

CONTENTS

Whence
wherewithal?
Planning for the
unknown moment
of new opportunity

The conundrum of
secrecy

Advice about human
nature

▲
Visit our
Web site at
www.wpam.com

Telephone:
317-228-0800

Toll-free:
888-868-3855

Fax:
317-334-1795

e-mail:

The Wherewithal To Realize Dreams

A financial planning goal exists to implement dreams. The goal is to establish a sense of personal and financial net worth that encourages creation of dreams, to insure that *realization* and *wherewithal* come about at the same time.

Beth Leonard and Evans Starzinger sailed around the world between June, 1992, and Memorial Day, 1995. Here is the description of their *realization*:

“For the five years before our departure, we spent almost every waking minute living the life of successful 1980s baby boomers. We worked 70-hour weeks, traveled to different cities and countries weekly, and saw each other for only a few hours each weekend. When we were asked to stand for partnership election in our firm, we both took a hard look at ourselves and considered what we wanted to do with the rest of our lives. Despite the applause and accolades, neither of us had ever accomplished anything we considered worthwhile. We knew we were on the wrong track. With that *realization* [italics added], we took the first step toward our journey and a new life”¹

Beth and Evans had a realization, a dream. Concomitantly, they had wherewithal. Without wherewithal, the dream would have dis-

appeared into a mysterious labyrinth of buried information and forgotten aspirations. A dream cannot exist in a vacuum. It must be nurtured, watered and fertilized. In minutes, a dream that is impractical vanishes. However, dreamers having sufficient resources begin to think “I can do that. I can do something new. I can pursue this dream.” And so, the dream flourishes. It has a chance to become reality.

Beth and Evans provide no information about their personal resources. However, they do summarize their three-year costs as living expenses (\$50,537, or \$16,845 per year) and capital costs (\$45,000, or \$15,000 per year). In addition, they set aside \$25,000 for emergencies and for job hunting upon their return. Therefore, their resources were at least \$125,000 and probably more. We assume that these resources were a result of saving during the years before their *realization*. At the moment of realization, they had wherewithal.

Personal resources arise from only three sources: inheritance, income from labor and invention, and savings. For most young people, savings is the only sure means to accumulate assets. However, many forces mitigate against savings and creation of a positive net worth. For example, many students leave college with significant debt and do not create a positive

¹ From “The Voyagers Handbook” by Beth A. Leonard, 1998, p xi.

A Commentary about Institutional Investing. . .

Secrecy is a haunting conundrum. The public wants disclosure. Students and trustees need information. But, trustees do not want to disclose.

The important reason to promote disclosure of both investment committee actions and results of investment policies is to permit observers and students to study committee performance. With full disclosure, serious observers could develop hypotheses regarding why one committee produces better results than another. Also, members of a committee supervising a poorly performing investment account could compare their decisions to actions of committees that supervise the best-performing accounts. However, full disclosure is not in the modern investment play book.

Pensions&Investments discussed secrecy on November 2, saying “. . . secrecy in a government agency [The District of Columbia Retirement Board] is suspicious and deeply troubling. This secrecy could harbor corruption, just what sunshine laws were designed to prevent. . . . [It is] improper and must end.”

Thoughtful Wealth Planning&Management

is published six times per year by Wealth Planning&Management, LLC, P.O. Box 40994, Indianapolis, IN 46240-0994. All rights reserved. Reproduction in whole or in part is strictly forbidden. News services may quote from this periodical with proper attribution. This issue was completed March 31, 1999. The DJIA was 9786.16. The S&P 500 was 1286.37.

Publisher: John W. Guy
Editor: Lois Sherman
Design: The Art Room

Quasi-public entities such as endowments and foundations also do not disclose policies, names of investment committee members and investment managers, or results. Private retirement plans maintain even more stringent confidentiality.

William M. O’Barr and John M. Conley discussed secrecy in their book *Fortune & Folly: The Wealth & Power of Institutional Investing*. (Business One Irwin, Homewood, Ill., 1992). They said:

“Private [pension] funds. . . view the details of their investment strategies and performance as trade secrets. . . . There is little communication with other funds. . . . [They] typically subscribe to services that report the performance of all large funds, but with the names deleted. They can identify themselves and can therefore see where they rank, but they do not know how specific competitors are doing, or, more significantly, how well particular strategies are working in the pension world as a whole. . . . One issue that seemed particularly sensitive at one of the *public* [italics added] funds was whether we would be permitted to observe the portion of a trustees’ meeting at which investment strategy would be discussed. After consultation between investment professionals and lawyers, we were excluded.”

Malintent is not the reason for secrecy. Instead, the reason is human nature. Individuals, whether elected or appointed, public or private, want confidentiality. They want confidentiality in their personal affairs, and they want confidentiality in their roles as trustees. Individuals always have guarded personal financial affairs. They be-

lieve that governments, competitors, or even neighbors potentially could damage either their financial condition or their reputations by misuse of personal data. The strongest threat has been the tax collector from whom millions around the world withhold important information.

Investment committees are made up of individuals inclined toward privacy. A reason might be found in the portion of human nature that is embarrassed by decisions that cannot be rationally explained. Individuals accustomed to managing tangibles seem self-conscious when asked to manipulate intangibles. Most people can explain personal or business decisions in practical terms, such as “I built the new deck because we need a place to relax,” or, “We need a new science center to attract top students.” In these examples, needs are reasonable and results measurable. The decision-making process is orderly and comprehensible to an observer. Contractors are hired based on objective criteria such as skill and price.

Investing is not the same. Our language does not have enough words to explain *exactly* why a board places 20 percent in bonds, 40 percent in growth stocks, 20 percent in small cap stocks, 10 percent in venture capital, and 10 percent in managed futures. Committees cannot precisely explain these decisions. Explanations do not sound compelling even to the spokesperson. Why does the board hire Modern Portfolio Management, Inc., instead of Old-Fashioned Growth Stocks, Inc.? Both work in the same market, charge the same fees, and have access to similar information. Recent

continued on page 4

Wherewithal, continued from page 1

net worth until their mid-30s.² Meanwhile, society creates in young people desires for expensive accouterments, such as cars and homes. Society promotes permanent, expensive ownership, instead of flexible, temporary, economical borrowing and leasing. By definition, an expense is not a saving. Savings are funds not spent. Cutting expenses automatically increases savings.

Cutting expense might not be difficult. Analyzing and eliminating routine purchases might do the job. Take compact disks or videotapes, two among the hundreds of diversions available. Commonly, college students own a portfolio of CDs that costs over \$2,000. (At \$15 each,

\$2,000 buys *only* 133 CDs.) Similar commitments are made to videotapes of movies and sometimes to books, both of which are **available free** at libraries. Suppose a consumer saves \$500 per year (instead of buying CDs and videotapes) between ages 15 and 30 and earns 6 percent interest on the money saved. This simple discipline results in resources of \$11,637.98 by age 31. Buying used cars, renting apartments instead of owning and paying mortgage interest, and borrowing books, CDs and movies instead of purchasing, contribute to the savings discipline and to future wherewithal to facilitate creation and implementation of dreams.

No person knows what dream or new ambition will appear. The dream might already be hiding in

an obscure mental corner, ready to see full light (realization) upon occurrence of a timely coincidence. Or, it might evolve through months of discussions with friends or with romantic partners. Planning for the unknown moment of new opportunity is as important as—perhaps more important than—planning for the common experiences of life, such as parenthood, educational expenses, and retirement.

In March, 1999, *Sail* magazine reported that Beth and Evans are cruising “East coast waters” on *Hawk*, their 47-foot cutter. They sold their 37-foot ketch, *Silk*, acquired a larger boat, and are continuing the voyaging life. Meanwhile, both contribute to the literature by speaking and writing. How long will their dream last? It will last as long as their desires, and their wherewithal.

² Beth and Evans do not reveal their ages. However, photographs suggest that they are 40 years old or younger.

Advice to a Person Seeking Advice (from a consultant’s letter)

This morning I write to you about relationships compared to performance. Relationships are powerful and important. They are important to you and to me. In a recent call, for example, you spoke directly about the quality of relationships. You said, “I feel more comfortable” with certain relationships than with others. I understand and accept this part of human life. In fact, it brings joy to life.

We have a dilemma, however, that in the investment world relationships might not be important. An assumption of every search is the goal to locate the best-performing advisors. However, no statistical data exists to prove that some professional investors earn greater rates of return than others, except during short periods. No evidence exists that one advisor

consistently performs better than another. (In this context, the word “advisor” includes trust departments, mutual funds, and both large and small money managers.) Most professional investors become famous for reasons other than performance. For example, John Templeton is famous because of longevity, Peter Lynch because he did well over a short period and because he has written books, and Warren Buffett because he is a wonderful writer and teacher.

If investment performance is the determinant of success, the search for a good relationship is futile. One author even argues that superior investors, if they exist, are people with whom a good relationship is unlikely. Being geniuses and loners, these “superior” investors are inaccessible

and hard to get along with. They are not likely to become our friends.

If investors cannot rely on the quality of a relationship for performance, and if no investor, no matter how smart or well-informed, can guarantee an above-average, positive investment performance, what is left? What can the consumer-investor control? What can any investor do to improve performance? My answer is that the *only element* within the control of an investor is expense. Every investor can reduce expenses by these means:

- Reduce turnover and related commissions.
- Negotiate lower fees and commissions.
- Reduce unnecessary taxes on investment activities.
- Develop long-term affiliations with providers.

continued on page 4

Secrecy, continued from page 2

performance figures are different, but 10-year average results are about the same. Frequently, trustees say in private that the choice “*felt right*.” Since a journalist, author or beneficiary might not have the same *feeling*, committees do not want them in the room. Imagine the headline: “State Board Hires Semi Duration Bond Managers, Inc., Because ‘It Felt Right.’” Yet “it felt right” is accurate.

Another benefit of confidentiality is avoiding protests. Responding to protests is expensive. Response requires time and legal fees. Changing an investment generates commission expense. Committees incur expense even when no policy is changed.

Personal considerations further abet concealment. While trustees enjoy investment activities, they also fear loss. Mighty are both the psychological and practical effects of loss. Neither committee nor trustee wants to be accountable for investment losses, and many individuals would refuse to serve if their names might become publicly associated with loss or with below-average results.

In addition, public disclosure could discourage easy-going, candid discussions that foster good communication and thorough consideration of issues.

Hence, the conundrum: trustees do not want to disclose, but opinion makers, such as *Pensions&Investments*, demand it. The rallying point is that nondisclosure could “harbor corruption.” This argument is not weighty. Policy-making committees are unlikely to be in a position to

fraudulently divert funds. Diversion is more likely to occur at the level of implementation. On the other hand, following sunshine rules might reveal personal conflicts of interest, such as when a trustee promotes retention of a best friend as a paid investment manager, custodian or consultant.

The most important disclosure is annual results, tabulated uniformly. If public and private investment accounts disclosed results using uniform data and computational techniques, every investment entity could compare itself to every other entity. Private retirement plans could be compared to public plans. The endowment of one college could be compared to the endowment of another college, or to endowments of museums, symphonies and private foundations. If investment committees also pub-

lished written investment policies, as well as deliberations leading to creation of policy, observers could effectively relate policy to results. The information would lead to new theories about both investment activities and governance of organizations.

Society must deal with disclosure in a manner that accommodates both the personal needs of trustees and the requirements of law and custom. We do not need a general mandate that every discussion and decision be taken in public, but we do need uniform disclosure of results. When we know who does well, and who does poorly, we can make more rational judgments about what constitutes effective governance, and we can more accurately weigh the importance of policy decisions compared to manager selection, security selection, and timing.

Advice, continued from page 3

The last point is relevant to your circumstance. Let me elaborate. Investors incur excessive expense by changing advisors. Part of the expense is time—the effort and energy of the investor to make the change. Travel and communications costs are an element. Sometimes a change of advisors involves legal fees, or termination fees, as well as commissions on securities sold by a new advisor to raise funds to purchase securities on a new approved list. Some investment accounts—and many mutual funds—have termination fees if the investor leaves or liquidates prior to a specified date. An additional cost is time to become familiar with operations of a new advisor. For example, every time I deal with a new custodian, I must work to understand new statements,

procedures and charges. To the extent that time is money, this effort is costly. I would rather watch the market than try to decipher new administrative procedures. Therefore, I recommend that you commit to at least three years with the new providers you select. The reason is that stability of asset management automatically reduces investment expenses. Unfortunately, over any long period of 1 to 10 years, circumstances will occur that *make you want to leave* a provider. The most common circumstance is a down market. Massive numbers of investors make major changes in down markets. Usually, the changes are made at or near the lows. This is human nature, and it is expensive.

PLEASE READ THIS DISCLAIMER: Clients and principals of Wealth Planning&Management, LLC, may own securities mentioned in this newsletter. This newsletter is designed to stimulate thought, to help readers to formulate investment philosophies, and to encourage the assumption of risk. However, WP&M does not in any way warrant results from the use of information in this newsletter. WP&M does not guarantee the accuracy of this information. The information is not an offer to sell, or a solicitation of an offer to buy, any security. Readers should not assume that recommendations herein will be profitable or will equal past performance. The possibility of loss is inherent in making any investment, and no information source, including this one, can present all facts and all risks.