Retired Investor: Getting Through Difficult Markets

We all want to achieve retirement security—and to maintain our sanity during volatile market periods. If we could only predict tomorrow's markets, we would handily satisfy these needs—we would be able to sell before a market decline and buy at the bottom.

Truth be told, probably the single most important element of successful investing is recognizing that we are all handicapped by the inability to see into the future.

A process called "personal portfolio management" recognizes these limitations; it is a goal-oriented skill set that calls for making a series of correct investment decisions in circumstances that are never certain and enjoying, or enduring, the consequences.

Instead of eliminating the potential for loss, this process helps us measure and adjust risk to acceptable levels. It is based on the premise that mistakes will be made in assumptions and in execution, and builds in a mechanism to adjust course.

Let's review some of the attitudes and skills needed to navigate through rough waters toward a secure retirement.

Attitudes

Your attitude toward investing will influence the choices you make as an investor and, in turn, can have a significant effect on your results. Think about the following:

- Your investments will rise and fall in value due to many influences outside of your control.
- Manage what is in your control: your cash flow needs and the types of investments you make.
- Recognize that retirement investing is unlike the stock-picking you might have done when you were younger. Take a big-picture view of your finances and cash flow needs, formulate goals, and only then address the particular investments that can meet those goals.
- Be particular about how you judge your progress. At this point in life, it's important to use measures that identify action steps—those buy, sell and hold decisions that you will need to make to ensure that you are continuously on track to meeting your goals.

The Importance of Monitoring

To ensure good results, it's important to catch and correct mistakes. That calls for regular monitoring that focuses on the effectiveness of each decision in achieving desired outcomes. How? By identifying problems and mistakes that you can correct midcourse.

The individual investor's job is to stay on target so that he or she can reach his or her destination in a safe and timely manner. Risk is always a consideration for your overall portfolio and for each and every holding. Every investment must be assessed from the point of view of liquidity (can I get my money out?), potential for success (will this achieve my goals?), and potential for failure (how much can I lose?).

Let's contrast two investors.

The first reviews his monthly bottom line. Looking at whether he is ahead or behind has the advantage of being simple, but it stops short of putting things into a decision-making context. If the accounts are down, then what does he do? If the accounts are up, should he do nothing? Looking at the bottom line alone is not enough to enable him to tee up appropriate action steps.

The second judges his happiness by measuring from valleys lows to peaks highs and peaks to valleys. If his account is down from a market high, he might set a goal of recovering his "losses" as quickly as possible (a risky strategy) or holding on to ineffective investments until he gets even (an ineffective strategy). You don't want to lose more money trying to regain your peak value or waste time in investments that are not performing.

Personal Portfolio Management

Following these steps can help you make the best investment decisions in uncertain environments.

1. Accept that uncertainty is an element of every investment.
2. Accept that you will make bad decisions from time to time. Instead of trying to achieve the unachievable, focus on finding and correcting mistakes. What is a mistake? An investment that does not meet expectations and an assumption that proves to be wrong.
3. In order to set expectations, think about what you want to achieve for yourself and your family in the time that you have to devote to investing for retirement.
4. Frame your goals in terms of consumption. How much of your savings, or capital, are you consuming for current living expenses? If you are able to limit consumption to interest and dividends, while preserving and growing capital, you are ahead of the game. Bad or volatile

markets will have less affect on you.

5. Think of your retirement assets not as individual stocks and bonds but as a portfolio that is the sum of its parts. In other words, think in terms of the big-picture. How is each element of the portfolio working to help you meet your retirement goals?
6. Define how much risk you want to take. Do you want to assume general market risk, as measured by the S&P 500 index, or a higher or lower level of risk? The measure will help you put things in context when it comes to reviewing your portfolio.
7. Once reasonable objectives are determined, decisions can be implemented. Then, start paying close attention to the results of your decisions.

No System?

Without a system—or with an ineffective system such as the ones discussed above—it is all too easy to be compelled to action by outside events. In bubble markets, which you will likely see again during your lifetime, many otherwise conservative investors can be drawn into highly speculative investments. During bear markets, normally cautious investors can be spooked into pulling out of the market at the worst time, often without realizing that they are engaging in the risky practice of market timing.

> This post was adapted from Julie Jason's article from the November 2011 issue of the *AAII Journal*. Click here for an unabridged version of the article.