**What You Need to Know About Investing Going into 2020**

Two crucial factors define success or failure when it comes to designing an investment strategy:

1. Projected performance of the market
2. A clear understanding of your risk tolerance

Many investors make a big mistake by focusing attention on the market as opposed to their unique risk tolerance. The reason for this mistake is due to the difficulty of clearly identifying risk tolerance. The market is much easier to think about since it is continuously in the news. It seems so easy to increase risk when the market is going up and decrease risk when the market is going down. Unfortunately, this simple market timing approach does not work. If it were that easy, everyone would do it and we would all be filthy rich.

T**he market.** When speaking of the market, most people think of the stock market. I'll stick with that definition in this essay. But what exactly is the market? Given the advanced development of technology, the market is a highly sophisticated mechanism where investors cast their votes on what they perceive as the accurate price of a particular stock every minute of every day somewhere in the world. The price of a specific stock represents one apple in a basket comprised of literally tens of thousands of apples. That basket represents the market. Voting is a pure democratic process where everyone is equal and is driven by supply and demand. At any point in time the supply of stocks is reasonably fixed, which means demand drives market prices. So, what drives demand?

Two main factors drive demand: emotion and corporate earnings. Day-to-day, emotion rules the market. Fear, greed, and euphoria all combine to send stock prices on a wild roller coaster ride every moment of every day. These unpredictable emotions can turn on a dime. Trade wars, military tensions, and political wrangling all combine to exert a complicated mixture of sentiments. Trying to sort out the constant flow of new information in an attempt to predict future stock prices is akin to trying to reason with a hormone-induced teenager. The drama is overwhelming. Investors who focus on the market play a game of Russian roulette not knowing from minute-to-minute whether the chamber has a round in it or not. I am a firm believer of not playing such a guessing game, which boils down to speculating as opposed to investing!

Longer-term, emotions smooth out and corporate earnings set the pace. Older firms that don't adapt to current changes drop out of the race and are replaced by newer, younger firms that bring in fresh ideas. Capitalism thrives on these new ideas; socialism has trouble adapting. Investors who bet on the longer term believe in the merits of capitalism and democracy. The two go hand in hand. But how long is the long-term? Great question and one that defies a clear answer, but generally speaking, at least 5 years. Investors who have a long-term horizon should diversify

their portfolios by including other asset classes as bonds, real estate, energy, and natural resources.

**Your risk tolerance.** Instead of trying to figure out where the market is headed and why it is doing what it is doing (an impossible task!), a much more sound strategy is to focus attention internally as opposed to externally. An internal focus brings up the question of what factors you should consider. Here the answer is multifaceted. Your age is certainly a major factor but not the only one. The older you are, the less time you have to react to market corrections. Alternatively, the younger you are the better able you are to take risk. But age can be misleading.

A retiree presumably with a short-term horizon may actually have a long-term outlook when considering passing assets to his/her heirs. In this case, a growth strategy oriented toward the stock market makes sense. In addition, a 60-year old retiree may easily have a 25-30 year life expectancy, which is not a short-term horizon. If that is the case, the stock market is an excellent vehicle for protection against loss of purchasing power over time. Generally speaking, tilting the portfolio composition toward income (bonds, real estate, energy, and commodities) during retirement is more appropriate than a heavy orientation toward growth when you are still employed. The operative word is, “tilting”.

Besides age, your current net worth also affects portfolio composition. If your net worth is relatively low, you may be in a position of having to play catch-up ball if retirement planning is the goal. In that case, a growth strategy may be appropriate even if you are near or already in retirement. Such a strategy requires being mentally prepared for inevitable corrections to the market. No rules apply to such a touchy situation. Careful consideration and professional judgment are required to delicately walk that tight rope.

On the other hand, if your net worth is relatively high, you may not need to take the risk associated with a growth strategy regardless of your age. My question is always, why take the risk if you don’t need to. If you are living within your means and you have the financial resources to deal with health issues and other unknowns down the road, taking unnecessary risk is not advisable. In that case, tilting the portfolio toward conservatism (non-growth assets) is appropriate.

This discussion emphasizes the importance of looking inward as opposed to outward when designing an investment strategy. The market is a marvelous mechanism that coordinates the flow of funds between corporations that need capital and investors who have capital. It is a place investors can gain enormous wealth or lose it quickly if played recklessly. Wise use of this fascinating vehicle requires careful thought. I think of the market as a wild animal that needs a tight chain of thoughtful restraint. When designing an investment strategy, you should first look inward, not outward. I hope this essay helps some toward understanding this important approach.

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