When to Switch from Offense to Defense with Your Investments

(7/25/2014 AZ Republic by Dr. Harold Wong)

Typically, Wall Street financial advisors concentrate on offense and are always talking about how much money you might make on the upside. They rarely stress the downside. In contrast Warren Buffett's Number 1 Rule is "Don't Lose Money!" His Number 2 Rule is "Don't Forget Rule Number 1!" Buffett says "I will not lose even one night's sleep trying to get extra return by taking too much risk".

Here's a real-world example, which is a composite of clients that I have seen over the last 6 years. The couple is 55 and lost their big home during the real estate crash that started in 2006. When you count their down payment, $60,000 to put in a pool and landscaping, and other major improvements, they lost $160,000. At the peak of the real estate boom in 2005, they organized a group of 20 friends to invest a total $2 million in a building project. Unfortunately, there were allegations of builder fraud and then the real estate bust made the project a total loss. Because they had signed as a guarantor for the bank loan, they were forced to declare bankruptcy so that the bank would not try to collect over $3 million from them. They personally lost $40,000 in this investment.

When I met them, the best thing they had going for them was that they both had good jobs and earned a total of $120,000 annually. They spent $60,000 per year and their total Social Security payroll tax and combined Fed and AZ income tax was $30,000. So, it was possible to save $30,000 per year. Their top 2 priorities were tied at "Never Running Out of Money" and "Growing Assets". When I asked them what they hoped to earn on their investments, they said 10 percent. I asked why and they said that many Wall Street financial advisors had told them they could average 10 percent annual returns in the stock market. The actual returns in the S&P500 index from October 1, 1998 to September 30, 2013 have actually been only 1 percent gross. If you pay 2-3 percent annually in mutual fund or financial advisor fees, your return has been negative over the last 15 years. They were shocked when I showed them the historical chart.

Time to Play Defense: They understood that it takes high risk to make high returns. They were lucky to have $475,000 inside 401(k) accounts, which creditors could not grab during the bankruptcy. I told them it's time to play defense, given that they only plan on working 12 more years. If they saved $30,000 annually for the next 10 years, and earned 5 percent, they would have $501,389 more retirement savings. This is Part 1 of their plan. By being OK with a 5 percent annual return, they can take much less risk and lower the chance that they lose big during the next stock market crash. Part 2 is depositing $400,000 in a personal pension plan that is not in the stock market. This will give them $51,524 of annual income at age 67. When one adds a combined $48,000 of Social Security benefits at age 67, they will have a total $99,524 of steady,

guaranteed income. In addition, they will have $501,524 more savings plus whatever the other $75,000 in their 401k has grown to.

Summary: Wall Street likes to stress offense but once you are 15 years from retirement, it's time to play defense with your investments. We have had 2 major stock market crashes: the Dot-Com Bust of 2000-2002 and the Real Estate Bubble Crash of 2008 to early 2009. Each time, the stock market declined by half. When you reach 50, you no longer have time to recover from a major loss of your investments.

Contact Dr. Wong at (480) 706-0177, haroldwong1@yahoo.com, or www.drharoldwong.com. For his previous articles, click on www.DrWongInvestorGuide.com.