Lighthouse Beacon

A Guide in the 21st Century

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Dealing with Volatility & Complexity in the Financial Markets

The Value of Private Investment Management

As investors, we continually face a nagging question that never seems to go away: "How do I differentiate short-term, transitory developments from significant, long-term trends?" Put another way, "How do I separate the noise in the markets from the truly important issues?"

Your answer has an enormous impact on the success of your investments.

As we entered the 21st century a few years ago, stocks were riding high and many investors were emboldened enough to think they could keep gaining ever-higher rewards just by putting more and more money into certain sectors, notably technology. Those who placed too much faith in this proposition were rewarded by a brutal three years of terrible returns. Then the good times returned in 2003, and stocks entered another sustained rally, this time led by the financial, materials and industrials sectors. Everything was great until the second half of 2007, when the markets abruptly switched direction and investor losses once again started piling up.

Many who just following the most recent trend or the latest headline were left dispirited, with smaller portfolios than they had ten years earlier.

Abrupt reversals in the market's momentum are nothing new. They do, however, underscore the importance of perspective and expertise. How do you navigate through these periods to attain successful long-term results? Probably not alone!

A private investment advisor has the experience and knowledge to provide direction in all markets. A private investment advisor, acting as your portfolio manager, has the ability to provide ongoing advice and make adjustments to your portfolio as market circumstances change, as new information about companies or industries becomes available and as personal situations and attitudes change.

Mutual funds certainly can play a role, particularly for small investors. However, the volatility we have seen in recent years has exposed the weaknesses and vulnerabilities of many mutual funds. Often measured against a market benchmark, such as the S&P 500 or the NASDAQ Index, mutual funds by their nature cannot react to the personal goals and needs of their investors. Their portfolio managers rarely, if ever, talk with individual investors. Often these managers are less experienced individuals who do not have the perspective that comes from working through multi-year market cycles and reversals. Frequently, managers of individual funds are changed, leading to a lack of continuity.

This combination of a succession of managers over time and a fund's inability to make adjustments to accommodate the personal needs of shareholders all too often has exacerbated the damage done by volatile markets that quickly reverse direction. Particularly vulnerable are those investors who tried to make their market decisions by themselves, choosing mutual funds based on last year's performance or the number of stars next to the fund's name. This pain can be sharpest for those who are older, either nearing retirement or in retirement. Many have seen their dreams placed in jeopardy.

These older investors especially need to reassess their investment goals to protect their wealth and to have the opportunity to rebuild their portfolios on a course that is consistent with their circumstances and with their willingness to accept risk.

The involvement of a private investment management firm or advisory firm can make a critical difference for many investors. These firms provide you with an experienced, personal portfolio manager who has the ability to identify your investment needs and manage your money to meet those needs. A private investment manager will communicate with you directly, control your trading costs, and focus on your after-tax returns. All these factors mean that a private manager has the ability to achieve the best absolute returns for you, based on your needs, rather than attempt to beat some arbitrary index or mutual fund group average, without regard to your goals or the tax consequences to you.

Private investment advisors offer many advantages, including:

- **Management for specific, personal goals.** Your investments are managed for your stated needs. The investment strategies, exposure to risk and even buy-and-sell decisions are worked out to be consistent with your stated goals. You can meet personally with your manager to identify your tolerance for risk, what you hope to achieve and how long you are willing to be invested in the market before you will need money for other purposes. You are never part of an anonymous group of fund shareholders with generic objectives.
- **Risk is viewed as personal, not institutional.** If you are like most investors, you are not so much risk-averse as you are loss-averse. Risk, to

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you, is not quantified through some mathematical formula, and it is not a philosophical abstraction. You will not be told that a 10% loss is good because a benchmark or a competitive fund average was down 15%. Your manager understands that you care more about losing money than you do about beating an index.

- **Maximization of after-tax results.** Mutual funds and institutional managers have been slow to take into consideration the impact that taxes may have on the actual returns realized by investors. But taxes do matter. You, and when appropriate, your tax advisor, accountant or attorney can interact with your private manager. You all can also receive current reports on income and capital gains, and use the gains or losses incurred by your portfolio to offset a loss or gain somewhere else. The situation is far different for mutual fund shareholders. They can be subject to long-term gains by the fund from investments that arose long before individual investors may have been shareholders. Thus, a mutual fund's reported returns may not accurately reflect an investor's actual returns.

- **Objective, informed evaluation of alternatives.** Very often, personal advisors provide their most valuable service when they steer you away from the latest trendy products. We live in an age when esoteric financial products can attract a lot of "buzz" and seem to be alluring, whether they be hedge funds, annuities, asset allocation strategies or market-timing services. Many of these products can carry risks and hard-to-find fees that are not always evident. Your personal investment advisor can help examine the appropriateness of an idea to your personal situation and tolerance for risk.

- **Continuity of management.** You will know your manager and the investment style that is being used. You have assurance that your manager will continue supervising your investments for as long as you wish. At large mutual fund or investment companies, managers frequently change –either for their company's needs or because of their own career choices. In an era of heightened merger-and-acquisition activity, it is hard to predict who will own your mutual fund company next year or what changes they may want to make. In addition, bigger companies often change investment strategies, styles and managers after periods of poor performance. It is not unusual that the changes occur at the worst possible times, when one market trend is about to give way to another trend. In 1999 more than a few firms abruptly removed or demoted "value managers" who had avoided go-go growth stocks during the technology boom. All too often, these changes in management style occurred just as the value style of investing began to assume performance leadership –a trend that persisted through much of the first half of the next decade. In other cases, managers adjusted their decisions because of institutional pressures or the need to keep up with a peer group. The result was style change and the assumption of more risk than shareholders had expected.

- **Frequent, personal communications.** You are in touch with your manager whenever you wish, either in person, by phone, e-mail or written correspondence. We at Lighthouse Asset Management, for example, are committed to being responsive to the questions and needs of clients and we respond to the specific points of each enquiry. Our clients don't hear canned "talking points" developed by marketing writers.

- **Control of costs.** As a private client, you always know how much you are paying. That includes the costs of brokerage commissions incurred in buying or selling individual securities. Published mutual fund expense ratios only tell part of the story. Less understood is that mutual funds do not include trading costs and brokerage commissions in their reports of fund expenses. And yet, those expenses reduce the performance realized by shareholders. A typical equity mutual fund may have a turnover rate of 100% or more in a year. That is a signal that the manager is constantly rotating in and out of stocks, incurring significant costs and tax consequences affecting the returns of shareholders. Other hidden expenses also are incurred. For example, a mutual fund often pays a premium to the market price in order to acquire a large block of shares of a specific company. The reverse —and another expense— can occur when a large block is sold at less-than-market price. Your private manager is very aware of the costs of trading and can keep the turnover rate of your portfolio low to maximize your net return. The combination of all these factors can result in mutual fund expenses —hidden and reported— of 2% or more in a single year, which can be two or three times the cost of a private manager. And, none of this takes into account the effects of mutual fund front-end loads, back-end loads and level loads, which can reduce an investor's real return.

Remember, it is never too late to make sound, prudent decisions regarding the management of your investments. It doesn't matter how old you are, what you think about investment risk or how much the market volatility of the past few years has cost you.

This may be the right time to consider a private investment advisor and manager.

We at Lighthouse Asset Management have managed the investment needs of clients for more than ten years. Our managers, each of whom has more than three decades' experience in the markets, always welcome the opportunity to meet with individual investors who want to learn more about the advantages of working with professionals on a personal basis.

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