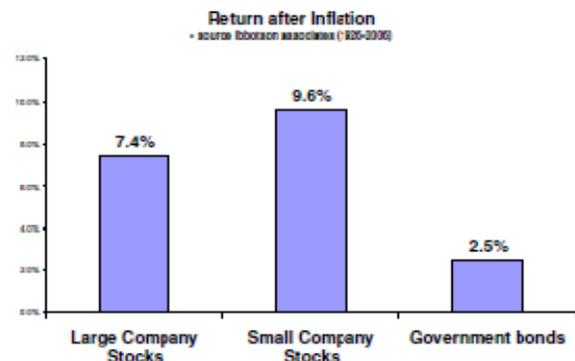
The table below shows the returns of large stocks, small stocks, and government bonds and the average inflation rate from 1925-2005. As compelling as this difference is (stocks deliver about twice the annual return as government bonds),



the return picture is only one piece. In order to gain a higher return, some risk has to be taken on.

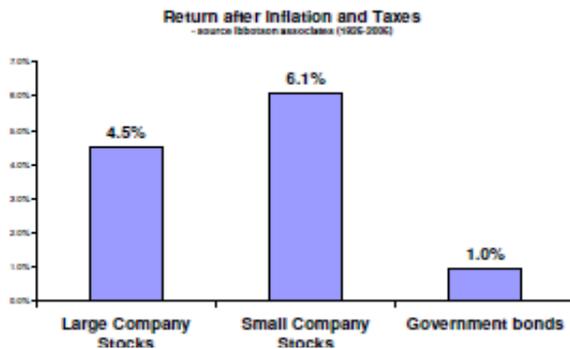
Accounting and Legal Professionals know very well that because their clients rely on them so closely for

financial information, their clients might feel they are “responsible” for having made a bad investment decision (not legally but that is how your client may feel). With all the other risk you take on, it is easy to understand why your default answer is advise your client to make the “low risk” investment. The client’s outcome is fairly certain with government bonds and we all seek to avoid uncertainty.



In reality our clients will be exposed to inflation. Taking an inflation rate of 3% inflation, the government bonds returned only 2.5%, or about 1/3 of large company stock’s historical performance over the same period.

The nail in the coffin comes when we consider the effect of income taxes. If we assume that all of the gains made from large stocks, small stocks and government bonds are taxed at the Federal level at 28%, the return on government bonds is only 1.0%, less than ¼ the return of large of small company stocks.



The simple magnitude of this difference and the reduced wealth effect the “conservative” choice may have on your clients portfolio are enormous and may result in your client running out of money!

At Global View, we feel it is absolutely essential to have a more complete understanding of the need before a recommendation is made. First we learn about the client’s income needs in relation to their investments and determine how much our client needs to earn from investments in order to meet their expected income shortfall; we call this their **Minimum Acceptable Return**. In order for us to calculate the Minimum Acceptable Return target, we need to spend a couple of hours with your client.

Based on the Minimum Acceptable return target we develop together with your client, we can then illustrate to him his odds of meeting this goal. We use both Morningstar’s assumed returns (projections) and the historical returns of our target asset allocations using the Margin of Safety approach, focusing on downside risk reduction. With this information we run Monte Carlo simulations to establish a 90%

confidence level of goal attainment.

We can illustrate this in a simplistic fashion by showing a case where a client needs \$100,000 additional income (pre-tax equivalent) on a \$2,000,000 portfolio. This is a Minimum Acceptable return of 5% before inflation, 5.2% to retain retirement lifestyle, and 8% to retain purchasing power.

Running this proposal using Morningstar’s projections and a moderate asset allocation, the client will run out of money in 18 years at 90% confidence. When we change assumptions based on the historical risk and reward parameters of managers we use following the Margin of Safety strategy, our odds are substantially improved. The client has a 99.8% chance of meeting his goals (not running out of money) and will have over \$1.7 million in assets in 2024 at 90% confidence.

The next time you are asked “What is a conservative strategy for my investments,” please give us a call. We promise you won’t regret it. Past performance is not a guarantee of future results. We discuss all of this at great length with our clients.

Global View Team