# KENNEDY BLACK
## WEALTH MANAGEMENT

QUARTERLY PRIVATE CLIENT NEWSLETTER ISSUE 6: MAY 2011

**Welcome to the latest Kennedy Black Private Client Newsletter. It's hard to believe that we're already on issue six, but business continues apace and there's plenty going on in the world to keep investors, advisers and their clients very occupied.**

**Now that we are into the new tax year, we move away from the usual tax-related topics and have attempted here to highlight two of the core investment principles that we believe here at Kennedy Black. Furthermore, we include some articles that hopefully might inspire you to take control of your financial plans. Don't hesitate to get in touch to discuss anything contained herein.**

### THE PERILS OF STOCK PICKING

The rewards for picking a winning stock are immense. For example, at the time of writing, Google shares are up 510% from their 2004 launch price according to Morningstar. Had you timed it correctly (see next article) you could have seen returns of 773% in just over three years (turning £1,000 into £8,727). That's an addictive proposition for anyone with money to invest.

Yet such an outcome is no different to the stories you might hear down your local bookmakers about a recent big win on the horses. In fact, at Kennedy Black, we call this part of finance, "financial pornography." If only real life were as easy.

A recent Bloomberg report in the US entitled "Analysts Prove Hazardous as Contrarian Stocks Surge" has highlighted that even professional stock pickers get it wrong. Not just occasionally, but more often than not. And if the pros cannot get it right, what hope is there for the rest of us?

Since equity markets rebounded in March 2009, the Bloomberg report points out that the shares that research analysts loved the most have risen a spectacular 73 percent on average. That's not too shabby for some of the biggest brains on Wall Street. However, it goes on to point out that the stocks that they loved the least have risen 165 percent in the same period.

If the glowing intellect of Wall Street cannot call it right, with their seemingly limitless resources, then how can a retail investor expect to beat them at their game?

### THE PERILS OF MARKET TIMING

The other great fantasy of "financial pornography" is market timing. Again, the rewards can be great if you get it right. For instance, someone who bought Google shares when they launched would have made out handsomely had they sold just three years later when they peaked in November 2007. Returns of 773% were there for the taking.

Yet, in reality, only a very fortunate few can claim to have predicted this outcome with perfect foresight, not once but twice. Even fewer will have acted on it.

In reality, the launch price of the Google IPO had to be reduced sharply from its initial guidance in response to investor reluctance and there were plenty of market analysts claiming it was still overpriced (http://econ.st/lk6Sew).

Hence, the majority of investors who bought Google shares will have done so after launch, as it began its seemingly unending climb past $100, $500 and beyond. Having peaked at $741 in 2007, the shares are now at a more modest $518 (a decline of 30%).

A recent paper entitled "Past Performance is Indicative of Future Beliefs" by Maymin and Fisher has highlighted that investors place too much emphasis on past performance and end up buying funds once they are close to their peak. In the words of the authors, "investors chase returns and in doing so create the conditions of their own demise."

Kennedy Black recommends a different strategy, one that attempts to ignore the temptations of market timing and stock picking. In our view, it is better to decide how much risk you are willing to take and to base your investment decisions on accessing a diverse range of assets with exposure to the proven drivers of long-term returns.

Once invested, the same strategy should determine how you make adjustments to the portfolio. Annual rebalancing is to be encouraged, so that the portfolio remains in line with the acceptable risk profile adopted

Kennedy Black Wealth Management Ltd • 10 Nelson Terrace • London • N1 8DG
Tel: (020) 7125 0224 • email: enquiries@kennedyblack.com • web: www.kennedyblack.com

at the outset. However, jumping in and out of funds or sectors simply erodes long-term returns through trading costs.

Investing should therefore be a genuine buy-and-hold strategy, where there is no temptation to over-react to price movements.

With a structured and well-tested methodology behind the portfolio, investors should take comfort during times of strain. When times do get bad (and they will), investors should revisit that methodology and the assumptions behind it, to reassure themselves that this time it really isn't any different.

## Are you a centurion?

Life expectancy is on the rise. Improvements in medicine and lifestyle mean that current and future generations are living much longer on average than their predecessors.

Figures released by the Department of Work & Pensions in April illustrate exactly what this means. These figures suggest that a quarter of all under-16s today will live to reach the age of 100. The life expectancy of the average newborn girl is now over 90.

Steve Webb, Minister for Pensions, has pointed out that this means that nearly a third of their lives could be spent in retirement.

Unfortunately, pension provision is on the decline, with employers and the State increasingly reluctant to support pensioners through this length of time. Pension income, healthcare, incapacity support and help within the home all come at a cost, and it is now the clear responsibility of each individual to ensure that these are properly provided for.

If your retirement plans include holidays, visiting relatives and treating yourself on occasion, then its time to take control of your savings and start building up a retirement plan of your own.

## What is your biggest asset?

At a recent investment conference, a presenter posed the question: "what is your client's biggest asset?"

As you read this, you might think it is your house. You might (if you've been paying attention to my various rants about the cost of retirement) think it is your pension.

Yet in both cases, you would be a long way from the truth. Your biggest asset is you. And you need protecting.

Let's illustrate it another way. Imagine that you own a machine that sits in the corner and prints money. Five days a week, between the hours of 9 and 5, it spits out ten pound notes. Unfortunately, one day it will stop, often without warning.

Everyone would want one, and importantly, everyone would look after it. In fact, I'm sure nearly everyone would insure it in case it suddenly stopped working.

And yet, when the analogy is applied to you and your earning power, people are reluctant to invest in protection products such as Income Protection, Life Assurance or Critical Illness.

A survey conducted by AXA Life (http://bit.ly/mkIwwK) suggests that half the UK population would be penniless within a month if their income dried up. Only a third believe that they would have enough to pay their mortgage.

Protecting your wealth from the unexpected is perhaps the most important part of financial planning. Not investing in you could be a far more costly decision than not starting an investment plan.

## Investment Rule #6:

"Be aware of incentives"

Incentives are powerful things. The book 'Freakonomics' (by Steven Levitt & Stephen Dubner) highlights the hidden incentives in life that create very unusual outcomes (from drug dealers living with their mothers to corruption in sumo wrestling).

Incentives are everywhere in finance, and canny investors should always be aware of them before parting with their money.

Likewise, don't believe everything you read, be it stock tips from stockbrokers (who are incentivised according to the volume they trade, not how successful their clients are) or articles in newspapers (who are incentivised according to the papers they sell, not the accuracy of their reporting).



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