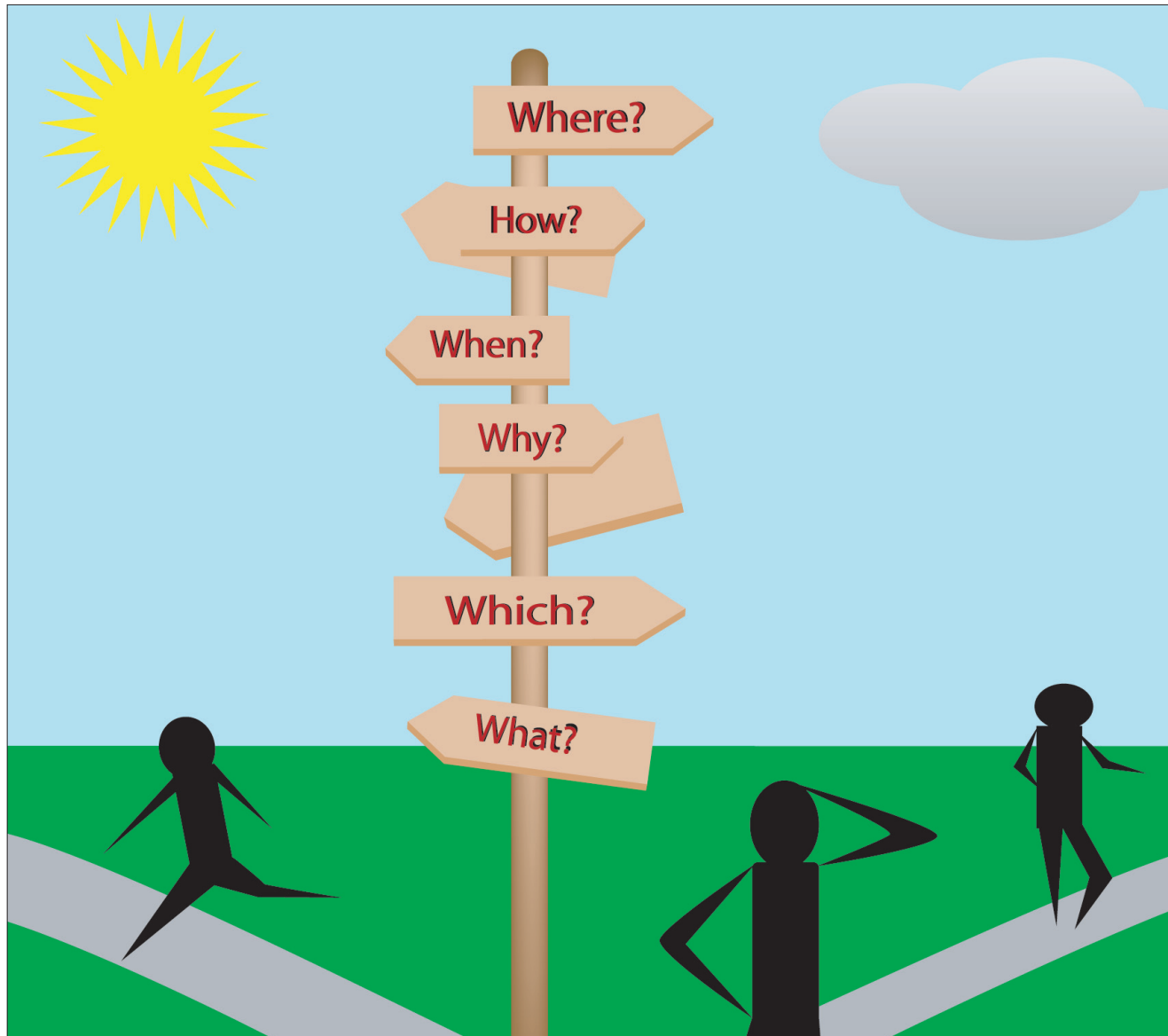


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Create your investment plan now

No one plans to fail but many fail to plan. Creating a carefully laid-out investment plan and implementing it is essential for providing a clear path forward when markets turn volatile.

By Wilfred Ling

Markets have been extremely volatile recently. Problems with the US sub-prime problems have affected global equities. This to the extent that even the US Federal Reserve had to reduce its discount rate to improve liquidity in the banking sys-

tem. As I type this article, Asia markets are all in the red due to the announcement of an unexpected drop in U.S. payrolls by 4,000 jobs last month. Economists had expected a gain of 100,000 jobs instead.

With such volatility, what should a person do?

In order to answer that question, it is important to note that the question should not be asked during periods of market volatility. Instead, it is important to ask the question before starting any investment. Thus, I would like to introduce the concept of an investment plan.

Why should we plan?

No one plans to fail but many fail to plan. The purpose of an investment plan is to provide a roadmap for the investor. Just as a person needs a map to navigate a rough terrain, such an investment plan provides a path forward when the markets turn bad. Without such a roadmap, the investor's direction is unclear and the decision becomes clouded with the market's noises and personal emotions.

Creating A Plan

An investment plan specifies the objectives of the investment. This can be saving up for retirement, accumulating enough for the child's college tuition fee or simply ensuring that one's assets are protected from inflation. Without stating the objective, it is easy to lose track. For instance, if the investment plan is abandoned in the future for some reason, the immediate implication is that the stated objective has been abandoned. Abandoning one's retirement goal or children's education plan is not something anyone should take lightly.

The investment plan must have a finite time line. This means that the time horizon is important. If it is accumulating wealth for retirement, the expected age of retirement marks the end of life of the investment plan. Of course, a few years before that age, it is important to draw out a new investment plan for the post retirement period.

The plan must take into account the risk appetite of the investor. When stock markets go down south (like at this moment), some investors sleep well while others have nightmares. Moreover, not all investors have the ability to take risk. For example, a person with a higher networth has more ability to take risk than another person with significant amount of debts simply because the latter cannot afford to lose more money.

With the time horizon and risk appetite determined, an asset allocation can be developed. Traditionally two asset classes are used – these are bonds and equities. In recent years, there has been some concern that these two asset classes are getting too correlated. Those who are more adventurous may want to consider structured products and commercial property funds. However, not all structured products and commercial property funds are created equal. Many retail structured products are inferior due to its complexity, overly long period to maturities and limited upside. A good structured product – although not easy to find – should be simple to understand, has a short maturity period of 3 years or less and does not cap the upside yet providing capital preservation.

As for property, consider funds that invest directly in the commercial properties rather than property shares or Real Estate Investment Trusts (REITs). REITs are listed on the stock exchanges and are often traded at a premium above its Net Asset Value (NAV). However a property fund that buys directly to the commercial property permits the investors to buy at its true NAV. As I understand it, there do not seem to be any such property fund for retail investors although such funds are available for accredited investors.

The investment plan should have a provision for what to do

during market volatility. To be sure, not all asset classes go down at the same time. Yet, a traditional aggressive portfolio would usually contain a significant amount of equities. There are two common responses when the stock market goes down. One way is to rebalance the portfolio to its original asset allocation when the equity portion has “sunk” significantly. This way of rebalancing forces the investors to “sell high” those assets that have relatively done better and to “buy low” on those assets that have done badly. This is a mechanical form of “sell high” and “buy low” without attempting to time the market.

Another way of reacting to market volatility is to double his regular saving plan for that month. Assuming the investor is already on a regular saving plan (RSP), a bad month that suffered say – 5% losses – would trigger the investor to double his RSP for one month. This is another form of mechanical investing although there is a small element of market timing.

Finally an investment plan should be regularly reviewed. The plan should be reviewed whenever there is a significant life change. Examples are: marriage, birth of a new born and death or a major illness of a close one. When using active managed funds, it is also important to regularly review the performance of these funds so as to ensure that the fund manager is doing his “job.” If monitoring becomes too tedious, passive funds can be used instead, because a passive fund guarantees to give market returns before cost. There is no worry of fund manager resigning for such passive funds.

Pitfalls to Watch For

The greatest pitfall to watch for is reviewing the plan too frequently. Most investors review their plan whenever market sentiment changes. Since the investment plan has already catered for market volatility, there is no need to review the plan when market turns bad. In practice, many of my clients requests for changes to asset allocation too frequently. This is despite their investment plan being just a few months old. The right approach is that whenever market turns bad, the investor should read the investment plan again so as to seek its guidance on the path forward. Once the investment plan is in place, the investor should follow the plan's roadmap and not the other way round.

Another pitfall to watch for is adding the latest “hot” funds into the portfolio. Often these thematic funds are sold aggressively by investment salespersons without due consideration to the investor's existing portfolio. If such funds are added to the portfolio without due consideration, the risk profile of the portfolio could dramatically change to either above or below the investor's risk appetite. With so many hot funds added, the investment plan may eventually be abandoned and this means that the investor has lost a roadmap to his investment objective.

In times of market volatility, do not formulate decisions based on what the Federal Reserve has to say or how many mortgage companies have filed for bankruptcies. It is always unwise to look at market indices everyday. Instead, in times of trouble, look to your investment plan and follow that plan. **SI**



Wilfred Ling is an investment adviser with Promiseland Independent. He is licensed by the Monetary Authority of Singapore to provide investment advice. For consultation, prior appointment at telephone 62942461 is required. A consultation fee may be charged.