Episode 303

Welcome to Money for the Rest of Us. This is a personal finance show on money, how it works, how to invest it, and how to live without worrying about it. I'm your host, David Stein. Today is episode 303. It's titled, "How to Go About Financial Planning."

I recently received an email from a new member of Money for the Rest of Us, Plus. He wrote, "I have listened off and on to your podcast for the last 6 years and finally upgraded to your Plus features recently. My reason for doing so is I'm stuck between 2 investment narratives that are becoming increasingly divergent in thought. As I struggled to reconcile between the 2, I'm hoping your podcast can play the role of mediator.

"My current financial advisor who I'm very happy with and have been with for 15 years, he espouses conventional, institutional investment mantra and has delivered mid-single-digit returns. So predictably I rode the 2008/2009 recession down 34% and then have ridden it back up. He always has convincing arguments to dissuade me from pursuing alternative, speculative investments such as gold, Bitcoin, etc. I have a well-diversified portfolio made up of conventional equity asset classes."

Here is the second narrative. He writes, "The other extreme are a random collection of podcasts that I find myself drawn to, which highlight the extreme precariousness of the American economy, and specifically the US dollar with the emerging threats of the Chinese yuan, COVID-19, ushering in UBI, QE infinity, and social upheaval due to extreme income disparities, among other concerns. These podcasters sound reasonable, logical, and all operate off of fundamentals, my same guiding principles as an engineer by training.

"I'm sure you are familiar with some of these. The Investor's Podcast and various guests that the Investor's Podcast interviews, such as Jim Rickards, Luke Gromen, Grant Williams, and Ray Dalio." Although I don't think Stig and Preston have actually interviewed Ray Dalio. "The theme of all these guys who call chicken littles is our system is broken and it's simply a matter of time before it will be replaced, either with the Chinese yuan or oil as the basis for a new monetary standard, gold, or Bitcoin. Even going so far as to compare current American with Venezuela and Weimar Republic in 1930s Germany. At the end of the day I need to rationalize these 2 disparate viewpoints into an asset allocation that accommodates both perspectives."

Now these are the same questions that I deal with in my investing. It's one reason I've done episodes on some of those topics. Here's what he would like: my perspective on the validity of these chicken little themes promoted in these podcasts. He writes, "Clearly there is a non-zero probability of these events happening, but is it 0.1%, 1%, 10%, or 50%?"

He wants to know the shortcomings of conventional financial advisors and how to effectively use an advisor. He would like me to discuss my overall asset allocation philosophy. And why I have such a small percentage in stocks, and what would cause me to increase my allocation to stocks.

Now regarding these, what he calls chicken little themes, I've recommended the Investor's Podcast on this show. Stig Broderson is a good friend of mine. And I've discussed the views of Ray Dalio, most recently in episode 300. I discussed James Rickards views in episode 49. Luke Gromen's view in episode 260. Grant Williams, he's the co-found of Real Vision which is a video service where you can watch and listen to interviews with many of the individuals that this new Plus member mentioned. Real Vision was an early sponsor of Money for the Rest of Us. And I've covered these themes off and on because they are plausible. Most recently, in episode 295 when we talked about the potential for the Federal Reserve to go insolvent.

Unfortunately, we can't put a probability to these things happening. They are uncertain and things that are uncertain by definition you can't assign probabilities to them. We don't know. I think it's a possibility, but it is not my base case. My base case is we just keep plodding along like we have been for decades.

Whenever you hear someone share a logical view of disastrous things that could happen, we always have to step back and ask "what are their incentives.?" What is their business model? Do they have a newsletter that they're selling? A subscription service? Are they selling books? That doesn't necessarily mean they have a conflict of interest, but we want to understand what's their model.

My model is I do a podcast and I have Plus membership. And one of the most important things that I do in that Plus membership, which I think all individuals that are sharing their investment and financial views should do, is show their portfolio. Show me what you're holding in your portfolio. That's why this member could ask me why do I have so little invested in stocks, which I'll get to in a few minutes.

One of our challenges is how do we potentially plan for catastrophic things that could happen but may not. And probably will not. I actually listened to a recent episode on the Investor's Podcast with Luke Gromen and Grant Williams. And one of the things that struck me is how frequently they said they didn't know about specific things. They didn't know why the dollar wasn't weakening or other events. Because we don't know, which gets to some of the shortcomings of traditional financial advisors.

There are many terms for people that provide financial and investment advice. Financial advisor, financial planner, investment advisor. There's a lot of overlap. This member used the term financial advisor for the individual he has had a relationship with for the past 15 years. I'm not sure to what extent he's done financial planning, but he certainly has provided investment advice which is what an investment advisor will do. Sometimes financial planners provide investment advice.

Now, I am not a financial planner. I have never hired a financial planner. I have managed assets for the clients of financial planners. And I've spoken to many financial planners over the years and analyzed the different financial planning software that they use.

One of the smartest financial planners I know is a good friend of mine, Roger Whitney. He is the host of the retirement podcast, Retirement Answer Man, and the Agile Financial Planner Podcast. Roger spent more than 25 years working with individuals over age 50, helping them transition into retirement.

Last December he had an extensive guest post on Micheal Kitces' blog. Micheal Kitces is also a very well-known financial planner. In that post, Roger contrasted traditional financial planning with, what he has labeled, agile financial planning. He described traditional financial planning as where you ask the client to complete comprehensive questionnaires. And then he says the advisor takes the questionnaire up to the proverbial mountain and eventually comes back down with the tablets. Burdensome, comprehensive plans, often hundreds of pages long.

And then the advisor sits down with the client for hours and reviews these binders and the recommendations in a multi-step financial process. Then the client often takes these leather-bound tomes, as he said, the plan, and puts it on the shelf. Check the mental box and ignore it. Now, obviously not all advisors do that. But that's often what happens. You hire an advisor, they give you a plan, and then it becomes this document that sits there.

He contrasts that with agile financial planning. And he writes, "True financial planning is no longer a product. It's a fluid, never-ending project focused on managing change." And the first principle is to accept uncertainty. "To recognize," as he writes, "financial planning precision does not equal more accuracy because the future is knowable." We talked about that last week. Investing is not knowing. We just don't know. The basis of agile financial planning is to accept that we do not know. We are not sure what will happen to markets, taxes, inflation, or even our lives.

And he mentions that by accepting that it frees up a lot of mental space that is focused on trying to predict accurately what is going to happen. And instead, we can focus on the new information that is coming as life unfolds. And make small incremental decisions along the way. Little adjustments is how he puts it.

That's how I invest. And I'll share my portfolio, it's based on that. I don't know if the dollar is going to crash or if it's going to soar. I don't know what's going to happen and I want my investing and how I approach financial planning to reflect that. Roger points out "that traditional planning focuses on the plan, the one road map to follow." Whereas his process is much more collaborative. Working with the client on an ongoing basis. Having short meetings. Constantly communicating. Making smaller decisions as things happen.

It's been 8 years since I quit my investment firm and went out on my own. Sometimes calling myself retired, sometimes not calling myself retired. But having a nest egg and having to plan for the next 50 years. There's no way, the time length was too long. So I take it one year at a time. The planning is about managing change as new information comes in. I call that investing and planning on the leading edge of the present, adapting as things change. Both financially, with the markets, but also within our personal lives.

I got an email from another Plus member that wrote about how these last months have allowed him to test drive his financial plan. His is 2 pages long. He has a 2-page plan. He updates it regularly. His target allocation is 60% and 40% bonds and fixed-income. He writes, “What is written in my plan is that I should shift money from these 2 buckets to maintain the 60-40 split. In January I sold equities, about 2%, and bought more bonds. I followed my own plan precisely as written, however in mid-March when my equity percentages was down to about 55% and bonds were 45%, I couldn’t pull the trigger to sell bonds and buy equities. If anything I wanted to buy more bonds.”

He said the lesson he learned is that he’s not comfortable with a 60-40 split between stocks and bonds. So he gradually has shifted to a 50-50 balance. That's okay to fine-tune it. That’s what he was doing. He was test-driving his plan. He was adapting, not out of fear. Not trying to time it, but to come up with a different allocation.

He also pointed out that he has 3 ½ years of essential living expenses in very safe and liquid stable funds. My understanding is that it is seperate from the 60-40 piece. So he has this cash balance, or very low-risk balance that he lives on. And that, he says, helps him sleep better at night. I think that we should use an agile financial planning process. That’s adaptable, that is focused on managing change as opposed to having the plan that is fixed.

I thought about this in a different context. I read an article in *The Financial Times* by Rana Foroohar. She’s a columnist and associate editor. It was about big food and how agriculture has become incredibly efficient. She pointed out US farmers have nearly tripled their per acre production over the past 70 years. And have become increasingly specialized. So much specialized, in terms of the supply chain, that we saw shortages of food at the grocery store at the same time we saw farmers destroying crops because some farmers were part of the supermarket food chain, while others supported restaurants and institutions, such as schools and hospitals. And they weren’t mixed and they couldn’t adapt the supply chain fast enough to meet the huge demand.

She mentioned the most efficient product out there is iceberg lettuce. Which she describes as one of the ubiquitous and tasteless vegetables ever created. It’s been a major cash crop in the US for 50 years and it travels well across the country. Initially, it was put in actual ice as it traveled across. But it has very few nutrients and it’s mostly water. And an example of super-efficient, but not necessarily the end product we want.

She discussed moving from efficiency to resilience. And that’s kind of the difference in traditional financial planning. It's focused on efficiency. Let’s get this plan down. Let’s create an efficient frontier and figure out that optimal asset mix and optimal plan. Whereas agile financial planning is focused on being more flexible. Being more resilient.

In the conclusion of my book, *Money for the Rest of Us: 10 Questions to Master Successful Investing*, I wrote, “portfolio management is not about accurately predicting the future or outsmarting other investors. It is the process of combining multiple asset categories that contribute to a positive return that earns more than the rate of inflation, while minimizing the personal financial harm caused by major market drawdowns. Portfolio management is about understanding the math and emotion of investing and recognizing there isn't a right answer, a perfectly optimized portfolio. Just as there aren't optimized flower or vegetable gardens." I use an asset garden approach when it comes to my allocation. I want a variety. And it's not optimized, but it is organized.

In that conclusion, I talked about the word satisficing which is a word coined by the economist Herbert Alexander Simon. The word is a combination of satisfied and suffice. And it means to make a good enough decision, not an optimal one.

So in looking at my portfolio, I have 4 buckets. Currently, 22% is stock-like risk, with expected returns in the 6-8% range. That includes publicly-traded stocks, which is low, about 4-5% of my net worth. Preferred stocks, real estate investment trust, yieldcos, master limited partnerships, and private capital funds, which are alternative investments like we've discussed in last week's episode 301.

These are asset classes that have stock-like returns, but potentially stock-like maximum drawdowns. Anywhere from 30-60%.

Now, on Money for the Rest of Us, Plus, I segment those between stocks and income strages. In my personal portfolio I call them stock-like because they can fall significantly in price, but have a higher expected return. Now that bucket right now is 22%. At the beginning of the year it was 29%. And that's kind of the range it's been for the last few years, kind of 20-30%. But publicly-traded stocks are just one part of that.

The next bucket is what I call lending strategies. That's 24% of my allocation and at the beginning of the year it was 33%. That includes traditional lending, such as bonds, but also direct lending strategies where I've lent money that's backed by real estate and other assets. Where I'm effectively acting like a bank and holding a mortgage. This bucket includes fixed-income closed-end funds. So these are income-generating primarily interest income.

I have 30% in real estate, including land. And that's about what it was in the beginning of the year. And one of the things that I've noticed in the 8 years since I left my advisory firm, is how comforting it is just to own some land that doesn't generate any cash flow. We have some farm ground that generates a little bit. But the taxes are super low. And there is some peace of mind knowing a portion of your net worth is just there. And will be protected against inflation or if there is a currency crash in your home currency. So that's about 30% of my net worth.

And then currently I have 24% in cash and cash alternatives. It includes 5% in gold, 2% in cryptocurrencies. It's 24% now, it was at 8% at the beginning of the year. Now at the beginning 9 percentage points of the 24% was in lending strategies and 7% was in stocks. I reduced risk as investment condition deteriorated this year. I reduced credit risk and I pulled some money out of stocks and bonds. But I still have 22% of my allocation in my stock-like bucket, down from 29% at the beginning of the year.

But my longer-term target, and again this isn't optimized. If investment conditions are neutral to bullish, I generally will have 30% stock-like investments, 30% lending strategies/fixed income, 30%, and 10% in cash and cash alternatives. That's the allocation that I have grown to become comfortable with. And my goal, and I should've mentioned this at the beginning, is preservation of capital. I want my net worth to increase by the rate of inflation, including business profits that I have. That's all I'm trying to do. I just want the nest egg to keep pace with inflation so that somebody when I draw upon it, it's there.

But this allocation is flexible enough that no matter what happens, I can make some adjustments. If one of those remote possibilities that Grant Williams and Luke Gromen or others are worried about, Ray Dalio as we discussed in episode 300, I have a flexible enough allocation that I can make adjustments as things change. Without trying to predict what's going to happen.

So this member final question is what would cause me to increase my allocation to stocks. Well, when you consider my stock-like bucket it's only about 8% underweight my quasi-long term target. If investment conditions improve, or when they improve, I'll increase my allocation. Which I did, I mentioned that last week. I allocated more to preferred stock and dividend-paying smaller-company stocks in Japan and the US. An incremental change as conditions have changed.

And so while I'm fascinated by these theories of what could happen and what central banks, what currencies are doing, geopolitical risk, I don't let it drive my investing. I want different buckets, different roles, different types of risk. Assets that protect against inflation. Assets that can grow as capitalism continues to evolve. Asset classes that generate income in order to live on. Diversification and different roles.

This particular member has 10% in gold and cryptocurrency. So he has this as a target. I think that's reasonable. I have no idea how much gold Grant Williams has. Maybe he shows his portfolio. I don't know how much gold Ray Dalio owns. I'm willing to share with you every month what I own and the trades I make because I think that's part of being transparent.

Figuring out how to allocate our assets in a world of uncertainty is one of the things that I have focused on and continue to focus on over the last 8 years. And on the Plus membership site I'm rethinking and redoing every single video, and the portfolio and asset allocation tools. They help you better make these decisions if you're a do-it-yourself investor or if you're working with a financial advisor.

It is a challenging exercise because at the end of the day we do have to choose to invest in something. We can't just stay in cash. We do have to have different roles which means we do need to understand different asset classes. What's the upside of those asset types? What's the downside and how do we combine them together? Not in an optimized fashion, but in a way that allows us to be agile and flexible and resilient.

That's what investing is. And that's episode 303. Have a great week.