Creative
wealth maximization strategies*

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"Strategy is a route to achieving your objectives." *Simon Ramo*

Simon Ramo truly meets the definition of a polymath – a person of wide-ranging knowledge or learning. Wikipedia identifies Ramo as "an American physicist, engineer, business leader and author" who pioneered microwave technology, is known as the father of the intercontinental ballistic missile, and was the "R" of TRW, a Fortune 500 technology company. Born in 1913 (and still living at the time of this writing), at age 100 he became the oldest person to ever receive a US patent, for a computer-based learning invention.

An example of the breadth of Ramo's interests was a 1973 book he wrote called *Extraordinary Tennis for the Ordinary Tennis Player*. Tennis was a lifelong passion for Ramo, although he was not a gifted player. And just like his scientific and business activities, he studied the sport intently. Over time, Ramo concluded that success on the court was determined by dramatically different factors, depending on the skill level of the participants. This was Ramo's insight:

Professionals win Points, Amateurs lose Points.

For professionals and a few gifted amateurs, tennis is about making excellent plays: scorching a service ace, finessing a well-placed drop shot, blasting a strong volley. Ramo found that 80 percent of points in high-level matches were the result of winning shots and only 20 percent the result of unforced errors by one's opponent.

In contrast, the dynamics of matches between amateurs were reversed. Eighty percent of points came from unforced errors. An amateur player seldom "beats" an opponent; rather, the player who makes the fewest mistakes, who simply continues to keep the ball in play, usually ends up winning.

From Ramo's perspective, if you want to win at tennis, you have to adjust your strategy to your abilities. For the "ordinary" tennis player, this means understanding that amateur tennis is a "loser's game" where success comes from avoiding losses.

Extraordinary Tennis and Investing

As you might have already imagined, the tennis strategy of avoiding losses could be applied to financial decisions. And indeed, once you get past the Amazon listing for "extraordinary tennis" the most prominent hits in an Internet search reference financial experts. Even more interesting is how many of these experts recommend playing the investing game as amateurs.

Charles D. Ellis, in his best-selling book, *Investment Policy: How to Win the Loser's Game*, (first published in 1977, with five subsequent updates) highlighted Ramo's *Extraordinary Tennis* philosophy. Ellis felt there were so many variables and unknowns associated with investing that it was almost impossible to consistently make "winning" decisions, and even the best financial managers were really "amateurs," who would be better served by adopting safer

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* The title of this newsletter should in no way be construed that the strategies/information in these articles are guaranteed to be successful. The reader should discuss any financial strategies presented in this newsletter with a licensed financial professional.

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IF THE PROS ARE REALLY AMATEURS, WHAT ARE YOU?

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approaches that minimized loss as opposed to maximizing gain. Other investment pros who believe that investing is a "loser's game" also consistently reference Ramo in their blogs and commentaries, touting safe and loss-averse approaches.

Which leads to an interesting thought: If many investment "pros" see themselves as amateurs, how should those with far less financial acumen see themselves? And what strategies should they be using?

Well...just how amateur are you?

For the past decade, Olivia S. Mitchell of the University of Pennsylvania's Wharton School and Annamaria Lusardi of the George Washington University School of Business, have administered a three-question financial literacy test to people in the US and around the world. The questions address the concepts of compound interest, inflation, and risk tolerance.

"When we first started, we thought these questions were way too simple and that the majority of respondents would get them correct without any question," Mitchell says in a newly-released update of their research. Wrong assumption: Only half of Americans over age 50 (theoretically, the ones who have made the most financial decisions) could get the first two questions right and only 34 percent could correctly answer all three. "Only half got the third question right — and that was a true or false question," Mitchell says. "You had a 50-50 chance, and one-third answered 'Don't know.' "

Here are the questions:

Financial Literacy Test

1. Suppose you had $100 in a savings account and the interest rate was 2% per year. After five years, how much do you think you would have in the account if you left the money to grow?
   a. More than $102
   b. Exactly $102
   c. Less than $102
2. Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After one year, how much would you be able to buy with the money in this account?
   a. More than today
   b. Exactly the same
   c. Less than today
3. Please tell me whether this statement is true or false: "Buying a single company's stock usually provides a safer return than a stock mutual fund."
   a. True
   b. False

The Correct Answers: 1. A. 2. C. 3. B

Okay, let's just say it. If most Americans had problems with these three questions, their financial skill level is in a category below amateur. But even if you aced the quiz, does that elevate your financial understanding to the professional level, especially when many of the pros admit to being amateurs? (Yes, it's a rhetorical question.)

"Amateur" Ways to Win the Money Game

Stunning financial success stories grab our attention, but most of those events cannot be duplicated, even by pros. We can't start another Microsoft in our garage just like Bill Gates, or win the Powerball by getting a ticket from the same convenience store; these successes are often singular moments of preparation and luck. If and when we encounter unique opportunities, we should certainly consider taking a chance and scoring big. But over the long haul, the best financial strategies are those that keep us from losing.

1. Save methodically. If there's any financial activity that equates to simply keeping the ball in play, it's saving on a regular basis – paycheck after paycheck, month after month. As long as you are saving, you're not losing the game. And the longer you can keep playing, the greater your odds of winning.

2. Look for ways to increase savings. Adding more to the pile is usually more productive than seeking a higher rate of return. Long-term financial objectives are defined as accumulation milestones, not annual performance numbers; when it comes time to pay for college, buy a vacation home, or retire, it's how much you have that matters, not the rate of return you've earned along the way. To illustrate:

Option A: Save $1,000/mo. at 0.5% annual interest

or...

Option B: Save $800/mo. at 5% interest.

The numbers:	Option A	Option B
After 1 year:	$12,032	$9,864
After 2 years:	$24,125	$20,232
After 5 years:	$60,768	$54,631
After 10 years:	$123,075	$124,743

Option B is earning 10 times Option A, but it isn't until 9 years and 8 months that Option B's balance exceeds Option A. Yet, which task would be harder to achieve, finding another $200 each month or guaranteeing a 5 percent return for 10 years? Cash flow management – even into accounts that earn almost nothing – is a superior strategy for financial amateurs.

3. Use insurance to protect against big losses. Amateurs must avoid losing, but some losses are unavoidable and unforeseeable. However, the financial impact of unexpected losses can be offset by prudent insurance decisions. Any insurance that preserves your ability to save is vital.

Some might characterize it as the amateur's way, but diligent saving, efficient cash flow management and comprehensive insurance coverage can deliver winning results. If even the pros have to acknowledge their amateur status, avoiding losses might be your best way to play to win.

HAVE YOU HAD A CASH FLOW ANALYSIS TO INCREASE YOUR SAVING? WHAT ABOUT AN INSURANCE REVIEW?