NAIFA's advisor Today

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practice specialties

FINANCIAL PLANNING

Bye-Bye to Buy & Hold?

It may be time to take advantage of other investment strategies.

I hear a lot of advisors talk about "riding out" the current economic crisis, hoping that traditional buy and hold strategies will recover in time to help client portfolios rebound.

No one knows when - or if - the markets will again permit conventional buy and hold strategies to deliver reliable investment performance. In the meantime, advisors would be wise to consider if the game has changed and the time has come to take advantage of other investment strategies sparked by the changed market environment.

Investors, particularly high net worths, expect something more sophisticated than unwavering allegiance to a strategy that isn't working. One alternative to traditional investment strategies involves the use of tactical adjustments that seek to take advantage of opportunities spawned by market instability. If there is a silver lining to the market downturn, it's that the volatility and uncertainty have created numerous opportunities. Finding them calls for thorough research by advisors, but it's a commitment well worth the effort in terms of meeting client portfolio concerns.

Morningstar research notes that for the 10-year period ending March 31, 2009, the S&P 500 Index is down 38%. Imagine the stress this causes investors. Not only a decade of lost investment returns but a near-40% erosion of principal. Throw in the effects of inflation and the loss is staggering. Advisors making consistent tactical adjustments and rebalancing client portfolios are able to actively help their clients align their portfolio with market cycles.

As advisors, our task is to assess client circumstances, objectives and risk profiles while doing our best to enhance returns while protecting their downside. That cannot be accomplished in severe markets without a vigilant effort to find opportunities created by market inefficiencies and investor misperceptions. As recent evidence has demonstrated, during stressful markets, we must be willing to deviate from traditional buy and hold approaches.

Where are the Opportunities?

From a risk/return perspective, there have been opportunities with the narrowing spreads of Treasuries versus high yields, corporate and municipal bonds. Obviously, caution is warranted to help prevent overexposure, and while default rates may increase across the board in these areas, low prices have provided a hedge against the short-term risk. Even with some anticipated defaults, a diversified bond portfolio including an appropriate allocation of high quality corporates, agencies and municipals can provide adequate ballast against defaults.

Opportunities must be explored promptly because they sometimes dissipate as quickly as they surface. By the time this article is published, new opportunities may exist that are not available today. We may, for example, see a shift from fixed income back to equities and other sectors. Those hit earliest or hardest in a downturn can be among the first to recover, including small caps and emerging markets.

Adjustments Promote Relationships

An ancillary benefit of making tactical adjustments is it brings advisors and clients closer together because of the more frequent communications between them. The process of uncovering investment opportunities provides advisors with another opportunity, a chance to create a "higher touch" relationship with their clients.

I have always been an advocate of regular client communications. Given the recent market conditions, I have intensified that focus and now meet even more often with clients. There is a substantial time commitment required. Making effective tactical adjustments calls for reviewing each individual client portfolio on an overall and individual account basis, evaluating asset allocations, and determining whether rebalancing is needed. All of this must be done before contacting clients. In addition, we strive to make these adjustments and place investments in the most tax efficient manner for clients. If the adjustments are to be implemented, additional staff time or resources may be necessary as well. Advisors lacking time management skills, adequate resources or who have been more passive regarding client contact in the past will probably have to change their business model.

I see tactical adjustments and the portfolio diversity they create as an important facet of helping clients focus on the big picture, especially during downturns, when perspective can become distorted. Nothing performs well all the time (witness recent events) and clients understand this, but we all have seen clients become upset because one area is underperforming, even if their overall portfolio is doing well. There's no way to know our client's disposition without continuous communication.

Advisors who are alert for opportunities to support tactical adjustments will be better positioned to help client portfolios weather economic storms. These adjustments require additional time and research, but they help to differentiate you from advisors in the marketplace who are content to stand pat and maintain buy and hold strategies. Advisors who are willing to implement this strategy in their practice will give their clients additional confidence and trust that their advisor is putting them in a position to react to current market conditions. Utilizing this strategy also allows for increased communication with clients who feel more confidence in their long-term planning knowing that action is being taken on their behalf.

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