RULES OF PRUDENT INVESTING

Overview: The following rules can help investors build and adhere to a well-designed investment plan.

CONSTRUCTING AN INVESTMENT PLAN

Recognize that the ability, willingness and need to take risk is different for everyone. Plans fail because investors take excessive risks. The risks unexpectedly show up and the plan is abandoned. When developing a plan, investors should consider their investment horizon, stability of income, ability to tolerate losses and the required rate of return.

Don't invest in any security without fully understanding the nature of all of the risks. If investors cannot explain the risks to their friends, they should not invest. It's critical to understand the nature of the risks being taken.

A well-designed investment plan has many elements. It should integrate portfolio management with tax planning, estate planning and risk management.

Don't treat the highly improbable as impossible, nor the highly likely as certain. Investors assume that if their horizon is long enough, there is little or no risk. The result is they take too much risk. Stocks are risky no matter the horizon.

Only work with advisors who will provide a fiduciary standard of care. That is the only way to ensure that the advice provided is in the investors' best interest. There is no reason not to insist on a fiduciary standard.

MAINTAINING AN INVESTMENT PLAN

The more complex the investment, the faster investors should run. Complex products are designed to be sold, not bought. Investors can be sure the complexity is designed to favor the issuer, not the investor. Investment firms do not simply give away higher returns.

The only thing worse than having to pay taxes is not having to pay them. The "too-many-eggs-in-one-basket" problem often results from holding a large amount of stock with a low cost basis. Fortunes have been lost because of the refusal to pay taxes.

The safest port in a sea of uncertainty is diversification. Portfolios should include allocations to the asset classes of large-cap and small-cap stocks, value and growth stocks, real estate, international developed markets, emerging markets, commodities and the appropriate amount of bonds.

Owning individual stocks and sector funds is more like speculating than investing. The market compensates investors for risks that cannot be diversified away, such as the risk of investing in stocks versus bonds. Investors should not expect compensation for diversifiable risk¬, such as the unique risk related to owning one stock or sector fund. Prudent investors only accept risk for which they are compensated with higher expected returns.

Take risk with equities. The role of bonds is to provide the anchor to the portfolio, reducing overall portfolio risk to the appropriate level.

BUCKINGHAM
STRATEGIC WEALTH

STAYING THE COURSE

The consequences of decisions should dominate the probability of outcomes. Investors should ask themselves if they can live with the outcome, regardless of how small of a chance there is of the outcome occurring.

The strategy to get rich is entirely different than the strategy to stay rich. One gets rich through inheritance or by taking risk. One stays rich by minimizing risk, diversifying and not spending too much.

The four most dangerous investment words are "This time, it's different." Getting caught up in the mania of the "new thing" is why the surest way to create a small fortune after starting out with a large one.

If it sounds too good to be true, it probably is. Investment decisions should be based on the evidence from peer-reviewed academic journals.

Keep a diary of market predictions. After a while, their "insights."

Good advice does not have to be expensive, but bad advice always costs dearly no matter how little is paid for it. Smart people do not simply choose services based on cost (the cheapest doctor or CPA). Costs matter; but it is the value added relative to the cost of the advice that ultimately matters.

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