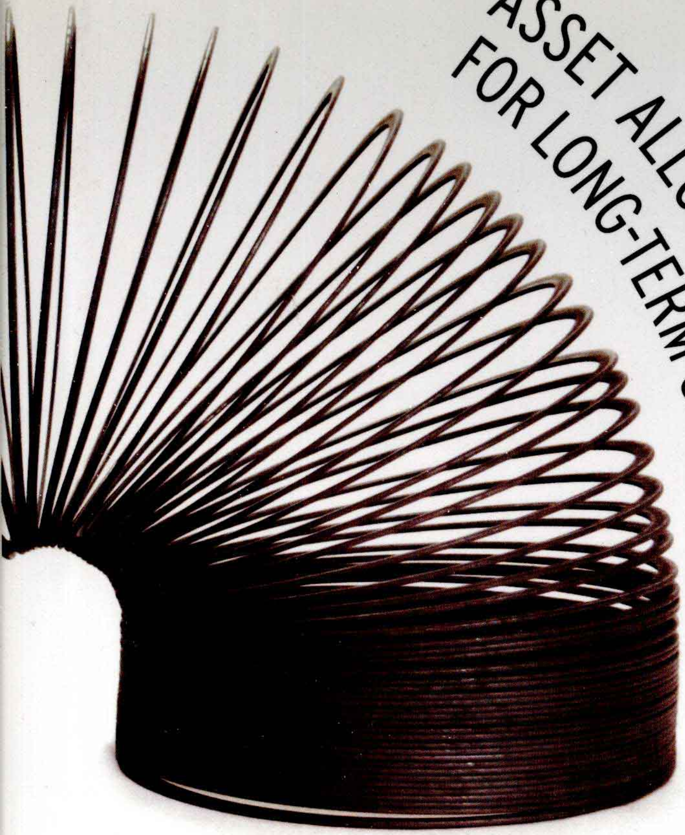
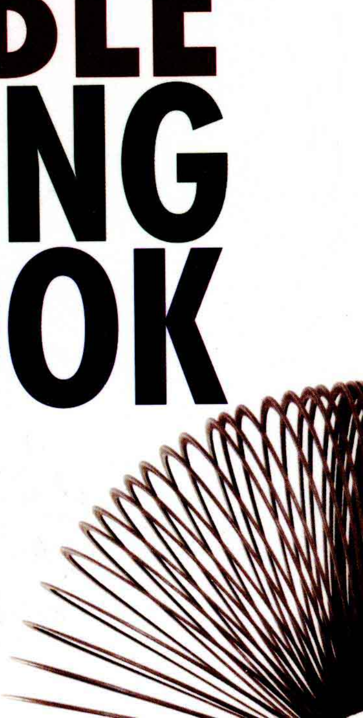


ASSET ALLOCATION STRATEGIES FOR LONG-TERM SUCCESS

The FLEXIBLE INVESTING PLAYBOOK



ROBERT A. ISBITTS

The Flexible Investing Playbook

ASSET ALLOCATION STRATEGIES FOR LONG-TERM SUCCESS

Robert A. Isbitts

WILEY

John Wiley & Sons, Inc.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

Library of Congress Cataloging-in-Publication Data:

Isbitts, Robert A.
The flexible investing playbook: asset allocation strategies for long-term success/ Robert A. Isbitts.
p. cm.
Includes index.
ISBN 978-0-470-63616-9 (cloth); 978-0-470-87556-8 (ebk); 978-0-470-87555-1 (ebk)
1. Investments. 2. Securities. 3. Finance, Personal. I. Title.
HG4521.I83 2010
332.6—dc22

2010008454

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

To Dana, Jordann, Tyler, and Morgan Isbitts.
Everything I do, I do for you.

Acknowledgments

There are so many people who have influenced the thoughts and opinions that led to the creation of this book. First, there are the investors and financial advisors who had the courage to be early adopters of my investment philosophy. Now that this genre of investing has matured from a set of basic ideas into a formalized, sustainable, investment process, those who have come along for the ride have been rewarded for their patience.

The mutual fund managers whose investment styles piqued my curiosity starting in the mid-1990s were the true inspiration for this book. Just as a good team coach needs to effectively use his players and put them in positions to help the team win, so it is with the outstanding and innovative fund managers I have had the pleasure to spend time with over the years. They do the day-to-day security selection, and I use my strategic approach to determine how to set and maintain the team's "lineup." Mutual funds have been around since 1924 and I don't see them going away anytime soon. Thus, I am excited about the prospect of finding additional funds to blend into the portfolios for the next many years.

My parents, Joyce and Carl Isbitts, are the ones who instilled in me the discipline, energy, and persistence to make the concept of Flexible Investing a reality. I owe my inner strength to them.

My brother Mark and his family, while many miles away, have been a constant reminder that one's support network and family bond is more important than any financial victory or defeat.

My in-laws, Max and Vicki Rosen, transcend (nearly) every stereotype about "in-laws." They have been among my biggest fans, and they have completed the family picture that provides the backbone for all great ideas.

My aunt and uncle, Myrna and Paul Fruitt, and cousins Lisa Fruitt, Gary Markowitz, and Sid Krex have taught me so much and

have been longtime supporters of the goals and dreams that are described in this book. I can truly say that when it comes to family, I don't have quantity, but boy do I have quality!

John Lohr, my mentor in the writing business, shares the accolades for this book. My first book, *Wall Street's Bull and How to Bear It* was published by John's publishing company, Isle Press in 2006. Before and since that time, John's perspective on the investment management business has been both thought-stimulating and very enjoyable. He is one of the unsung heroes of fair play in the investment business, and I am grateful for having the opportunity to know him.

My career has had numerous twists and turns and at each bend, I accumulated some knowledge and relationships that allowed me to eventually put together the "playbook" you are now reading. People like Donna Naitove, Scot Hunter, Allan Budelman, Medon Michaelides, Denise Karp, Pamela Nelson, and Leana Alu have all played a role in moving the process forward. In particular, I wish to thank those who have gone to battle alongside me in the day-to-day effort to uncover investment ideas and analyze their potential: Keith Stoloff, Michael Kahn, Suzie Dean, and Matthew MacEachern.

And most significantly, my wife Dana, and our three fantastic children have been the meaning behind everything I do. As any parent will tell you, one reaches a certain point in life where as much as you enjoy your professional accomplishments and free time, it just means more when you have your family there to share the joy with you. There is no shortage of that in our family, and I could not ask for anything more than I have at home. As a country song says, "the view I love the most is my front porch looking in."

INTRODUCTION

Replacing Your Old Investment Playbook

When a football player is cut from his team or traded to another team, his former team immediately asks him to turn in his "playbook," which shows diagrams of all the different ways his team will try to move the ball forward to score (if on offense) or how to defend when the other team has the ball. When the player arrives at his new team, one of the first things they give him is his new playbook. They ask him to go learn it. One reason why many rookie quarterbacks don't play very much is that they play the position responsible for leading the execution of that playbook on the field. That is a huge undertaking, and the training process can last months or years until the coaches feel he is ready to take on that role.

Whether you are an investor or a financial advisor helping investors, I am asking you right now to turn in your old playbook. In other words, I want you to put aside any preconceived ideas you have about how to protect and grow wealth inside an investment portfolio. By reading this book, you have been traded to a new team. This new team does not run the same, typical plays that most of the other teams run. In investor terms, that means that I will show you the weaknesses in traditional approaches to allocating and managing assets, and introduce you to a genre of investing I created. Your new "team" (investment strategy) realizes that success starts with a solid defense (i.e., a plan to limit losses when the financial markets are busy destroying value in other people's portfolios) and then tries to score enough points on offense to win games (producing solid long-term performance without a lot of flash and sizzle, and by staying out of the deep hole many investors dig for themselves).

There is an old saying in many sports that "defense wins championships." Start thinking that way, even if your investment objectives require you to achieve a fairly high long-term return. You will understand why I say this as you continue to read the book.

Your new team takes tremendous pride in not beating themselves as they have observed other teams do. I will point out common mistakes that I have seen investors make during my quarter-century in the investment industry. Your teammates are by no means mistake-free or perfectionists. They just don't tend to make big mistakes (i.e., they have a strategy to avoid major losses when markets are destroying value in their neighbors' portfolios). Big mistakes may force the team to change strategies during a game to play "catch up," and that is not desirable.

Your new team has a history of being very competitive no matter who the opponent is (I will show you how to keep your portfolio from being ruined, regardless of the market environment). They don't win every game, but they are one tough team to play against, no matter what the outcome.

While the playbook your new team uses may appear complex at times, the more you understand it, the more simple, logical, realistic, and purposeful it is to you. The strategies I will introduce you to are likely different from the traditional approaches you have seen—and in this case, different is better! But, like playing football, the exhilaration of a game plan well executed is tremendous. Welcome to your new team!

Later in this book, I'll get more specific about how to run the plays (use the strategies I created and manage today), so to speak. You may continue to follow my work at www.flexibleinvesting.net.

In Case of Fire, Use Stairs

A sign just like this was next to the hotel elevator, and I noticed it one morning while making my way down to present at an investment conference:

At that moment, it struck me that this sign and its instructions are a beautiful metaphor for the primary message I am communicating to you: The method you take to get up to your hotel room may not be the method you take on the way down. While you don't think a fire in the hotel is likely, you do want to know what to do if one occurs. If it does, you may not be able to use the elevator. In that case, your escape route is the stairs.

What does this have to do with the approach one takes to researching and allocating investments? *Everything!* Investors have been conditioned to use the same approaches they used on the way "up" (i.e., in a strong stock market) when the market is going "down a few floors." But that may not work. There may be fires to navigate around. You may have to do what is less convenient and less comfortable—take a different approach, a different route to your goal. You may have to take the stairs instead of the elevator.

Perhaps this was so poignant to me because I was reminded of a time when I took the stairs to get down ... 97 floors. I was working near the top of the World Trade Center in 1993 when the building was bombed. This, of course, was when terrorists "missed," and limited damage and casualties resulted. For a few hours, however, we did not know what was going to happen to us. Naturally, when a true tragedy occurred in that building on September 11, 2001, and some of my former colleagues lost their lives while others escaped death by taking the stairs, it brought back memories of that day in 1993. And years later, when I noticed that sign next to the elevator in that small hotel, the investment/elevator metaphor was obvious to me. Now, I hope it is to you, too.

In this book, I plan to point out how what you can learn from the experience of the past decade, how to avoid many common investment pitfalls, and how to allocate your assets to take advantage of the realities and opportunities of today's markets. Along the way, I will help you identify, as I said in my first book, Wall Street's "bull." I intend to show you not only how to "bear it" but persevere through it. After the events of 2008, that should be a welcome sight for your eyes.

I hope this book helps you.

Rob Isbitts
Weston, Florida
June 2010

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PART I

SETTING THE STAGE TO BE REEDUCATED

CHAPTER 1

Tired . . . but Not Retired

That's what a majority of Americans predict for themselves. This book offers investors and financial advisors an investment philosophy and process to avoid that predicament. For advisors and for the do-it-yourself investor (by definition you are your own financial advisor), it allows insight into approaches and techniques that might just change the way you look at the investment markets . . . for the benefit of you and your family, for this generation and beyond.

While investors save and invest for many financial goals, in my experience the most common one is retirement. While retirement means different things to different people, the common piece of each different person's retirement definition seems to be this: the point in life at which your desired lifestyle can be paid for without your having to work. That does not necessarily mean that you don't work; many have adopted the idea of a "second career" as something they always wanted to do, but were so entrenched in their current industry that they could not afford to give up their high income level. Retirement is as much a state of mind as anything else. It's a feeling that the pressure is off, that you can comfortably afford to support yourself and those you are financially responsible for, now and in the future.

In 2006, I wrote the book *Wall Street's Bull and How to Bear It* (Isle Press, 2006). There, I reviewed many of the threats to investors and their advisors. I then suggested ways they could work together to defeat the hurdles that financial markets and financial "salespeople" put in front of those who make an earnest effort to serve their clients, so one day they can both retire. This, my second book, contains some sections of that first effort. I repeated them because today as then, they reflect my core investment philosophy.

The other reason I have duplicated parts of the first book is that so many of the warnings of that book did indeed come to pass during the awful period for investors and advisors that followed in late 2007 and 2008. My hope is that by reviewing what happened, you can learn how to be prepared for whatever comes next.

In early 2009, I read with much interest an article from Savita Iyer-Ahrestani in the April 23 online edition of *Investment Advisor* magazine. The article, "Retirement Confidence Plummets," notes that a 2009 survey from EBRI, which studies, among other things, consumer financial behavior, shows that only 20 percent of those polled are "highly confident" they'll have enough income in retirement. This is the survey's 19th year, so the results and trends over time are based in reality, in my opinion.

In this book, I will draw out a blueprint for you to take on the most pressing financial issue of our time—will investors be able to retire? To start, I'll quote from the aforementioned article, then provide my feedback.

> According to the survey, workers who say they are very confident about having enough money for a comfortable retirement this year hit the lowest level (13%) since the Retirement Confidence Survey started asking the question in 1993. Retirees also posted a new low in confidence about having a financially secure retirement: Only 20% now say they are very confident about having enough to live on comfortably in their retirement, down from 41% in 2007, the survey noted.
>
> As the general confidence level has plummeted, so too has peoples' desire to want to try and plan for the future, (Director of the study Matthew) Greenwald said. "The time when retirement planning seems toughest is when it seems harder for Americans to focus," he said.

Here is some tough love for those who may find themselves in this mind-set. Realize that if you are behind the curve on this, you don't have a choice whether to attack this problem. You have to! Sometimes investors and their advisors feel "frozen" and don't act to improve their lot when things go wrong. They become paralyzed by the seemingly numerous possible roads they can take to work out of the problem.

The shifts that have occurred in investment planning, with 401(k)s on the rocks, jobs being lost, and so on, lead you to one conclusion: you **don't** have the option to do nothing this time. Okay, tough-love section over; let's move on to another piece from the article.

> Retirement finance experts like Francis M. Kinniry Jr., a principal in Vanguard's Investment Strategy Group, believes that clients should steer the course and not give up. On the contrary, focus and clarity of thought and planning are needed more than ever, Kinniry says.

Hey, that's what I said! Yes, clarity of thought and planning. That is why many investors have sought out professional advisors (not professional investment salespeople!) for partial or total help, after doing it themselves for years, or at least since 2002, when investors last threw up their hands—after throwing up their savings—in a market whose decline was as fierce as 2008's but took three years to collapse instead of one, so it hurt one third as much (my "scientific" estimate).

> Kinniry advocates good old-fashioned investing in the stock market. "We know that the stock market has outperformed the bond market in most 10-year periods and even more so in 20-year periods," he says.

What else would you expect a partner at one of the biggest equity money managers in the world to say? Sorry, it's not that simple. "Buy and Hope" is not a strategy, especially after the emotional letdown investors have had with the markets and many of those who participated in it. I am generally bullish on the stock market over the next 20 years, but that's like saying I think the sun will come up 20 years from now. If you are right, that was to be expected. If you are wrong, no one will remember or care because they will have other things on their mind.

Also, there is bound to be a false sense of security involving bond investments, as the long-term threat of inflation from America's deficit buildup has the potential to put returns of high-quality U.S. bonds into the red, big time, for a long time, at some point.