# Frank is contributing to The New Book of Investing Rules which will be published by Harriman House in Autumn 2017. Preview it here:

*The New Book of Investing Rules*

View from the Cockpit

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**Introduction**

In a previous life, I was an Air Force Pilot and then an Airline Pilot. Rules I learned then are directly applicable to my life as an investment advisor.

I began my career as an investment advisor forty-three years ago when after Vietnam I was furloughed from Eastern Airlines. Landing as gracefully as I could, I used my college degree in economics and business to transition to a job designing pension plans for small business owners. That in turn led to full service financial planning and eventually opening my own Registered Investment Advisor. Today that firm, Investor Solutions, Inc., manages over $750 million for several hundred clients in 39 states and five foreign countries.

Here are some cockpit rules that you can apply directly to your investment portfolio:

**Plan Ahead**

Strategic Air Command Aircrews used to joke that the SAC motto, "Peace is our Profession", should have continued "But, flight planning is our obsession." Four of us on a Tanker crew spent a full day planning and filling out the paperwork for a six-hour mission. More time planning than flying! But, when we got to the aircraft, we knew EXACTLY where we were going and what we were going to do. As little as possible was left to chance. Whatever our mission was, we couldn't just take off and fly around aimlessly.

Similarly, you are highly unlikely to get a decent outcome for your investment plan without some detailed planning.

Industry professionals joke that while a family may spend weeks researching a flat screen TV, they don't spend ten minutes planning their retirement. It sounds funny, but you know it's true.

There are many parts to an investment plan. For instance, for retirement planning:

How much capital you will need to maintain your lifestyle?

How many years until you retire?

What's an appropriate withdrawal strategy?

How can you maximize your tax advantages?

How much risk should you take?

What is the range of returns you should reasonably expect?

What asset allocation is appropriate for each stage of the trip?

What funds will best execute the asset allocation strategy?

How much will Social Security contribute?

Each of those are important variables that will dramatically impact the outcome for better or worse. Screw up just one part and you are likely to have a disaster.

You only get one shot at retirement accumulation. You can't learn this game as you go along. You can't hit rewind in real life. Early mistakes may never be made up. Spend some time planning your financial future.

It's painless to get started. There are a huge number of free resources available on the Internet that can get you started. For instance, my company, Investor Solutions, has over 100 financial calculators that will help you do everything from mortgage illustrations to an retirement plan calculation that is integrated with Social Security.

http://InvestorSolutions.com/media/calculator

Speaking of calculators, the Social Security Administration calculator is already preloaded with your earnings history, age and other information so they can turn out a personalized Social Security projection at various ages.

https://www.ssa.gov/retire/estimator.html

Now would be a perfect time to begin to plan for your family's future. If you can't do it yourself, or don't want to do it, engage a competent financial professional. One way or another, plan ahead.

**High Probability Shot**

When two enemy fighter pilots approach each other they start maneuvering for a position behind the other. The contest usually ends when one finds himself at the enemy's six o'clock position. That's the high probability shot. While very occasionally a pilot might succeed in a head on shot, that's the hard way to do it, and it leaves him open to additional risk. After they pass each other, the enemy pilot might very well end up on his six. Game over! So fighter pilots study tactics which combined result in strategy with the highest possibility of success.

Whatever you are doing, whether it's basketball, chess, medicine, law, or home construction there is an elegant solution, a low risk approach, and an easy way.

For investors, the high probability shot is the strategy that maximizes the return per unit of risk the investor is willing to accept. There are a few tactics that individually advance you toward that goal, but used together they are truly powerful:

Don't take more risk than you need to and can tolerate.

Divide your portfolio into risky and riskless parts. The mixture of the two should reflect your risk tolerance, liquidity needs, goals and objectives.

Diversify both portfolios widely to avoid unpleasant surprises while obtaining market rates of return. The gold standard is global diversification.

Use low cost collective investments like index funds and ETFs. They deliver market returns at the lowest cost, risk, and tax costs possible.

Utilize tax free or tax deferred accounts where ever possible.

Start early because time is the most valuable commodity for investors wishing to accumulate assets.

Accept market returns. Don’t try to time markets or identify mispriced securities. It’s a loser’s game. The evidence against active management is clear beyond a reasonable doubt.

Consider overweighting your portfolios to favor small companies, cheap stocks (value), and more profitable companies. Those tilts have been shown to reliably enhance returns over reasonable periods of time.

Stay the course. Don’t react to headlines, herd mentality, market predictions, fear or greed,

**Commitment**

Flying an underpowered aircraft at close to its maximum gross weight on a runway just barely long enough was a normal day at the office for tanker crews. But, if you are going to soar with eagles, first you need to get it off the ground.

As the aircraft slowly accelerated, we spent a long time on the runway. It wasn’t unusual to break ground a second or two before the end of the runway.

So, takeoffs had our full and undivided attention. Flight planning for takeoff was a serious matter that generated a dozen numbers the most important of which was Critical Engine Failure Speed or S1, our go no-go point. If one of our 4 engines fell right off the wing after S1 it was far better to take off than try to stop on the remaining runway. We were committed! Short of catastrophic failure we were going flying!

If, after planning, you have a well-designed global asset allocation plan that meets your unique needs, once you put your money down, you are committed. If the planning was right in the first place, changing your mind every few minutes is not a viable option. Things will happen, but if you are prepared, staying the course is almost always the right thing to do. Jumping in and out is highly unlikely to enhance your portfolio.

The other part of commitment for investors is that they must actually contribute some capital. America has a huge savings problem which is reflected in a woeful preparation for retirement. The days of the guaranteed pension are gone, not likely to ever come back. If you don’t make an early commitment to savings, not even the best investment advisor or asset allocation strategy is going to help you. You will never be able to retire comfortably. In other words, planning AND execution are necessary for a successful mission.

**Expect Turbulence**

Back in another life I flew Airbus 300s for the departed Eastern Airlines. While they may appear to be arrogant and cocky, professional pilots have a great deal of concern about their passengers. They would willingly die to protect them. Keeping them safe, comfortable, happy and stress free is mission one!

Turbulence is a fact of life. It makes passengers cranky. So, we spent a fair amount of time avoiding it. But, sometimes it must be simply endured. All we could do, short of staying home, was to re-assure passengers. No airline could ever guarantee you that you won't have an occasional bump in your journey. Few trips would ever be completed if the pilot turned around at the first bump. If we waited for a guarantee of smooth air we would never leave the terminal.

Pilots expect occasional turbulence. After a few thousand hours in the air, they know it goes with the territory. Occasionally the air is bumpy. What's the big deal? The airplane is inherently stable. When bumped it tends to return to its former attitude. The airplane is so strong that several commercial airliners have withstood five to seven times the G forces that they were designed for.

So, when the plane is bumping along, the pilot's primary concern is usually trying not to spill his coffee. He doesn't enjoy the turbulence, but besides a concern for his passenger comfort, he isn't worried.

But, on the other side of the cockpit door things may be different. Most of the experienced passengers will sleep right through it. But, a few passengers see a different world. There they are, trapped in a big aluminum tube, hurtling along at about 500 miles an hour seven miles above the ground! At the first sign of turbulence, anxious glances are quickly followed by wide eyes, and white knuckles. This thing is out of control! It's going down! The pilot must be insane! Why doesn't he get us on the ground? Oh, how I wish I had never seen an airplane!

That experience was good training to be an investment advisor. Just substitute investment advisor for pilot, investor for passenger, and market decline for turbulence.

As an investment advisor, I expect an occasional market downturn. It's built right into the system. I don't like it. I do every thing I can to avoid it. I try to make it as small as possible. But, sometimes I just have to live with it. Market downturns are not the fun part, but they are business as usual in the financial arena.

We endured the Crash of 87, the Crash of 89, The Tech Wreck of 2000, and the near disaster of 2008. Markets endured, recovered, and went onto new highs.

Our economy is incredibly strong, stable and resilient. But, markets must go down occasionally in order to function. There is no way to anticipate when that might happen. We must accept a measured amount of risk (the market fluctuations) in order to earn the extra returns necessary to accomplish our life goals.

Many Investors are not comfortable with market volatility. They feel out of control, and imagine all the worst possible outcomes. Their version of safety is to chuck it all and seek refuge in cash.

Of course, that's the classic buy high, sell low, and wonder why we don't make money in the stock market behavior. Investors that panic and follow the herd are unlikely to succeed It's a recipe for failure.

The world isn't going to end. This baby isn't going down, and this ship isn't coming apart. You must be on board in order to reach your destination.

**Maintenance**

Airplanes don't fly around long without maintenance. That varies from a quick inspection every night to completely stripping the aircraft to the bones, inspecting and rebuilding. Keeping several million moving parts perfectly airworthy for a projected useful life of 50 years takes a little TLC. Parts wear out and must be replaced. Other parts need to be upgraded to take advantage of improved design and efficiency.

By the way, aircraft mechanics are professionals certified by the FAA. You expect before you put your family on an airplane that the person signing it off as airworthy has the training, testing, certifications and experience to care for your precious cargo.

Your investment portfolio needs continuous maintenance, too. Clearly you would like to avoid catastrophic failures. But avoiding crashes is only part of the problem. Keeping it running at optimum efficiency will greatly enhance your future security.

Rebalancing to keep the original risk profile. Left to it's own devices a very well designed portfolio will morph over time as asset classes diverge to grow or fall at different rates. It's counterintuitive to sell assets that have appreciated in value in order to buy underperforming asset classes. But, rebalancing enforces a discipline of buying low and selling high at the margin that adds considerable value over time.

Addition of new desirable asset classes. Thousands of new investment products are introduced each year. Most are clones of existing products, or a bad idea recycled under a new brand name. However, a very few offer valuable diversification benefits that over time will enhance performance while reducing risk. We prefer to incorporate new products after they have stood the test of time. I'd much rather be late adopting a new asset class than jump on to something that I didn't fully understand and have it bite my clients.

Substitution of cheaper funds. The market has vastly improved pricing for exposure to asset classes through the mutual funds and ETFs that offer them. The internal expenses and trading costs today are a very small fraction of what they were when I entered the security business. If there are no tax consequences and low trading costs it's always better to own a low cost portfolio than an expensive one. Costs matter and small incremental cost reductions add up to large differences in performance over the long haul.

Dividend avoidance. ETFs and Mutual Funds announce their estimated dividends in advance. Those dividends will come with a tax cost. If selling the fund in a taxable portfolio just before the dividend is declared has a smaller cost than recognizing the dividend, that will clearly save capital that can live to grow for you. It takes a few calculations to net out the costs and benefits, but because taxes are the greatest expense investors face, it's well worth the effort. Keeping dollars in play that would otherwise get taxed away pays huge dividends.

Tax loss harvesting. Occasionally investments go down in value. It's annoying when that happens. But, it gives the investor an opportunity to recognize a taxable loss that she can deduct against gains otherwise in her portfolio. If she doesn't have gains, she can store them against future gains. Again, it takes a few calculations to sort out long term gains, and short term gains, but it's a very positive thing for long term performance. Think of it as turning lemons into lemonade.

Conversion of short term gains to long term gains. Whenever you must sell a security you should look at the tax implications. If that security has a short-term gain, the tax will be approximately twice as high as if you waited to sell it when it qualified for long term gain. Perhaps you should sell another security at less tax cost, or simply wait until it qualifies for the lower taxation.

Tax aware investing is complicated and tedious unless you have sophisticated software to track your portfolio on a daily basis. But, every dollar that marches away to the tax man is never coming back. It can't be reinvested or spent. So, your yardstick for measuring performance must be after tax returns.

There is nothing magic about portfolio maintenance. It's just the basic TLC that keeps a portfolio tuned up and performing optimally for the long haul.

Every decision to buy or sell a security involves multiple tradeoffs. Many investors can't or won't take the time and effort incorporate it into their long-term strategy. If not, they might be well advised to hire a professional to do it for them. Protecting that precious cargo must be mission number one. After all, your investments are your future.

**Have a good trip**

When aircrews meet each other anyplace in the world, they often end their conversations with: "Have a good trip". It's a metaphor for life.  If you plan, follow a few basic rules, exercise judgement and discipline your life and investment experience can be a good trip.

So, let me wish you all: Have a good trip!