THE MITCHELL REPORT

By Michael Mitchell

Given the upheaval in the markets recently, I thought it would be a good idea to shift the focus on my columns from investment management to financial planning. The main reason for this change is that it appears some investors — and their advisors — are weathering the economic storm better than others. It's not that they haven't suffered portfolio losses, but their losses have been far less debilitating. Most have not had to compromise their standard of living or make dramatic lifestyle changes.

I wanted to know what these advisors and their clients had done differently so I could share that knowledge with my readers. I suspected the answer was linked as much to sound planning as it was to investment philosophy. Investors who are able to maintain their financial stability and avoid selling out of a depressed market are invariably those with the most in-depth financial plans supporting their investment decisions.

The majority of financial advisors I have interviewed over the past two decades indicate their clients typically place far greater value on investment performance than on detailed planning. Given that advisors tend to make most of their income from managing assets versus planning fees, it's probably not surprising that so few investors have a comprehensive financial plan to fall back on when the markets tank.

Given this background, my first "planning" oriented interview is with Wayne von Borstel, founder of Oregon Trail Financial services near Portland. Over the past 25 years, von Borstel has earned a reputation throughout the region's financial services community as one of its staunchest advocates of comprehensive financial planning. In fact, he does not accept new clients who want a relationship based solely on investment performance.

Here is the transcript of the interview with Mr. von Borstel:

Mitchell: *Thanks for taking time to chat with me today. I know you must be very busy right now.*

von Borstel: As a matter of fact, this is a good time for us to talk. Things have been pretty quiet around here for the most part.

Mitchell: *Really? I would have thought all the market volatility would have you glued to the phone responding to anxious investors.*

von Borstel: Well, there is certainly some angst over the uncertainty and the drop in equity values, but during the historic run up in values the past few years, we continuously stressed the importance of having a sound plan in place to address the inevitable downturn. Not all of our clients listened but the majority did and most are weathering the storm without major damage to their financial ships. That's not to say they have not experienced losses, but it's one thing to be down 20% in a market that is down 30%; it's quite another to be down 75%. For retirees lacking sufficient resources, that kind of loss is debilitating because their investment capital has been eroded to the extent it can no longer generate sufficient income. Just as bad, they don't have time to recover or the ability to return to the workforce.

Mitchell: *How do you convince your clients to prepare for downturns? That's an awkward conversation to have when the markets are experiencing double-digit returns, isn't it?*

von Borstel: For some it is, yes. When people are euphoric about soaring markets and real estate values, the importance of planning tends to be minimized. The notion of an eternally rising economy mesmerizes investors into ignoring the lessons of history. They concentrate their holdings into what they perceive as hot segments and their lack of portfolio diversity betrays them once the market turns south.

Those lacking a sound financial plan have nothing to fall back on and when the fur starts to fly, they tend to make irrational decisions because they have not committed to a planning strategy designed to minimize damage in an economic storm.

The mass media plays a major role in all of this, paying lip service to financial planning while talking heads from investment banks hype the stocks in their trading desk accounts. Supporting the euphoric illusion are the companies who sell financial products and services, the sponsors who make money when investors trade, not when they sit on the sidelines.

Mitchell: *So how do you help prepare your clients for what is currently happening?*

von Borstel: For years, we've been reminding our clients that at any time, a confluence of just three events can subject them to the perfect financial storm: a significant market drop, double-digit inflation and failing health.

Over the past 50 years, the markets have suffered above average losses on thirteen occasions, or about once every four years. Of course, when these losses will occur is unpredictable. Retirees with a life expectancy of 30 years are likely to experience another six or seven major market slides. Combine one of these drops with high inflation and someone's failing health and, barring detailed planning, you have a recipe for financial disaster. Markets are not always going to rise; inflation is not always going to be low; our health will not always be good. Without preparation, you probably won't survive financially. With proper planning, potential disasters can become almost a non-event.

Mitchell: *So the detailed planning process is really at the heart of everything you do for your clients?*

von Borstel: It is. I just heard from some clients who vacationed in Paris. They said almost everyone was nervously watching TV or going online to see how their portfolios were doing. My clients couldn't believe it; they thought everyone had gone mad.

You must have confidence in your plan and process. Yes, you may be down, but probably not as much as the broad markets, and certainly not enough to be forced to change your lifestyle or go into panic mode. The biggest enemy in times like this is being forced to spend your investment capital. You must have a plan in place for times like this, a plan that includes emergency funds, five year's worth of conservative assets, a budget that allows you to live comfortably on three percent of your wealth, and no debt. When times are good, many investors ignore these guidelines, but the price they pay when things go bad is the loss of peace of mind, and that may be an irretrievable loss.

If you are glued to the TV every morning, fretting over the markets and your portfolio, you have no peace of mind. Worrying about the markets is futile because in the short term, they are unpredictable. Your worries should be about your grandchildren's soccer game, where you will be taking your next vacation, where you plan to go fishing or play golf tomorrow, but not your portfolio or the markets. An obsession with day to day market movements is like trying to overcome seasickness by going out on a small boat and watching the waves instead of the horizon. It's a futile exercise; go enjoy your life and have confidence in your plan.

Mitchell: *Some think the current environment is the worst since the depression. Do you agree?*

von Borstel: Not at all. Those whose portfolios have been most adversely affected may think we are experiencing a singular financial meltdown, but that's not the case.

Every bad market appears to be the worst ever while it is occurring. It isn't. As gloomy as things seem to many people today, they do not begin to compare to the aftermath of the stock market crash of 1929 when people were jumping out of windows and there were no jobs. Today is nowhere near as bad as after the attack on Pearl Harbor in 1941. There was not a family where I grew up that didn't lose a member during WWII. Loved ones were dying by the thousands overseas in places Americans had never heard of before. The 1962 Cuban missile crisis was also worse. People huddled in front of their televisions, praying they were not witnessing the start of a nuclear holocaust. In 2001, we watched in horror as those poor souls in the World Trade Center leapt to their deaths just before the Twin Towers collapsed into rubble.

The nation held its collective breath, wondering if this was only an opening salvo by terrorists. That was tangible fear; people were dying. The current financial challenges we face may be daunting, but they are hardly life threatening.

As frightened as some people might be today, things are not as bad as they have been at times in our nation's past. Most recently, we were riding the second-longest market rally in history. It had to come to an end. Everyone knew that, or should have known it. No one knew what would happen to trigger the downslide, nor how fast or how far. But any rational person recognized that eventually, something was going to happen to cause the market to reverse itself.

Success borne of good fortune is a recipe for euphoria, greed and poor financial decisions made impulsively. This is true universally and in all market sectors. I don't know how far the market will ultimately drop, but no matter how bad it gets, those committed to a sound financial plan will invariably fare better than those flying by the seat of their pants. This is true not only for our current situation but for the future as well because it's going to happen again. And again.

Mitchell: *Some retirees have suffered a significant erosion of their investment capital as a result of the equities debacle. Is it too late for them to benefit from a comprehensive plan?*

von Borstel: It's almost never too late for good planning. Investing doesn't end when we retire; that's only halftime of the game. We still have to play the second half. While we are working, we're investing for retirement. After we retire, we invest for ourselves and to maintain our lifestyle. Once we reach our mid-seventies and older, we are typically no longer worried about ourselves as much as what we wish to leave to our heirs and perhaps charity. The game becomes one of how to preserve wealth for our family and last wishes.

You must remember that there is another team playing against us, a team made up of inflation, taxation, occasional bad markets and eventual declining health. That team takes the field and plays whether we do or not. If we don't show up for the second half, we lose by forfeit. We have to show up and play. To do that effectively, we need a good game plan, whether it was drawn up at the beginning of the season or at halftime.

Our ultimate goal is to achieve peace of mind. Given how they have planned, how many people have that today? How many people don't have to watch TV or check the markets every day to see if they are okay? Not as many as there would be had they had been vested in a solid planning process.

Mitchell: *How much of the responsibility for planning lies with financial advisors? If they make most of their income from investment management, how strongly are they going to push their clients to invest in planning?*

von Borstel: I think a great deal of responsibility lies at the feet of advisors. Of course, as I mentioned, the mass media hypes the "investment strategy du jour" at the expense of planning because it's a juicier topic and generates more interest. But as advisors, I think we have to take the lead in changing the public's perception of what is more important: planning or management.

Today's markets illustrate the value and importance of planning. Most investors who thought they had a plan now realize they don't. Their brokers have stopped calling them or if they do call, it's to beg them to "stay the course" or some similar bromide. But what value does that advice hold when retirees are spending out of a down market?

Investors without a solid plan lack a belief system; they act out of emotion, and that emotion is fear or worse, panic. Without trust and faith, investors are unable to act rationally or systematically when markets tumble. They do everything for the wrong reasons and end up with investor returns instead of investment returns.

Mitchell: *What do you mean by that?*

von Borstel: We've all heard the DALBAR research about how investors on average have only reaped about 25% of the market's investment gains over the past 40 years because of emotional decision-making. The difference is having a plan that helps prevent you from doing counterproductive or irrational things during times of stress.

You recall the adage of a rising tide lifting all ships? Well, when the markets are soaring, brokers feel the need to compete with each other by promising inflated returns. What they don't disclose is the likelihood of those returns continuing unabated. That likelihood is zero. So when a broker tells a retiree "I can get you 6% annual return so feel free to spend that much", he's setting the client up for a downfall. It's just a matter of time.

Over the past year, a lot of brokers and advisors have not only quit calling their clients, they have quit their clients altogether, having retired to the golf course. Their clients have been left to fend for themselves while mulling their decision to chase investment returns without a formal planning process. Investors with a good coach who prepared them for the volatility and market chaos that is currently going on are likely doing fine, but they tend to be the exception. Investors who placed greater value on performance than planning don't know what to do or where to go with their money today. How do retirees generate sufficient income?

It's not hard to see how all this happened. The media's focus is on performance; commissioned broker's focus is on performance; so it's only natural that the investing public's focus would be on performance as well. The price of this misplaced emphasis is that many investors, and retirees in particular, are simply scared out of their wits. They are reduced to asking others what to do. Of course, the others aren't any better off or more confident of what to do, so any advice they might offer is of no value. People see others jumping into the ocean and so they do the same thing, even though they can't swim. A herd mentality has taken over and people will do anything they see others doing because they no longer trust their own judgment. The reason they lack faith is because they have no basis, no plan, to fall back on.

Mitchell: *You're saying that preemptive financial coaching is the key, even if someone is already retired?*

von Borstel: I am. Look, why do great athletes use coaches? Why does Tiger Woods, the greatest golfer in history, continue to spend money for the advice of a coach who can't hit the ball anywhere near as well as Tiger can? Because he doesn't know when his swing will get out of tempo or when he will get into a bad habit, and he realizes he needs someone watching to help him get back on track when something goes wrong. Just like great athletes, we get the most out of our potential with a concerned coach and a good plan.

Mitchell: *Can you share any details about your planning process?*

von Borstel: There is no single "grand plan". Each person is different. Each has a unique set of circumstances, preferences, time horizon, risk tolerance, lifestyle requirements, late-life wishes and other factors: These things can only be assessed by meeting and discussing them candidly.

I will say this. No one knows when the next event will occur that rattles the markets to their foundations. It may be an act of terrorism, political lunacy, a financial meltdown, a scandal or assassination. Whatever it is, we know something will occur that will jolt the markets and cause the next downward spiral. Whatever it is, whenever it occurs, however long it lasts or how bad it gets, it will happen sometime in the not too distant future. Without a good coach and plan, investors will no doubt overreact and do something reactive and ill-advised that will cost them dearly. My mission as an advisor is to help them avert disaster by sitting down and crafting a plan that will help them maintain their emotional equilibrium and continue to make good decisions when the bad times come.❖

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