

from Chuck's Desk

Accounting

Income Taxes

Business Consulting

*Specializing in the Training and Consulting in the Use of
QuickBooks Accounting Software*

Fall 2004

Visit My Web Site: www.affordabl.com



In This Issue

Losing Money on Investments Is Not Acceptable

Volume 6 No. 3

from Chuck's Desk

is published periodically
during the year by
**Affordable Business
Services, Inc.**
8105 N.W. 58th Place
Fort Lauderdale,
FL 33321-4520

Tel. (954) 720-8750

Fax: (954) 720-1913

E-Mail:

cdonovan@bellsouth.net

Web Site

www.affordabl.com

I welcome any comments or
suggestions you may have.

Please call or e-mail me
at your convenience.

*If you do not wish to receive
my newsletter, please let me
know by e-mail or telephone
and I shall remove your
name from our mailing list
promptly.*

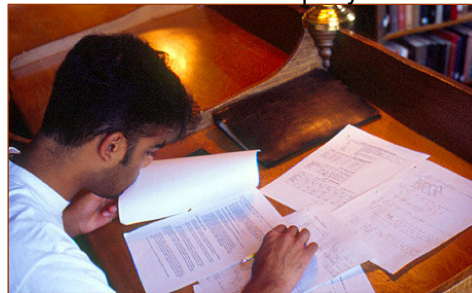
Chuck Donovan

Losing Money on Investments Is Not Acceptable

My company asked me a number of years ago to review the performance of its pension funds. The assignment turned out to be a crash course in the stock markets, investments, brokers, and investment management. ***The review illustrated clearly what a company (and you and I) should not do when we turn over our money to brokers and investment managers.***

The Review

I found that the company was doing the following things wrong:



- *expected the managers to **increase the value of the money** being given to them,*
- ***did not review or challenge** any of their investment decisions,*
- *met once or twice a year with them which **were mainly social occasions,***
- *suspected things were going wrong with the portfolio but **took no action to correct the situation,***
- *received monthly portfolio statements, **did not understand them,** and filed the reports, and*
- ***was steadily losing money** on the investments and knew the value of its portfolios was going down each year.*

This may sound very familiar to you and relate to your own experience.

I recommended what we all do when faced with this situation like this – change the managers! However, rather than rushing into it, I sent invitations to ten brokerage firms asking them to come in to discuss their respective firm and management of the funds. The invitations stated clearly that the person who would be responsible for funds should make the firm's presentation. Six accepted the invitation.

Initial Presentations

The first five, each an entourage of five or more people, dazzled us with a discussion of alphas, betas, and rho squares of stocks and the outlook for the economy, international situation, stock market, etc. The senior person present, not the manager, made the presentations and said nothing about how the company's funds will be managed. They spoke to their, not our, interests.



They all acknowledged that ***their investment policy was a buy and hold one.*** All investment decisions were based on the recommendations of the firms' research

Affordable Business Services, a full service accounting firm, offers innovative business solutions to small and medium size companies through specializing in the training, and consulting in the use of QuickBooks business management software.

Chuck Donovan MBA brings over 20 years of financial expertise to the business having worked as a senior financial executive with firms ranging in size from \$20 million to \$3 billion in sales.

His broad, hands-on accounting and finance experience has taught him that financial information must be more than just a series of numbers.

He shows and helps business owners to use their financial information to increase their cash flows, improve their profits, and build their companies, so they can plan for a secure future.

A QuickBooks Professional Advisor and experienced problem solver, Chuck is a graduate of Dartmouth College and received his MBA from American International College.

departments. A manager did no individual research on companies, had no authority to deviate from that of the research department's, and received extra compensation for placing into his funds securities the firm had an oversupply of.

Based on their presentations, we **concluded we would not be better off by switching the funds to any of the five.** Their thoughts were vague and confusing.

Final Presentation Was Different



He came in alone. After a brief review of his firm he said he

- spent about half his time on the research of companies,
- relied on the firm's research department for the rest,
- had the authority to make decisions on all investments,
- did not believe in or use a buy and hold strategy, and
- was not rewarded for buying securities from among those in the firm's inventory.

He had standard performance parameters for all investments. A 25% increase in value was the upper limit and a 10% decrease in value the lower one for each investment. An investment was removed from a portfolio immediately when it hit either of the thresholds. He acknowledged that he could be passing up larger gains if an investment advanced beyond the 25% limit but was preventing sizeable losses by strictly adhering to the 10% downward parameter.

He laid out his plan for the funds. He went on to say **the funds were our money** and mentioned **we should not sit idly by watching them decline steadily in value. That is not acceptable** - not only on a company's but also an individual's part. We had every right to review and challenge his investment decisions and assure ourselves he was sticking to his stated parameters.

His presentation and thoughts were clear and made sense. **We switched the funds to him.**

The Results

He steadfastly held to his stated performance parameters of plus 25% and minus 10% on all investments and was quick to move from stocks into other types of investments as the stock market was going down. **The company stopped losing money in the portfolio.** It certainly did not enjoy the large increases when the stock market was booming but at the same time had small gains, not losses, when the stock market had down years.

We Learned from Him

The twice a year meetings became business ones, at which he explained and taught us the basics of investment management. Among them were:

- He educated us on **how to read and interpret the monthly portfolio statements.** What was critical in assessing his performance was the relationship between the cost at which he bought an investment and its value as of the date of the statement. With that information we could easily and quickly see the increases or decreases and check them to his performance parameters. His firm's statements had this data.



- The previous managers' statements showed month to month performance but not the original costs which were only in the year-end summary reports. In that case we would have to **keep a separate record** in which we posted the original costs of investments to monitor how things were going each month.
- We **could not expect our portfolio to get much attention from a broker or manager** unless it was among the top 20% of his accounts. Therefore, we must continually monitor it and discuss the performance with him. We had to remember: **a squeaky wheel always gets the grease.**
- We had to be aware that any **investments made in mutual funds** should be in funds which could be transferred to another broker without having to be sold and the cash proceeds transferred in the event we added or changed investment managers in the future.
- His **performance parameters of plus 25% and minus 10% were very conservative ones** in his mind. Our upward expectation could be more liberal, but the downward one should not be much lower than 10% to assure losses are kept to a minimum.

Guidelines for My Money

The principles and guidelines for looking after the company's pension funds apply equally as well to looking after your and my investments.

The assignment opened my eyes. It made me realize how much I had to learn before I turned my money over to anyone and what rules I must set for that person and myself.



It showed me that I must pay close attention to my investments and not let them waste away.

With that in mind I **set the following guidelines for myself** a couple of years ago.

- Work with a broker who shares my views and appreciates my patronage. Make my selection a business one and not base it on a social, personal, or third party

recommendation.

- Expect that my portfolio will not be among his top accounts placing the obligation on my part to stay on top of the investments.
- Monitor the portfolio's performance a couple of times a month and insist on the broker's action when the performance is not what I expect. Do not be talked out of it.
- Consider my performance expectations to be plus 30% and minus 10%.
- Make sure that gains are taken when opportunities exist and do not let these decisions be avoided because I shall have to pay taxes on the gains.
- Be patient with the investments within the portfolio and accept the fact that occasionally an individual one may lose money.

With these guidelines in place my **ultimate goal is to manage some of my money.** It will be learning process, but within the Internet is a wealth of information on web sites, newspaper articles, and commentaries to learn from. In addition, there are numerous software programs and stock screeners available.

It will be interesting.