

## THE IMPORTANCE OF HAVING AN INVESTMENT MANAGEMENT PLAN

As an individual or organization accumulates wealth, they are presented the opportunity to invest that wealth, to preserve it, and hopefully create additional wealth from those investments. While capital preservation, and even some incremental returns may happen by chance over a short time period, over the long haul it is unlikely you will have such good fortune without a plan.

*The Investment Policy is the foundation.*

*Components of a typical Investment Policy:*

- *Investment Objectives*
- *Definition of Responsibilities*
- *Management of Assets*
- *Asset Allocation Guidelines*
- *Investment Guidelines*
- *Investment Manager Mandates*
- *Review and Evaluation Process*

The first step in developing your plan, is to define your investment objectives. These typically include statements on the relative importance of:

- capital preservation
- liquidity management (having your funds available when you need them)
- and return expectations.

Capital preservation is more often than not the #1 objective. The importance of this objective is a function of risk tolerance, and that tolerance needs to be assessed honestly. You need to ask yourself what is the percentage level of my portfolio that I am willing to not have available to me. That could be, for example, a 20% unrealized market value depreciation (or 'paper loss'), or it could be a 20% investment that became 'illiquid'. There is no place in the investment markets that you can hide from risk. If you invest, you take on risk, and if you invest according to a well developed plan, you will be paid properly for the risk you do take.

From that definition of risk tolerance, you can now lay out the risk management guidelines, or parameters, of your investment policy. These guidelines include, but are not limited to maturity, duration and credit quality restrictions, as well as concentration limits at the asset class, sector, industry and security levels.

The second part of this equation is the realistic return you can expect, given your risk parameters. There is no free lunch in this process. Many investors struggle with the low expected returns of a conservative investment strategy, and take on more risk than they should, in the quest for higher returns. That is why it is critically important to establish your risk tolerance first, and stick to it.

***Asset Allocation Strategy drives your expected return.***

The expected returns will be a function of what exposures you have to the permitted asset classes, and how the returns of those asset classes move in tandem - or correlate. Conventional wisdom suggests that a broadly diversified strategy, will produce the best risk-adjusted returns, over the long haul.

***To manage your risk, diversify your portfolio and establish benchmarks for each style.***

Diversification makes a difference. Don't try to guess which asset class to be in, and to manage market risk also guess when to sell out. When you spread your investments across asset classes you tend to spread your risks and increase the likelihood of offsetting losses with gains. Your investment management consultant can help you assemble a diversified portfolio of stocks, bonds, and money market mutual funds that best match your investment objectives. Typical allocations include:

Stocks-	Bonds
Growth and value	Government, corporate, and municipal
Large-cap, mid-cap, and small-cap	Investment and non-investment grade
U.S. and international	Short-, intermediate- and long-term

Stocks and bonds don't always move in the same direction. Historically, when stocks are down, bonds have been up. For example, stocks have posted negative returns in only eight different years since 1950. In those same down years for stocks, bonds delivered positive results, cushioning the impact and helping to minimize losses. By maintaining a diversified portfolio, you may be able to smooth out the inevitable ups and downs of investing. Even though there has been tremendous volatility in the stock markets over recent years, the average return for the S&P 500 over the past ten years (1992-2002) is 9.34%.

***Evaluate investment performance against stated benchmark returns and portfolio risks.***

Over the long term, fundamentals are the most important drivers for the performance of the markets and the economy. We believe it is important to maintain discipline and focus, especially in times of uncertainty. We encourage investors to stick with their planned investment strategy and not be swayed into making mistakes by betting on short-term event.

***Be sure to account for the impact of inflation on your returns.***

Growth <sup>1</sup> of a \$1 investment in stocks, bonds, and Treasury bills vs. inflation.  
\$1 invested in 1951 would be worth the following amounts at the end of 2002:  
\$ 223.09      Common Stocks (S&P 500)  
\$ 22.89      Long-Term Government Bonds (Lehman Brothers Long Gov Bond)  
\$ 12.55      Treasury Bills (3 month U.S. Treasury Bills)  
compared to the impact of inflation over the same period ::  
\$ 6.83      Inflation (Consumer Price Index)

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<sup>1</sup> Source: Prepared by Banc One Investment Advisors Corporation using data from Wiesenberger, a Thomson Financial Company. Measured by the Standard & Poors 500 Composite Total Return Index - capitalization-weighted.

***Stick to your plan.***

It takes time and effort to develop a plan that comprehensively defines your risk tolerance. And, it is no small undertaking to establish return expectations that can be produced within those risk management parameters. Once you've gone through this rigorous process of developing and stress-testing your Investment Plan and Policy, put it in place and let it work. Studies <sup>2</sup> show that asset allocation decisions result in an impact of 92% on your portfolio results. The next most significant factor is security selection - the skills your investment manager employs in constructing and managing an investment portfolio to a benchmark. The least significant factor is market timing, which is not a strategy that has produced a consistently good track record.

As market conditions, and your investment objectives may change, from time to time, it is appropriate to review your plan periodically. Many investors initiate such a review process every year or two. If your plan is comprehensive, it is quite possible you will conclude that no revisions are needed for you plan at that time.

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<sup>2</sup> Source: "Determinants of Portfolio Performance" by Gary Brinson, Randolph Hood, G Beebower. Financial Analysts Journal, May/June 1991.