

The Only Guide You'll
Ever Need for the

**RIGHT
FINANCIAL
PLAN**

MANAGING YOUR WEALTH, RISK,
AND INVESTMENTS

LARRY E. SWEDROE
WITH KEVIN GROGAN AND TIYA LIM

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You'll Ever Need for the Right Financial Plan*

“Larry Swedroe has given us an experienced and research-based treatment with examples of what should enter into the design and implementation of an investment strategy. The book includes a wide range of alternative investments and savings related plans that should prove to be beneficial to individuals and to their financial advisors.”

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**Larry E. Swedroe
Kevin Grogan and Tiya Lim**

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This book is dedicated to the employees of the Buckingham Family of Financial Services and the advisers at the more than one hundred independent, fee-only registered investment adviser (RIA) firms with which we at Buckingham have strategic alliances. Each and every one of them works diligently to educate investors on how markets really work, building long-term relationships by doing the right thing.

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Preface

Each of the prior eight books I have written reflects what I have learned in my almost forty years of managing financial risks for major corporations and advising individuals, institutions, and corporations on the management of financial risks.

Included among my books is the trilogy of “Only Guides.” The first focuses on equities, the second on bonds, and the third on alternative investments. Each presents what one might call the “science” of investing: evidence based on peer-reviewed academic studies. The “Only Guides” explore the best investment vehicles to use, the risks and rewards of major asset classes, specific types of investments, and the benefits of a globally diversified portfolio. The books even present model portfolios, but these are meant as starting points only. Each investor has a unique ability, willingness, and need to take risk.

What investors need today is a book offering more specific investment advice, one focusing on the “art” of investing and guiding investors to adapt a winning investment strategy to their own situation. That is what this book is all about.

This “Only Guide” addresses a wide range of investment issues. For example, who should consider owning more small-cap stocks, value stocks, and emerging market stocks, and who should consider owning less of them? It also addresses the often-overlooked subjects of asset location (as opposed to allocation), withdrawal strategies in retirement, and when and how to take Social Security benefits. Most importantly, it will help you integrate other financial issues into an overall financial plan. Having a well-thought-out investment plan is a *necessary* condition for success, not a *sufficient* one. The sufficient condition is integrating the investment plan into a well-thought-out estate, tax, and risk management plan. As we demonstrate in Part IV, even the best investment plans can fail if these other issues are not adequately addressed.

The goal of this book is to help both investors and professional advisers make better, more informed decisions in order to practice the winning investment strategy. Thus, the book is designed to help you understand the fundamental concepts of asset allocation, asset location, and other investing and general financial planning concepts. After reading this book, you will have learned how to:

- design an investment policy statement (IPS) and asset allocation plan, one most appropriate to your unique situation
- locate assets in the most tax-efficient manner
- maintain the portfolio's risk profile in the most efficient manner
- provide effective tax management
- integrate risk management and estate planning issues into the plan

While written to be accessible, this is not a “dummies” book. The assumption is that you know some basics about stocks and bonds.

How to Use this Book

This book can be used in two ways: read cover to cover or searched for topics of interest, providing quick access to information to answer specific questions that may arise and as circumstances change. Thus, it can serve as a reference manual. Most topics are broad based. You will find a brief discussion of a subject and perhaps a reference to an appendix or one of my other books containing a more detailed discussion of the subject.

Because investing is more art than science, this guide is not meant to provide hard-and-fast rules. While a physicist can measure the speed of light to the fourth decimal place with minimal estimation error, even the most fervent finance professor knows that such precision is impossible in investment theory. Investors and advisers alike must accept that they will never know, *ex-ante*, the optimal allocation to international investments or how much an investor's portfolio should tilt toward value stocks or small-cap stocks. In most cases, all they can be sure of is that they are in the ballpark. This book is a tool to help you make prudent decisions, remembering

prudence is determined not by the outcome, but by the process. Therefore, this book:

- raises questions leading you to the best answer given a particular situation
- helps identify issues that should be considered
- gives direction so you can best use your own judgment and apply it to each unique situation

As a final resource, the book contains an extensive glossary of terms.

LARRY SWEDROE

Acknowledgments

Books are seldom the work of one person, or in this case three people. Ours represents the collective wisdom of the investment professionals at the Buckingham Family of Financial Services.

For all their support and encouragement we would like to thank the principals of our firm: Adam Birenbaum, Ernest Clark, Susan Shackelford-Davis, Steve Funk, Bob Gellman, Ed Goldberg, Ken Katzif, Mont Levy, Steve Lourie, Vladimir Masek, Bert Schweizer III, Brenda Witt, and Stuart Zimmerman.

Too many of our co-workers contributed to list them all. But we would be remiss if we did not mention the special efforts and contributions of RC Balaban, Jim Cornfield, David Ressler, John Corn (who made major contributions to the sections on retirement plans and college savings plans) and Aaron Vickar (who made major contributions to the chapter on insurance). Jared Kizer, the coauthor of *The Only Guide to Alternative Investments You'll Ever Need*, also made important contributions. The usual caveat of any errors being our own certainly applies.

We also thank our agent, Sam Fleischman, for all his efforts.

Kevin adds: My wife, Julie, makes every day a joy. I thank her for her love and patience. I thank my parents and my brother, who have always supported me and had my best interests in mind. I owe an enormous debt to all the kind people (especially Jared Kizer and Vladimir Masek) who have taken the time to teach me what I know about investment theory.

Tiya adds: Thank you to my parents, Chak and Mira. You have supported my decisions all along the way.

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LARRY SWEDROE

P A R T
I

**INVESTMENT STRATEGY
IN AN UNCERTAIN WORLD**

CHAPTER 1

The Uncertainty of Investing

When there's uncertainty, they always think there's another shoe to fall. There is no other shoe to fall.

—Kenneth Lay, former CEO of Enron

Investing deals with both risk and uncertainty. In 1921, University of Chicago professor Frank Knight wrote (he is not the publisher) the classic book *Risk, Uncertainty, and Profit*. An article from the Library of Economics and Liberty described Knight's definitions of risk and uncertainty as follows: "Risk is present when future events occur with measurable probability. Uncertainty is present when the likelihood of future events is indefinite or incalculable."

In some cases, we know the odds of an event occurring with certainty. The classic example is that we can calculate the odds of rolling any particular number with a pair of dice. Because of demographic data, we can make a good *estimate* of the odds that a 65-year-old couple will have at least one spouse live beyond age ninety. We cannot know the odds precisely because there may be future advances in medical science extending life expectancy. Conversely, new diseases may arise shortening it. Other examples of uncertainty: the odds of an oil embargo (1973); the odds of an event such as the attacks of September 11, 2001; or the odds of an accounting scandal the size of Enron. That concept is uncertainty.