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Three Key Investment Strategies Hidden in Plain Sight

Plain Sight Strategy #2: Manage Market Risks

In our last piece, we described why most investors should ignore the never-ending onslaught of unpredictable financial news and tend to three strategies that can be much more readily managed—at least once you know they are there. Hidden in plain sight, these potent strategies include:

1. Being there
2. Managing for market risks
3. Controlling costs

Strategy #2: Managing for Market Risks

Don't take on more risk than you must.

There is no getting around the fact that the market does not deliver rewarding returns without periodically punishing us with realized risks. That is why it's so challenging for most investors to "be there," consistently capturing available returns by remaining invested over time. It's also why it's vital to avoid taking on more risk than you must in pursuit of your personal goals. For this, we have two powerful tools at our disposal, best used in tandem.

Diversification: Eliminating Unnecessary Risk

Diversification helps you spread your risks around. If you instead concentrate your portfolio in too few holdings, sectors or geographical locales, you may feel you've made smart selections when they happen to be doing well. But when bad news hits an undiversified portfolio, it often arrives without warning, and with a vengeance. That's a real risk that investors too often ignore at their own peril.

For example, sometimes, tech stocks are red hot; sometimes domestic securities may seem safer than international choices—or vice-versa. Your company's stock or a popular IPO (Initial Public Offering) may seem like a sure thing. But by trying to position yourself to catch the next trend or dodge some bad news, you're also accepting the risk that your "sure thing" may fail you.

Asset Allocation: Minimizing Unneeded Risk

Decades of academic inquiry has informed us that, despite the risks, there are no extra returns expected by trying to consistently predict individual winners and impending losers. Instead, you are best off eliminating this form of risk by putting diversification to work for you.

While some risks can be diversified away, some remain. These are expected to enhance your long-term returns if you build them into your total portfolio, *and if you stay the course with them over time.* They include a handful of factors, categorized into asset classes such as:

1. **Equity –** Stocks (equities) have returned more than bonds (fixed income).
2. **Size –** Small-company stocks have returned more than large-company stocks.
3. **Value –** Value companies (whose stocks appear to be either undervalued or more fairly valued by the market) have returned more than their growth company counterparts.
4. **Term –** Bonds with distant maturities or due dates have returned more than bonds that come due quickly.
5. **Credit –** Bonds with lower credit ratings (such as "junk" bonds) have returned more than bonds with higher credit ratings (such as government bonds).

By blending a customized mix of riskier and less risky asset classes into your portfolio, you can seek to build wealth toward your personal financial goals while fine-tuning the risks involved. In contrast, chasing returns you don't actually need can result in sacrificing what you've already accumulated if the risk is realized. Why go there?

Diversification and Asset Allocation: Your Double Defense

Investment risks are most effectively managed by using the combined powers of diversification and asset allocation. Many investors believe they are well-diversified when they are not. They may own a large number of stocks or stock funds across several accounts. But upon closer analysis, the bulk of their holdings may represent one or two factors, such as mostly large-company domestic stocks. They may think they are managing their risks through diversification, but by failing to implement appropriate asset allocation, excess risk remains.

In our next piece, we'll introduce one more plain-sight strategy for investment success: controlling the costs involved.

Until next time, no regrets!

David Bromelkamp

President and CEO

Headlines

- Dave Bromelkamp, Eric Hutchens, Derek Van Calligan, and Saul Baumann presented *How to Use the Bucket Strategy to Accelerate Impact* at the Allodium Spring Wealth Management Webinar on May 6, 2021. In case you missed it, the presentation is on our website.
- Congratulations to Dave Bromelkamp for earning the BCF™ Mark from the Center for Board Certified Fiduciaries™. Learn more at www.allodium.com/associations/alliances-cbcf.html.
- We are very pleased to announce that Eric Hutchens passed Level 1 of the Chartered Financial Analyst® Program. Visit www.allodium.com/associations/alliances-cfa.html for more information.
- Hats off to Derek Van Calligan for completing the Chartered SRI Counselor program (CSRIC®) through the College for Financial Planning.
- Kudos to Saul Baumann for earning the Accredited Investment Fiduciary® (AIF®) Designation through the Center for Fiduciary Studies. Learn more at www.allodium.com/associations/alliances-fi360.html.
- Allodium is pleased to add one new client into the firm during the first quarter of 2021.
- Our office will be closed July 5 for a company holiday.

Note: To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

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Steward is published quarterly by Allodium Investment Consultants. Please contact Ilona Avraamides at iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.

FINANCIAL PLANNING TIP

Six Ways to Plan for Health Care Costs in Retirement

Planning for your medical expenses during the retirement years can be complicated. The actual costs may depend on your lifestyle, health and longevity. It is likely that most of the expense will come in mid-to-late retirement when health conditions present themselves or slowly worsen. Here are six ways to potentially increase your health care (not long-term care) budget:

1. **Delay retirement.** Delaying retirement by staying in the workforce longer can make a big difference. If you are eligible, employer-sponsored health insurance may cost significantly less than individual insurance (pre-Medicare). Also, continue growing your 401(k) and other investment accounts by delaying withdrawals. In addition, by delaying your Social Security benefits, you may be able to increase the benefit amounts later which may help you during the years when medical expenses may be higher.
2. **Budget for health care expenses in your retirement plan.** Be sure to consider health care as you develop your retirement budget. An annual estimated cost per couple for Medicare insurance premiums, supplement plan premiums, deductibles and copays starting at age 65 can be around $4,000-$5,000. Costs will vary depending on your situation and must be adjusted for inflation. AARP provides a useful Health Care Costs Calculator at the following link: www.aarp.org/retirement/the-aarp-healthcare-costs-calculator/.
3. **Create your own "health care" investment account designated for health care expenses.** This account could be used for some long-term care expenses, but it is not intended to replace long-term care insurance. Set aside a portion of your investment portfolio into a "health care" account. Save this account for future medical expenses. Make sure it has enough of a growth component to keep up with inflation.
4. **Contribute to a Health Savings Account (HSA).** If possible, enroll in your employer's Health Savings Account (HSA) as it is one of the most tax-advantaged savings options available. Your pre-tax contributions to the HSA will grow tax-deferred, are tax-free, and will reduce your income for tax purposes. HSAs can be used to pay for Medicare supplement or advantage plans.
5. **Tap life insurance.** You may be able to take tax-free withdrawals or loans from the accumulated cash value of most life insurance policies to pay for health care and other expenses. These withdrawals are not taxed. However, if you don't pay back the loan, the death benefit for the heirs is reduced.
6. **Use the "bunching" strategy for medical expenses.** With the tax changes of 2017, taxpayers could use the bunching strategy to combine charitable deductions into one year so they could itemize deductions. Medical expenses can also be bunched. If discretionary medical expenses can be put off, you can bunch them into one year to take the medical expense deductions on your tax return.

This list is not exhaustive, but hopefully it will encourage you to include health care expenses in your overall strategy for your retirement plan. Discuss the options that are best for your situation with your financial and tax advisors.

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