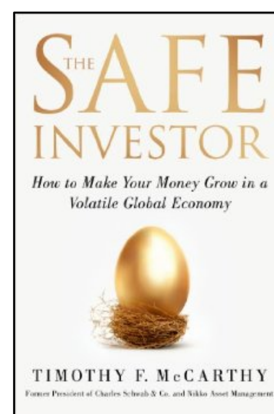
The Safe Investor
Press Breakfast Transcript
The Cornell Club, February 4, 2014

CONTEXT/SETTING



On February 4, 2014, Impact Communications hosted a Press Breakfast at The Cornell Club in New York City to celebrate the release of **Tim McCarthy**'s new book *The Safe Investor: How to Make Your Money Grow in a Volatile Economy.* Tim was joined by **Daniel Kern**, CFA®, a longtime money manager who did research for the book. Tenured journalist **Marion Asnes** (formerly with *Money* and *Financial Planning* magazines) served as moderator. McCarthy and Kern discussed the major findings of their research and the big take-aways from the book.

Speakers:
1. Marion Asnes
2. Tim McCarthy
3. Dan Kern

Asnes: Introduction of Tim McCarthy and Dan Kern

Asnes: So here is my initial question. In your words, Tim, why did you write this book?

McCarthy: I started out to write another book originally for Asian investors. I didn't think about writing for the US market. My view is after all that America is a mecca for investment acumen and I didn't' think I could add any insight. But in visiting with a large group of investors and advisors across America I was surprised to learn how unaware they were about what was really transpiring around the world.

Since 2000 more than 24 formerly emerging markets countries have actually emerged in a growth stage. Let's take BRICs, which have gone from only 3% global GDP to more than a fifth of world production over this last decade.

There are a group of 20 growth companies that continue to have good prospects for growth.
It was a shock to see how many foreign investors understood the global and investment opportunities better than most Americans. The US is still lumping all countries outside of North American into an emerging market bucket.

It starts off with the Core Objectives that most investors have. Namely:
1) Grow their money safely – yet with interest rates so low they feel there is no safe place to let their money grow
2) There is no single investment that doesn't have some sort of risk dimension
3) Short-term thinking and performance is prevalent in how people invest

I knew there was a solution for investors to grow their money more, without leaving it in a bank, but with less risk than active trading. I had refined a simple to understand approach that was easy to execute.

IMPORTANT DIVERSIFICATION TOOLS

There are three important diversification tools:

1) Broader diversification needs to be in place.
2) Single Point of Failure Management, which is often overlooked
3) More thoughtful diversification through international investing

The most powerful tool of diversification is time.

It is important to recognize that investment cycles last a decade or more, so it's like growing a fruit tree. Another important tenet is to stick to trickle-in and trickle-out investing (don't worry about economic cycles).

If an investor practices these diversification tools they can be assured that they can reach their goals and retirement without losing their nest egg; and that is the center of why I wrote this book.

Kern: My involvement of the book started over lunch in Walnut Creek, CA. Tim and I had worked together in the past and share a lot of the same underlying principles. I was initially interested in participating in the book but anticipated doing so on a limited basis. As I started reading the early drafts I became excited about the book and decided to commit more of my organization's resources to it. Tim has a way of being entertaining while educating, and I thought his approach would resonate with investors and advisors.

The byproduct of our research was the notion of survivorship. We had this a-ha moment: that many long-term investors are likely to outlive the funds they invest in, and that most investors are unaware of the tendency of funds to close or merge.

Asnes: Let's talk about the survivorship issue and look at mutual funds. Isn't it the advisor's job to look at what you've got? For instance: It's been three years and if it doesn't work move on?

McCarthy: People buy funds and they want to get involved. There is nothing wrong with selling a fund in 5-6 years; you just need to keep an eye on it. We just weren't seeing anything written about it. This is an important part of the advice and analysis process that should be covered.

Kern: Funds are sold, not bought. People want to buy a "hot-dot", top performing fund; they want to say "I own this fund". Unfortunately yesterday's success becomes part of today's walking dead. Part of the challenge is that more investors should be using advisors. There is something to be said for having professional guidance. Investing is a fulltime job. It's hard to do it yourself.

THE ROLE OF ADVISORS

Asnes: Let's talk about the role of advisors. The good advisors feel pushed by their client's discomfort or eagerness. How can advisors manage clients through their exaggerated moments?

McCarthy: The more the advisors try to stick to a plan, the more the client (investor) may go elsewhere. You don't want to lose business and this is a constant struggle we all face. I came up with a concept 12 years ago called The 3 Pockets. There is the Savings Pocket on the left, the Investing Pocket in middle, and the Trading Pocket on the right. This idea was to help advisors as a customer guidance tool – to keep them calm and relaxed (the client).

Asnes: Evaluation does matter. Now, let's talk about adding to your portfolio on dips; wouldn't it be nice to double up on your trickle?

McCarthy: That's the beauty of trickle investing. If you trickle in over 20 years up to retirement and, after retirement don't panic, just trickle out what you need to live off of, it doesn't matter what investment cycle you bought in. This is about a disciple that takes out the guessing when the market is up. Even the best investors are terrible at timing markets. Timing markets just don't work.

Kern: I'm a big fan of the trading pocket; it helps investors manage their own animal spirits. The trickle in and trickle out approach works well over time. Just stick with the investment plan. The concept of rebalancing will have you sell assets that have been top performers and reinvest in things that have lagged.

McCarthy: The Trading Pocket reminds me of the prohibition period. People are still going to do what they want to do. By having this pocket you have an outlet for them. Talk more peer to peer with your client. It's just a matter of how much to put in there.

This allows the advisor a more natural way of seeing what the client is doing overall. The wealthier the client the more they have other accounts and other advisors they don't talk about. It's about helping the whole patient.

Kern: Some firms spend their entire lives helping ultra-wealthy families invest $100 million or more. As advisors we think that we know about all of our client's financial interests, but the reality is that despite all the work our clients are still going to hide things from us! (laughs) it's just human nature.

Asnes: Personal integrity seems to be human nature.

McCarthy: Here's another role for the trading pocket: When the client's friend or brother says, "I have a great investment … we are going to make a lot of money" … If the client has the discipline of saying, "Okay, I have my 3 Pockets. I'm loaded up in my trading pocket. So I'm loaded up in my risk investments and I cannot endanger my investing pocket.

EMERGING MARKETS

Asnes: Let's talk about Emerging Markets since this is your area of specialty. You see a lot of volatility if you are a safe investor. You have the growth economies (markets that have already emerged) as well as the frontier markets (those that are just developing). Illuminate us on these ideas.

McCarthy: A good broad diversification in international investments can decrease overall long-term risk in the portfolio. We need to recognize two things: In the emerging markets (20-25) that have emerged (reached a critical mass of infrastructure), there are a couple of different groups. Ones that have already emerged and have strong balance sheets… these are all painted with the same brush, that over the next 5-10 years that will grow 50-100% faster than the developed and old world. And emerging markets, which have been looked down upon and there may be things you don't like; the American press covers their flaws well.

Asnes: If you look at the American economy before WWI, we were an emerging market. The nation was a manufacturing base, low-wage workers and a lot of agriculture and raw materials, a commodity base economy. Are we going back to that?

McCarthy: I wouldn't' say we are going back to that but we are certainly polluting more. We have reached a cross roads; we can go the road of Japan and not react as strongly and build up too much debt. America has taken the attitude we have to remake ourselves and keep a good fiscal discipline.

Asnes: What are the good developed countries and good growth countries in your option?

McCarthy: When Dan is doing his allocations, he is looking at the industry themes as well as the countries. They are a political entity and therefore become an economic entity. An example: Turkey, which is on a growth country road.

Growth countries, which are better than others, would be the ones that have positive reserves, low debt, and growth records; there are half a dozen.

- Mexico (great infrastructure and growth rate)
- Columbia, Peru, Philippines (for 30 years it didn't look like it would come out of the emerging stage, but it brought money and mindset)
- Poland, Chile, China (growth rate has dropped 7.6%). China is America's bank. They have 1.3 trillion dollars of US treasuries in their own reserve and 2.8 trillion dollars in reserves. It's hard to see a country be a zero in your portfolio when they are a fifth of the world's leading production

Kern: Two points on emerging markets: It's time for investors to have a selective approach to who the winners and losers are and how they are important in the investment process. Not all these countries will enjoy a steady growth trajectory like the American economy experienced after the first industrial revolution and after the two World Wars. There are many emerging markets countries that will fall into the middle market trap. Brazil and South Africa are experiencing this.

Q & A WITH THE PRESS

Reporter Question: Is 4% trickle out a reasonable rate?

McCarthy: It depends on your own personal situation and how much you need to take out each year. If you have a spouse, you're going to need your money to last a lot longer. So, you should be thinking of taking out less than 5% per year if you are looking at 30 years of retirement.

Kern: I am not a fan of the rule-of-thumbs that are used as the shortcut in our business such as the classic 60-40 portfolio or the 4% rule. Every individual and organization has its own liabilities, assets, objectives. It's an oversimplification of a complex process. When I look at interest rates going down and life expectancy going up; it's hard for me to see the 4% rule as a valid approach for all retirees.

McCarthy: Look at what people do vs. what people should do. People don't spend as much as they think they spend. Spending in the 40s is different than what you spend in your 60s and 70s. In retirement, people adjustment their spending and spend less than they think.

Reporter Question: What is your advice for someone who may not have the assets to get a good advisor? And please talk about the role of active management and where in the portfolio should the active management take place?

McCarthy: What if you are 55, what do you do to make sure your money lasts? Recognize the time you still have. You have an additional 10-12 years of earning and investing you can do. This is still trickling in. You are not going to take it all out, so that money can keep growing through your 70-80s. What you don't want people to do is panic. An advisor can be invaluable, perhaps saying, "let's dial up your risk/reward ratio and, therefore, put your large portfolio into a broader category of more percentages of carefully constructed growth countries."

Kern: There is no magic combination or solution to serve the underserved retail investor. There are pros and cons to each effort. You need to see what fits for you as a smaller investor. I think the next 5-10 years will come with new business models. Mainstream America has most of their assets through 401(k) plans. There is minimal advice provided to people with 401(k)s and that's very troubling. Technology is a potential tool for scalable advice, but I tend to think that the combination of technology and human advice is the optimal solution for most individuals.

Reporter Question: How do individuals learn about emerging markets, do their research and ask the right questions?

McCarthy: People are embarrassed to go to advisors. It's like admitting defeat. The reality is more than ½ of those with money today are still using advisors in some capacity. There is not a lot of detail about how to pick an advisor and if there is it's written by advisors. There is no objective way to look at advisors. About a quarter of The Safe Investor book is about how to pick an advisor. How do you trust them, what questions to ask, and what do you do with the answer afterwards? That is what my book is about.

Asnes: Is there a basket of single countries ETFs, or should we be looking for an active manager?

Kern: We are big fans of ETFs for market access, and use them extensively for foundational exposure to major asset classes. ETFs are also terrific for tactical moves, for example, if you want quick exposure to a country such as China or Mexico. We do use active mutual funds for a portion of our emerging markets exposure, to gain access to smaller emerging markets countries and companies and to take advantage of an investment environment that we think will reward selectivity in stock and country selection.

Reporter Question: There is a move from leading investors to be less style-box bound. What do you think of getting out of style purity and just go make some money?

McCarthy: Remaining flexible is important. I like doing this with an asset manager like Dan; we wanted to be careful in how we wrote the book. It's important to have a flexible structure. Don't prejudge that there is just one way to do it. There are a lot of international funds and a lot of them are the same. Someone like Dan can show the diversification of different styles and options. This helps keep down long-term risk.

Kern: It's natural as a portfolio manager to want as few constraints as possible. But the difficult truth is that few managers are capable of operating without constraints! The key thing in looking at the universe of managers that don't have a lot of constraints is to look at the team – does it have the resources, experience and demonstrated track record to (a) identify opportunities in a variety of segments in the market and (b) a track record in knowing when the relative valuation is attractive.

McCarthy: I want to emphasize that what The Safe Investor needs to watch more than anything else is not to fall in love with any one particular style or asset. You can try a lot of different things out but not all in one area; that's what's important to get the long-term growth. Broad diversity is key.

Kern: Investing is fun and is more interesting to talk about then saving and budgeting. But for most individuals, being smart about budgeting and savings habits will have greater impact on their financial health.

ABOUT THE PANELISTS

Timothy F. McCarthy has dedicated his entire career to the financial services industry. He has worked nearly half of his adult career overseas, giving him a uniquely informed view of the global economy. His notable positions include: Chairman – Nikko Asset Management, President – Charles Schwab and Co. and President – Fidelity Investment Advisor Group. He is the author of *The Safe Investor: How to Make Your Money Grow in a Volatile Global Economy* (Hardcover, 320 pages, Palgrave Macmillan, February 2014). As an executive who formerly led large and successful corporations, McCarthy understands how difficult it can

be for employed individuals to speak their minds. At this point, he prides himself on offering candid comments and frank opinions. For more information please visit: www.timmccarthy.

Daniel S. Kern is president and chief investment officer at Advisor Partners where he is responsible for establishing and driving the overall company strategy for Advisor Partners, and oversees all aspects of company operations. Prior to joining Advisor Partners, Kern was Managing Director and Portfolio Manager for Charles Schwab Investment Management. He's a graduate of Brandeis University, earned his MBA in Finance from the University of California, Berkeley and is a CFA Charterholder. Kern and his team did research for The Safe Investor book. Learn more at www.advisorpartners.com.

A nationally recognized financial editor, writer and speaker, **Marion Asnes** has over 25 years of personal finance and financial services industry experience, with a focus on independent financial advisors and their clients. Prior to establishing her consulting firm, Idea Refinery, LLC, in 2013, Asnes was Chief Marketing Officer for Envestnet, Inc., a provider of wealth management solutions to financial advisors and institutions. She served as Editor-in-Chief for *Financial Planning* magazine, and was a senior editor at *Money,* co-leading the magazine's coverage of personal finances, retirement, asset allocation, estate planning and health issues. Asnes is a graduate of Cornell University. Learn more at http://www.linkedin.com/pub/marion-asnes/0/97b/85a.

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Longer, more traditional keynotes and general session presentations are also an option for financial advisors, money management executives, and other financial services professionals.

If you buy books for your attendees, Tim will be happy to conduct a book signing for your group where he will personalize and sign them at your event. Tim may even be willing to waive his normal speaker's fee if the cause is right and/or enough books are secured for your event.

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