AlmanPartners
True wealth

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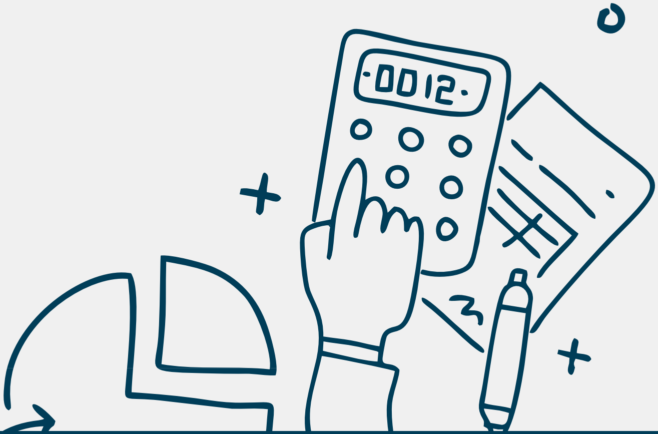
The Informed Investor

Five Key Concepts for Financial Success



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From the Executive Director

Many people today are facing difficult choices in achieving their financial goals and, as well they should, are asking serious questions. Our goal with The Informed Investor is to help you see through the noise of the marketplace in order to make wise decisions about your money.

Because educated investors are the most successful investors, we have created The Informed Investor to show you a Nobel Prize-winning approach (page 12 refers) crafted to optimise your investment portfolio over time. We have designed it specifically not only to support you in your efforts to preserve what you already have, but also to capture efficiently the market returns for your investments.

In addition, because we recognise that reaching your financial goals requires more than just good investment management, we have also described our formula - that systematically addresses your entire range of financial issues.

We believe in empowering people to make the best decisions for themselves or, if they wish, to choose astutely a financial adviser who can implement sound wealth management principles. We believe in sharing our own financial knowledge with everyone who wants to make smart decisions about their money.

Alman Partners is pleased to present The Informed Investor to our clients and prospective clients. We sincerely hope that it will provide you with a framework for an intelligent approach to making financial decisions that will help you to achieve all of your most important dreams.

Sincerely,

Steve Lowry

CFP® Professional, DFP, Accredited Investment Fiduciary®
Financial Adviser and Executive Director

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[1] Michael C. Jensen, "The performance of mutual funds in the Period 1945-1964," Journal of Finance, May 1968.

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Taking a Comprehensive Approach to your Financial Life

Money means different things to different people. Each of us has different dreams.

You may want to achieve financial freedom so that you never have to work again, or maintain it even if you plan on working the rest of your life. You may want to make high quality education possible for your children or grandchildren. You may want to provide the seed capital that will give your children or grandchildren a great start in life, whether that's with a home or a business. You may dream of a holiday home on the beach or abroad. Or you may have achieved tremendous success throughout your career and want to leave behind an enduring legacy that will enable your favourite charity to continue its work.

Whatever your dreams are, you need a framework for making wise decisions about your money that will help enable you to achieve all that is important to you. The chances are good that you have a wide range of financial goals, as well as diverse financial challenges.

Common sense tells us that such a broad range of issues requires a broad, comprehensive outlook. It's for this reason that most affluent clients want their financial advisers to help them with more than just investments. They want their entire financial house in order - a complete approach to addressing their entire financial lives.

As you've probably noticed, many financial firms these days say that they offer comprehensive services. The trouble is that many of these firms just provide investment management and offer a couple of extra services - such as education planning and estate planning - and call that comprehensive service. So the challenge for anyone who wants help addressing all their financial needs is finding a firm that provides clear, independently researched advice to help you achieve your life's goals.

We define our firm's formula for success below:

VP + IC + TA = Success

Values Based Financial Planning (VP)
In the grand scheme of things, money is not that important. It's significant only to the extent that allows you to enjoy what is important to you. And not worrying about your finances is critical to having a life that excites you, nurtures those you love, and fulfils your highest aspirations.

Investment consulting (IC) is the astute management of investments over time to help achieve financial goals. It requires financial advisers to understand deeply their clients' most important challenges and then to design an investment plan that takes into account their time horizons and tolerance for risk and that describes an approach that will maximise the probability of them achieving their goals. It also requires financial advisers to monitor both their clients' portfolios and their financial lives over time so that they can make adjustments to the investment plan as needed.

Trusted Adviser (TA) In this day and age when time is our most precious resource our clients recognise that outsourcing the co-ordination of their financial needs to one Trusted Adviser is paramount. In this role our advisers have a team of subject matter experts in the areas of law, specialist accounting, risk insurance to assist in getting our clients' entire financial house in order and keeping it that way.

= Success It is important to note that success is not a destination, it is a journey. By working with our firm you will have the confidence that your journey will be a successful one.

Our focus in this resource guide will be on the element of investment consulting. However, bear in mind that managing your investments is just one part of a comprehensive approach to your financial life.

Let's now turn our discussions to the concepts that can make you a more successful investor.

Rising Above the Noise

Some investment professionals work hard to make their work confusing. They believe they have a vested interest in creating investor confusion.

They use jargon that can intimidate and make it difficult for you to understand relatively straightforward concepts.

However, investing is actually not that complicated. It can be broken down into two major beliefs:

- You believe in the ability to make superior security selections, or you don't.
- You believe in the ability to time markets, or you don't.

Let's explore which investors have which belief systems and where you should be with your own beliefs.

Exhibit 1 classifies people according to how they make investing decisions.

Exhibit 1: The Investment Decision Matrix

		MARKET TIMING	
		Yes	No
SECURITY SELECTION	Yes	*Noise quadrant* 1 Most individual investors Financial journalists	*Conventional wisdom quadrant* 2 Financial advisers Stockbrokers Most investment funds
	No	*Tactical allocation quadrant* 3 Pure market timers Asset allocation funds	*Information quadrant* 4 Academics Many institutional investors Alman Partners

Source: CEG Worldwide

NOISE QUADRANT

Quadrant one is the noise quadrant. It's composed of investors who believe in both market timing and superior investment selection. They think that they (or their favourite financial guru) can consistently uncover mispriced investments that will deliver market-beating returns. In addition, they believe it's possible to identify the mispricing of entire market segments and predict when they will turn up or down. The reality is that the vast majority of these methods fail to even match the market, let alone beat it.

Unfortunately, most of the public is in this quadrant because the media plays into this thinking as they try to sell newspapers, magazines and website subscriptions. For the media, it's all about getting you to return to them time and time again.

CONVENTIONAL WISDOM QUADRANT

Quadrant two is the conventional wisdom quadrant. It includes most of the financial services industry. Most investment professionals have the experience to know that they can't predict broad market swings with any degree of accuracy. They know that making incorrect predictions usually means losing clients. However, they believe there are thousands of market analysts and portfolio managers with MBAs and high-tech information systems who can find undervalued securities and add value for their clients. Of course, we all want to believe that if you're bright enough and work hard enough, you will be successful in a competitive environment. After all, it works in other disciplines.

Unfortunately, as irrational as it seems, in an efficient capital market this methodology on average, adds no value. While there are ongoing debates about the efficiency of markets, most economists believe that, fundamentally, capital markets work well as a means of setting prices.

TACTICAL ALLOCATION QUADRANT

Quadrant three is the tactical asset allocation quadrant. Investors in this quadrant somehow believe that, even though individual securities are priced efficiently, they (and only they) can see broad mispricing in entire market sectors. They think they can add value by buying when a market is undervalued, waiting until other investors finally recognise their mistake and selling when the market is fairly valued once again. We believe that it's inconsistent to think that individual securities are priced fairly but that the overall market, which is an aggregate, is not. No prudent investors are found in this quadrant.

INFORMATION QUADRANT

Quadrant four is the information quadrant. This is where most of the academic community resides, along with many institutional investors. Investors in this quadrant dispassionately research what works and then follow a rational course of action based on empirical evidence.

Academic studies indicate that investments in the other three quadrants, on average, do no better than the market after fees, transaction costs and taxes. Because of their lower costs, passive investments - those in quadrant four - have higher net returns on average than the other types of investments[1].

Our goal is to help investors to make smart decisions about their money so that they are firmly in place in quadrant four. To accomplish this, we help investors to move from the noise quadrant to the information quadrant. We believe this is where you should be to maximise the probability of achieving all your financial goals.

Five Key Concepts for Financial Success

While investing can at times seem overwhelming, the academic research can be broken down into what we call the Five Key Concepts for Financial Success.

If you can examine your own life, you'll find that it is often the simpler things that consistently work. Successful investing is no different. However, it is easy to have your attention drawn to the wrong issues. These wrong issues - *the noise* - can derail your journey.

In this section, we'll walk through these five concepts and then explain how successful institutional investors incorporate each of these concepts into their investment plans. These plans both meet their fiduciary responsibilities and achieve their financial goals. You owe yourself and your family nothing less than what the institutional investors have.

It is important to note here that while these concepts are designed to maximise return, no strategy can eliminate risk, which is inherent in all investments. Whenever you invest, you have to accept some risk. It's also important to remember that you're responsible for reviewing your portfolio and risk tolerance and for keeping your financial adviser current on any changes in either your risk tolerance or your life that might affect your investment objectives.

Concept One:
Employ diversification to reduce risk

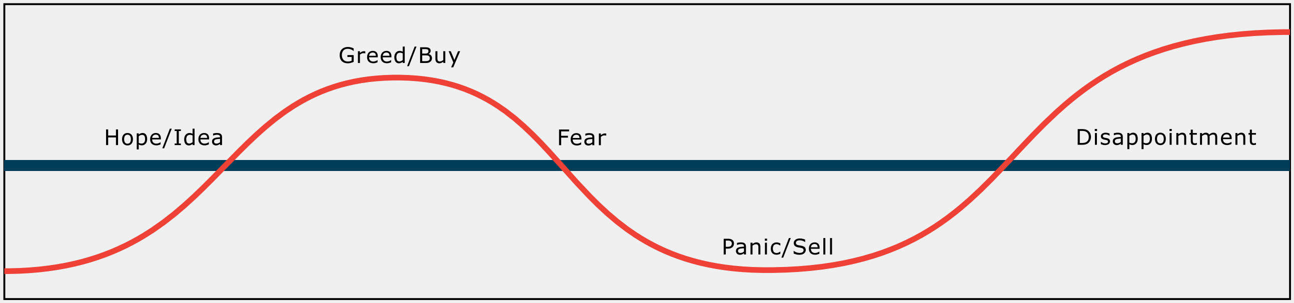
Most people understand the basic concept of diversification: Don't put all your eggs in one basket. That's a very simplistic view of diversification, however. It can also get you caught in a dangerous trap - one into which you may already have fallen.

For example, many investors have a large part of their investment capital in shares in their employer's business. Even though they understand that they are probably taking too much risk, they don't do anything about it. They justify holding the position because of the large capital gains tax bill they would have to pay if they are sold, or they imagine that the shares are just about ready to take off. Often, investors are so close to particular shares that they develop a false sense of comfort.

Other investors believe that they have effectively diversified because they hold a number of different shares. They don't realise that they are in for an emotional roller coaster ride if these investments share similar risk factors by belonging to the same industry group or asset class. 'Diversification' among a large number of high-tech companies is not diversification at all.

To help you understand the emotions of investing and why most investors systematically make the wrong decisions, let's look for a moment at what happens when you get a hot tip on a share (see **Exhibit 2**).

Exhibit 2: The emotional curve of investing



Source: CEG Worldwide

If you're like most investors, you don't buy the share right away. You've probably had the experience of losing money on an investment - and did not enjoy it - so you're not going to race out and buy that share immediately based on a hot tip from a friend or business associate. You're going to follow it for a while to see how it does. Let's assume, for this example, that it starts trending upward.

You follow it for a while as it rises. What's your emotion? Confidence. You hope that this might be the one investment that helps you make a lot of money. Let's say it continues its upward trend. You start feeling a new emotion as you begin to consider that this just might be 'the one.' What is the new emotion? It's greed. You decide to buy the share that day.

You know what happens next. Of course, soon after you buy it, the share starts to go down, and you feel a new combination of emotions - fear and regret. You're afraid you made a terrible mistake. You promise yourself that if the share just goes back up to where you bought it, you will never do it again. You don't want to have to tell your spouse or partner about it. You don't care about making money anymore.

Now let's say the share continues to go down. You find yourself with a new emotion. What is it? It's panic. You sell the share. And what happens next? New information comes out and the share races to an all-time high.

We're all poorly wired for investing. Emotions are powerful forces that cause you to do exactly the opposite of what you should do.

That is, your emotions lead you to buy high and sell low. If you do that over a long period of time, you'll cause serious damage not just to your portfolio but more importantly, also to your financial dreams.

But truly diversified investors - those who invest across a number of different asset classes - can lower their risk, without necessarily sacrificing return. Because they recognise that it's impossible to know with certainty which asset classes will perform best in coming years, diversified investors take a balanced approach and stick with it despite volatility in the markets.

Concept Two:
Seek lower volatility to enhance returns

If we consider two investment portfolios with the same average (arithmetic) return, the portfolio with less volatility will have a greater compound rate of return.

For example, let's assume you are considering two investment funds. Each of them has had an average arithmetic rate of return of 10% over five years. How would you determine which fund is better? You would probably expect to have the same ending wealth value.

However, this is true only if the two funds have the same degree of volatility. If one fund is more volatile than the other, the compound returns and ending values will be different. It is a mathematical fact that the one with less volatility will have a higher compound return.

You can see how this works from **Exhibit 3**. Two equal investments can have the same arithmetic rate of return but have very different ending values because of volatility. You should design your portfolio so that it has as little volatility as is necessary to achieve your goals.

Exhibit 4 shows two portfolios with the same average return. As a prudent investor, you want the smoother ride of Portfolio A not only because it helps you ride out the emotional curves, but more important, because you will create the wealth that you need to reach your financial goals.

Exhibit 3: Less volatility = Greater wealth

	CONSISTENT INVESTMENT		VOLATILE INVESTMENT	
Year	Rate of return	Ending value	Rate of return	Ending value
Start value		$100,000		$100,000
1	10%	$110,000	35%	$135,000
2	10%	$121,000	-20%	$108,000
3	10%	$133,100	15%	$124,200
4	10%	$146,410	-30%	$86,940
5	10%	$161,051	50%	$130,410
Arithmetic annual return	10%		10%	
Compound annual return	10%		5.45%	

Source: Alman Partners

Concept Three:
Use global diversification to enhance returns and reduce risk

Investors here in Australia tend to favour shares and bonds of Australian based companies. For many, it's much more comfortable emotionally to invest in firms that they know and whose products they use than in companies located in another country.

Unfortunately, these investors' emotional reactions are causing them to miss out on one of the most effective ways to increase their returns. That's because the Australian equity market, while highly developed, represents less than 4% of the total investable capital market worldwide. By looking to overseas investments, you greatly increase your opportunity to invest in superior global firms that can help you grow your wealth more quickly.

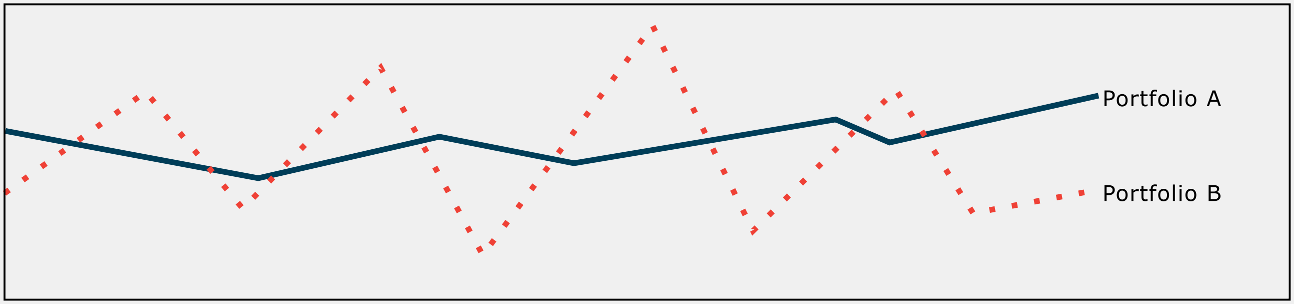
Global diversification in your portfolio also reduces its overall risk. The Australian equity market and international markets generally do not move together. The individual shares of companies around the world with similar risk have the same expected rate of return. However, they don't get there in the same manner or at the same time. The price movements between international and Australian asset classes are often dissimilar, so investing in both can increase your portfolio's diversification.

Concept Four:
Employ asset class investing

It is not unusual for investors to feel that they could achieve better investment returns, if they only knew a better way to invest. Unfortunately, many investors are using the wrong tools and put themselves at a significant disadvantage to institutional investors. It's often the case that using actively managed investment funds is like trying to fix a sink with a screwdriver when you really need a pipe wrench. You need the right tools and we believe that asset class investing is an important tool for helping you to reach your financial goals.

An asset class is a group of investments whose risk factors and expected returns are similar. Originally, institutional asset class funds were not available to the great majority of investors. Often the minimum investment for these funds was in the millions of dollars, effectively keeping them

Exhibit 4: Two portfolios with the same average return



Source: CEG Worldwide

beyond the reach of all but large pension schemes and the wealthiest individual investors. Fortunately, these institutional asset class funds are now accessible to all investors so you can gain the same advantages previously enjoyed only by large institutional investors.

Three major attributes of asset class funds make them attractive:

1. Lower operating expenses.
2. Lower turnover, resulting in lower costs.
3. Consistently maintained exposure to market segments.

We'll look at each factor in turn.

1. Lower operating expenses

All investment funds portfolios have expenses that include management fees, administrative charges and custody fees. These are expressed as a percentage of assets. The average annual expense ratio for Australian retail equity funds is approximately 1.6%. By comparison, the same ratio for institutional asset class funds is typically only about one-third of that of all retail equity funds. All other factors being equal, lower costs lead to higher net rates of return.

2. Lower turnover resulting in lower costs

Many investment managers do a lot of trading, thinking that it adds value. This is costly to their investors because each time a trade is made there are transaction costs, including commissions, spreads and market impact costs. These hidden costs may amount to more than a fund's total operating expenses if the fund trades heavily or if it invests in small company shares for which trading costs are relatively high.

Institutional asset class funds generally have significantly lower turnover rates because their institutional investors want them to deliver a specific asset class return at as low a cost as possible.

3. Consistently maintained exposure to market segments

Most investment advisers agree that the greatest determining factor of performance is asset allocation - how your money is divided among different asset categories. However, you can accomplish effective asset allocation only if the investments in your portfolio maintain a consistent asset allocation. That means your investments need to stay within their target asset classes.

Unfortunately, most actively managed funds effectively force you to relinquish control of your asset allocation. On the other hand, because of their investment mandates, institutional asset class funds must stay fully invested in the specific asset class that they represent.

Key definitions

Expected rate of return is typically calculated as the risk-free rate of return (such as from treasury bills or cash) plus the risk premium (the additional return compared to the risk-free rate) associated with that equity investment.

Standard deviation is a description of how far from the mean (average) the historical performance of an investment has been and is a measure of an investment's volatility.

Correlation coefficients measure the dissimilar price movements among asset classes by quantifying the extent to which they move together in time, magnitude and direction.

Concept Five:
Design efficient portfolios

How do you decide which investments to use and in what combinations? Since 1972, major institutions have been using a money management concept know as Modern Portfolio Theory. It was developed at the University of Chicago by Harry Markowitz and Merton Miller and later expanded by Stanford professor William Sharpe. Markowitz, Miller and Sharpe subsequently won the Nobel Prize in Economic Sciences for their contribution to investment methodology.

The process of developing a strategic portfolio using Modern Portfolio Theory is mathematical in nature and can appear daunting. It's important to remember that mathematics is nothing more than an expression of logic, so as you examine the process, you can readily see the commonsense approach that it takes - which is counterintuitive to conventional and over-commercialised investment thinking.

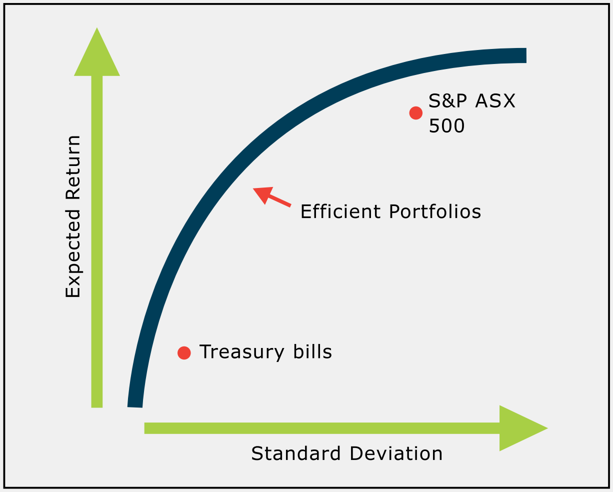
Markowitz stated that for every level of risk, there is some optimum combination of investments that will give the highest rate of return. The combination of investments exhibiting this optimal risk/reward trade-off form the efficient frontier line. The efficient frontier is determined by calculating the expected rate of return, standard deviation and correlation coefficient for each asset class and using this information to identify the portfolio with the highest expected return at each incremental level of risk.

By plotting each investment combination, or portfolio, representing a given level of risk and expected return, we are able to describe mathematically a series of points, or 'efficient portfolios.' This line forms the efficient frontier.

Most investor portfolios fall significantly below the efficient frontier. Portfolios such as the S&P ASX 500, which is often used as a proxy for the Australian equity market, fall below the line when several asset classes are compared. Investors can gain either the same rates of return with an asset class portfolio with much less risk, or higher rates of return for the same level of risk.

Exhibit 5 illustrates the efficient frontier relative to the 'market.' Rational and prudent investors will restrict their choice of portfolios to those that appear on the efficient frontier and to the specific portfolios that represent their own risk tolerance level. A wealth manager's job is to make sure that for whatever risk level you choose, you have the highest possible return on the efficient frontier so that you can maximise the probability of achieving your financial goals.

Exhibit 5: The Range of Efficient Portfolios



Source: CEG Worldwide

Next Steps

As we discussed at the beginning of this guide, taking a comprehensive approach to achieving all your financial goals requires more than just taking care of your investments.

It also means addressing your needs in wealth preservation, wealth enhancement, wealth transfer & philanthropy.

Such a wide range of financial needs requires a wide range of financial expertise. Because no one person can be an expert in all these subjects, our Trusted Advisers have built a network of subject matter experts to bring to the table the right advice at the right time for our clients. Imagine all of your professional service providers, such as Financial Planning, Accounting, Legal & Risk Insurance working together in unison for your benefit and you can have one Trusted Adviser co-ordinating that network on your behalf.

How do I become a client?

The relationship between you, the client, and your trusted adviser is a truly consultative process which usually unfolds over a series of meetings:

At the Financial Road Map meeting we will;

- Explore what is important to you about money which will enable you to align your financial decisions with your deepest held values.
- Identify what your goals and aspirations are for you & your family.
- Explain our business model, fees and processes.
- Determine and discuss your current financial position.

At the Financial Strategy Meeting we will;

- Discuss cash reserves, how much should you have, how to get it there and keep it there.
- Look at how your assets are allocated and we will discuss the best way to deploy or allocate those assets.
- Look at your debt and discuss how to reduce or eliminate your non-deductible debt on a schedule that works for you.
- Commence the process of building your Personal Financial Plan and getting your financial house in order.

Progress meetings

These meetings are designed to review the progress you are making toward achieving your goals. As we know the only constant in life is change. The progress meetings assist to ensure any changes in your situation or legislation which may impact on your plan is considered and action is taken if required.

About Alman Partners

Alman Partners True Wealth is an independent specialist wealth management firm located in Mackay and Brisbane. Since 1985 we have been leading, educating and inspiring our clients to achieve their most important goals. Whether you are looking for comprehensive financial advice designed to guide you on your journey to True Wealth, or a self-directed investment service, Alman Partners has a world-class solution for you.

Our team offers effective strategies and advice on investments, superannuation, retirement planning, wealth management and more. As an independent firm acting as your investment fiduciaries, you can rely on us to provide advice that is in your best interests. We are not licensed through the providers of financial products, which allows our firm the objectivity to select the most appropriate solutions available market-wide. Holding our own Financial Services Licence gives us greater capacity to put clients first, effectively removing potential conflicts of interest. We are pioneers in the industry, offering a fee-for-service model that provides clients with exceptional transparency and wholesale investment solutions.

Alman Partners Investment Committee

The Alman Partners Investment Committee plays a vital role in setting the implementation and monitoring of the fiduciary framework for Alman Partners and our clients. The Investment Committee meets quarterly and has the following framework which includes, governance, maintenance of CEFEX accreditation, review of investment performance and returns ensuring an appropriate level of return is delivered in the prevailing market environment, seeking to minimise investment costs, review of asset allocation and portfolio strategy, and market research. The Investment Committee is supported by an expert Independent Member and advisory firm.

Global Association of Independent Advisors

Alman Partners is a Founding Member of the Global Association of Independent Advisors (GAIA®). GAIA is a collection of like-minded firms in Australia, New Zealand, USA, Europe, South America & the Middle East, who strive to put their clients' interests first. GAIA members openly share information on business practices to ensure their clients receive advice they can trust. All GAIA members are required to maintain CEFEX accreditation and have at least one individual certified as an Accredited Investment Fiduciary (AIF®). **All GAIA member firms strongly believe in the evidence-based investment philosophy.**

CEFEX Accredited

Alman Partners is one of only a handful of Certified Fiduciary Financial Advisers in Australia. Since 2016, Alman Partners voluntarily participates in annual audits conducted by the Centre of Fiduciary Excellence (CEFEX), in order to maximise professionalism, ensure due diligence is adhered to and all compliance requirements are met. CEFEX is an independent global assessment and certification organisation established to evaluate firms through a rigorous set of criteria.

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For further information, please contact our team and ask to speak to one of our qualified advisers or alternatively, email **office@alman.com.au**

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