hf Hogan Financial

HOW WE VIEW MANAGEMENT OF THE LONG-TERM PORTFOLIO

As with your overall financial planning, our approach to portfolio management is to pair our deep understanding of you with our professional expertise and implementation.

You, including your values, circumstances, and goals, are the first order of consideration. Then, as we begin to tailor your portfolio, we focus explicitly on risk management, that is, what can be controlled, with no pretending that we—or others—can control portfolio returns. We don't sell sizzle. We focus intently on what can be controlled: risk exposure, investment costs, tax efficiency, and disciplined rebalancing.

> **In a nutshell:** When creating your long-term portfolio, we invest in a mix of stocks and bonds from across the world in proportion to your ability and willingness to take investment risk. Neither we nor the investment managers we choose attempt to predict the future by picking stocks or timing markets.

We rebalance when markets pull the portfolio away from the targeted allocation and/or in response to a change in your ability or willingness to take risk and/or when a new appropriate investment vehicle is identified, vetted, and approved.

Our strategy is based on a belief that markets work and that the prices of stocks and bonds fully reflect all available information. Therefore, attempting to beat the market by outwitting or outguessing other investors is not productive.

We tailor your portfolio to your overall ability and interest in taking investment risk. A key lever for controlling portfolio risk is the decision of how much of the portfolio to invest in stocks as opposed to other less volatile assets. In general, the higher the stock allocation, the higher will be the expected risk and return of the portfolio—and vice versa.

How much risk you are able and willing to take depends upon many factors, including your stage of life (accumulation or decumulation), your human capital (stability and safety of income), as well as the presence or absence of pensions, of other sources of lifetime income, and of possible future inheritances or personal obligations.

On the day-to-day, our investment process with you includes several standard steps:

Decide How Much Is Available For Long-Term Investment:
Portfolio management is a bit like painting a room. There is a lot of pre-work to do before getting to the fun part of picking colors and applying paint. We spend considerable effort with you figuring out how much of your financial wealth is truly available for long-term investment. For example, wealth that you might need for emergencies or for the purchase of a new car in the near future isn't really available for inclusion in the long-term portfolio. Similarly, we want to take a look at any debt you may have and think through whether paying down debt makes more sense than adding to the long-term portfolio. And finally, the best portfolio in the world won't be much help if you were to suddenly face an uninsured death, disability, or major home disaster, or an unexpected tax bill. Because of these pre-investing considerations we ask for a lot of information so we can understand your total financial picture. That's the first step to excellent portfolio management.

Decide How Much Portfolio Risk To Take
We don't think the decision of how much portfolio risk to take can be addressed with the short questionnaire approach that is surprisingly common in our industry. Risk is a lot more complicated and a lot more personal than that approach implies. Instead, we first separate consideration of your risk capacity (how much risk you can afford to take) from your risk tolerance (how much risk you are comfortable taking).

There are several factors determining your ability and willingness to take investment risk:

- Personal Circumstances aka financial resiliency: It matters for portfolio policy whether you are living paycheck to paycheck or have more financial ease. It also matters whether you could increase employment if you had a need or desire for more money. We also want to consider whether there are people close to you with financial circumstances that could impact your financial planning, Other questions include whether your income is uncertain or highly correlated with the stock market and if you have a pension, how long will it last and whether it is fixed in amount or somewhat variable with inflation.
- Investment Knowledge: It's not unusual that one's risk preference changes as investment knowledge grows, either downward from unrealistic investment expectations or upward with a fuller understanding of how investing works.

- Personal Background: Your own and/or your family's prior experience with investing can be a factor in determining your risk preference.
- Personal Preferences: Most of us are more highly attuned to losses than to gains, but each of us to a different degree.
- Portfolio Goal: Risk is goal dependent. Understanding the importance of the portfolio goal is key to setting the appropriate risk level. If the goal is so important personally that you can't afford to bear a loss, then you can't afford to take much if any portfolio risk with the investments funding that goal.

Decide Portfolio Structure

As academics have long pointed out, portfolio structure reflects your chosen level of risk, and then the markets deliver the portfolio returns. To make an analogy with weather, you can't control the weather, but you can decide where you will live and how you will dress.

As previously mentioned, the fundamental portfolio structure decision is how much to invest in stocks versus bonds. However, deciding how much to invest internationally is also key as is deciding how much to emphasize specific types of investments such as small company stocks and value stocks. (Value stocks have a low price relative to other stocks.)

Small company and value stocks offer a higher expected return and risk than the market as a whole and therefore can be thought of as adding a bit of spice to the portfolio. Since they also each tend to move differently from the wider market, they can also add measurable diversification benefits.

Our portfolios are globally diversified and include modest but definitive tilts towards both small company and value stocks.

In the bond portion of the portfolio, we use investments that are high in credit quality and short-to-intermediate term in nature, including some that are inflation-protected.

Decide Portfolio Implementation

Investors have a lot of control over how to implement their portfolios and decisions in this area are consequential for long-term returns.

Expense Control: Not only do you save money by keeping costs low, for example by investing in mutual funds with low operating expenses, you also lower portfolio risk. (Managers of high-cost mutual funds have strong incentive to ramp up risk in order to compete with their lower cost peers.)

Investment Choice: We use asset class (index) funds. They have low costs and in most periods, outperform their peers. Asset class (index) funds are the type of mutual fund where the manager buys whole slices of the global market instead of trading individual securities. We don't think it is reasonable in the modern economy to expect that active ("trading") money managers can over the long term reliably beat the market after adjusting for the risk and cost of their trading activity. And indeed, there is no data to support the benefit of what active managers purport to do. We use asset class (index) funds because of their low cost and relative high performance. Thus, your portfolio with us goes up and down with the markets to the degree tailored to your ability and willingness to take risk, and with the excess, retail-type expenses squeezed out of the portfolio.

Tax Efficiency: Tax efficient investing done well involves a nuanced sense of your whole financial situation, both now and down the road, and as it applies to you and to your heirs. It also saves money.

You can address tax efficiency in several ways. Most obvious is the choice of investment vehicle. For example, high tax bracket investors are usually better off using tax-exempt bonds in their portfolios and sometimes also the "tax-managed" version of their chosen stock mutual funds. Asset location, i.e. whether to hold an investment in the tax-deferred retirement account or in the taxable portfolio, impacts tax efficiency as does opportunistic harvesting of gains or losses. (Harvesting gains or losses means selling an investment for tax purposes while at the same time replacing it with a comparable investment, thus keeping investment strategy unchanged.)
Taking a multi-year tax planning perspective can be profitable. By coordinating tax and investment planning, it is more likely that you can arrange to have income and deductions land in the most favorable tax year, with commensurately big tax savings.

Intergenerational tax planning can also impact investment planning, Intergenerational tax planning includes deciding, whether or not to hold particular assets in an irrevocable or revocable trust, making sure to take tax losses during the investor's lifetime, and being very cautious about realizing capital gains for those at the end of their lives.

Determine Ongoing Maintenance

Portfolio management is not a "one and done" endeavor. After the initial portfolio is determined and implemented, there are the ongoing tasks of performance reporting, monitoring, and rebalancing to consider.

We provide performance reporting on a regular basis so you can see how your portfolio is performing over time.

Our daily work includes monitoring portfolio balances and allocations for accuracy and scanning the horizon for new information about investing best practices, evolving product offerings, and emerging tax planning opportunities.

Important to your investment success is that we are instrumental in keeping your portfolio on its targeted allocation, which means trimming investments that have risen above target and buying more of investments that have slid in value. Rebalancing sounds easy but in practice it is not something that individual investors tend to address well. Sticking to policy and avoiding emotion-driven trading can make a measurable difference in return and is something you should expect from your adviser.

Determine When To Adjust Investment Strategy

There will be times when there is a change in your ability or willingness to take investment risk substantial enough to warrant a change in investment strategy. In those instances, either you or we—whoever first identifies the possibility—will be in touch with the other to figure out and implement the course of action that is best for you.

There are many reasons that can trigger a need to reconsider portfolio policy. To give you an idea of the array of such reasons, here is a sample:

- You shift into a job where your income becomes much less (or much more) correlated with the stock market, suggesting that we consider increasing (or decreasing) your targeted stock exposure.
- Because of an unexpected change in your health or career, you discover that you might need access to your retirement portfolio earlier than planned, suggesting consideration of adopting a more conservative investment strategy.
- You receive a large inheritance and having used it to pay off debt and bulk up reserves and insurance coverage, find that you have more money available for long-term investment than previously anticipated, suggesting that a less

conservative portfolio allocation might be appropriate—unless, of course, having portfolio wealth is a new experience for you and the right decision is to move slowly, if at all, in ramping up portfolio risk.

- As you approach or enter retirement, you are interested in using portfolio wealth to create lifetime inflation protected income, and having done so, are able and interested in taking more investment risk with remaining portfolio funds.
- You realize somewhere midlife that you have achieved financial security and with that confidence are now ready to take more investment risk, perhaps with the idea that a substantial part of your portfolio has a multi-generational time horizon and purpose.

Portfolio planning is personal.

We tailor your portfolio to your life, not the reverse.

For more information, please email us at info@hoganfinancial.com or call us at 414-352-9111.

We look forward to hearing from you.

You can follow us at:

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