

## **“Buy and Hold”: BUST!!**

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When I sit down with a new client, I usually begin with the words, “We need to talk about your investment strategy and what your advisor either does not know or is not telling you.” The latter part of this statement has mostly been my experience, with only a few exceptions. It is quite rare that I am able to tell a client that they are one of the lucky few that don’t need to listen, learn or start asking some different questions because their portfolio reflects that they are in the hands of a savvy, well-informed financial advisor.

This process of engaging with new clients and sharing my investment analysis of their portfolios and financial situations has become acutely painful in the past year or so; there have been so many unnecessary losses.

When I meet with individuals (versus a fiduciary that has some form of investment responsibility for a portfolio), the story is often the same. The person’s vision of their future, frequently their early retirement, is no longer clear. What they once hoped and planned for is now shaded with grey – fear, confusion and rightful disillusionment have set in. In the past year I have encountered many men and women that have either panicked and sold everything (with serious financial losses incurred), or are following their advisor’s counsel to do nothing – to “hang on”. These advisors do genuinely believe that the “buy and hold” strategy works – they have been mesmerized by charts and graphs that make a case for the long-held and, well, worn out concept that stocks always get better returns over the long run. What they fail to understand is that there is a much more accurate picture available to the investor pertaining to actual individual investment returns than what is represented by the advisor’s hand-picked graphs and charts.

It is wise to acknowledge the truth of our collective financial situation. It is not “business as usual” or a “small bump in the road” we are facing (as I heard one advisor say to an audience recently!). Almost every financial system and structure is either collapsing or being impacted in ways that are forcing those systems to change and adapt in order to survive. The financial world has irrevocably changed and continues to change – some are good changes, some not so good. Within this larger view however, I have been pleased to read that financial journals are finally and frequently reporting that a buy and hold investment strategy will no longer work. In fact, some have gone on to say that in this environment, if used, a buy and hold strategy may very well lead many investors to financial ruin. I have heard this from professionals who have never uttered those words before.

Seven years ago when I originally began my studies in investing, it became clear to me, even then, that a buy and hold strategy is no panacea. At its premise is the belief that it will work in the long run within all markets and in all situations – this premise is flawed and thus, so is the strategy. What approach *always* works in *any* situation, no matter what?? Whether we consider work situations or personal life situations, do we ever have only one way of being, reacting to or interacting with others, regardless of what the issue we are dealing with is? Part of the complexity of being human is that we are intelligent, emotional and spiritual beings who use our skills, knowledge and experience to approach whatever life throws at us. Our approaches vary based on what we get handed in the moment. We are different in the way we would deal with a serious human tragedy in our lives as compared to being on vacation, for example. Our response to handling a rebellious teen or a young child being bullied at school versus handling a work crisis – each situation calls for the use of differing skills and knowledge.

Why then do we believe that only one strategy would *always* serve us well in our portfolios, as the buy and hold mantra suggests?

Now, there are most definitely times that buy and hold can and has worked. But what the charts, statistics, and graphs fail to show is the fundamental flaw inherent in the buy and hold concept. Buy and hold simply does not help the investor to manage risk. Certainly one manages a level of risk by having a well-diversified portfolio (which I certainly support) – the term “asset allocation” is used to describe the process of having money invested in a variety of asset classes such as domestic and international stocks and bonds, commodities and precious metals. But what I really want investors out there to know is there is a key element of managing risk that is seldom found, much less utilized, in the investment community. The method about to be discussed here has to this point been a long-held secret, used primarily by the Master Investors – those investors who have a long history of making profits in any market - up, down and sideways!

The most important action to take is clear – begin to truly and effectively manage risk by implementing a systematic and disciplined method for detecting when to buy and sell. In simple terms, as I explain to my clients, “Managing risk is never losing more than 1% of the total portfolio value on any one thing owned. So, if you have a \$200,000 portfolio, you would never lose more than \$2000 (or 1%) from the high price of anything owned.” The reality is that most stocks hit their highest prices in October/November of 2007 and unfortunately, the vast majority of investors have losses well beyond that 1%. So in this economic environment, which is incredibly volatile, it would serve us well to keep in mind that right now wealth preservation is priority one and he or she who loses the least in a “bear” (down) market will come out ahead. While always advisable, but especially in times like these, a solid and proven working strategy is absolutely required in order to minimize losses.

There is a term used in the money business to describe the mathematics of investment losses. It is called the “hole theory.” This exemplifies why it is so important to minimize losses beyond the obvious initial hit. This theory – the math - shows that if someone has lost 10% of his or her portfolio value, only 11% is needed to get back to even. However, if 25% is lost, it is necessary to gain 33% just to get back to even, e.g., if the initial investment is \$100,000 and a loss of 25% occurs (or \$25,000), only \$75,000 is left, thus a return of 33% is needed to get back to the original \$100,000 invested.

Most of the buy and hold portfolios during the 2000-2003 bear market finally got back to break-even in November of 2007 when the markets peaked. As the Baby Boomers get closer and closer to retiring, breaking even after 5 years is not helpful.

In today’s market I am seeing new clients with portfolios that have lost up to 40%. What this means is they have to gain 67% to recover their losses. Since we are in a long-term bear market, 0-3%/year returns are expected. To be generous, assuming a 3%/year return, it will take 22 years for these portfolios to get back to even. Even at 6% returns, it will still take 11 years. Unfortunately, many folks already in retirement (as well as the Boomers) do not have the luxury of taking 11 years or more to merely get back to where they started.

I hope I have helped the reader to begin to see how utilizing risk management does not fit with a buy and hold strategy. When I began my study of investing, I was determined to learn from the Masters. Remember - they’re the ones who know how to make money in any market. What I learned from them is that the most important decision to be made is **when to sell**.

I suggest that people speak to their advisors as soon as possible to get a strategy in place that will allow them to know exactly when to sell and how to minimize losses. If the advisor is a “dyed-in-the-wool” buy and hold person, I suggest they look elsewhere. If he or she has the extreme view that anything other than buy and hold is market timing, also look elsewhere. I am **not** an advocate for market timing. Very few make money using this strategy, which is generally a risky process anyway and often involves extensive trading costs. The point is this: any advisor you employ should have a solid and disciplined system in place for minimizing losses and managing risk. If he or she cannot explain to you how their investment strategy accomplishes this, just say no... politely, of course.

I have a few points to make in summing up that I feel are very important: it's challenging for me sometimes, but I find that many people simply don't want to be closely involved with their investments. I fully appreciate that it can feel overwhelming to take on "one more thing" when life is so intense and schedules so full. However, this is a time when it is imperative for all of us to remember what those investments are for – to support our own lives as well as the well being of our loved ones. My point here is this – make it a priority to become more involved in managing your money. Secondly, it is crucial to ask your advisor a few well-placed questions. After all, these folks are being entrusted with holding the hopes and dreams for your future in their hands. Lastly, it is important to remember this, too: the outdated, worn out rules such as the buy and hold strategy no longer apply. Continuing to use only buy and Hold IS a bust and will not help you to achieve your financial goals. The reason? The game has changed – forever – and you need to know the new rules.

Simply put, I encourage all of you who have money invested in the market or are investing on the behalf of others, to become better educated and perhaps ask a new question: Is it time for my investment strategy to get a makeover?

*Megan Gelhar is an investment educator - training individuals, fiduciaries and advisors on the drivers of financial markets and systems used for employing successful investment strategies.*

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