Provided by Investor's Capital Management www.feesonly.com

INVESTMENT POLICY STATEMENT STEERS PORTFOLIO THROUGH VOLATILE TIMES

Euphoria one moment, panic the next, followed by a heavy dose of indecision.

That pretty much describes the roller coaster life of investors since the late 1990s. Smart investors know, of course, that they should stick to an investment plan and change it only when their personal circumstances and needs dictate, not on market movements, but that's easier said than done in these volatile times. One technique that can help, however, is the implementation of an investment policy statement.

An investment policy statement (IPS) is a *written* document that articulates the investor's overall investment goals and how those goals will be accomplished. It's designed to take the emotion out of investing and keep the investor on track, regardless of what the market or the economy is doing. Investors can write an IPS on their own or with the help of their financial advisor.

An IPS should be a detailed plan, not a general statement. It should cover such specifics as investment objectives, desired annual returns, asset allocation, any tax management strategies, benchmarks, rebalancing methods and monitoring procedures.

Start by identifying your investment goals: college, retirement, assets to pass at death, charitable intent. How much should be set aside in cash reserves? Will you be making regular withdrawals for living expenses or a specific withdrawal down the road such as for the down payment on a home?

Once you know where you're going and your investment needs, you can determine what rate of return will accomplish that goal. Remember, a portfolio is not designed to simply make as much money as possible. It's designed to accomplish specific goals. That's where the IPS is able to restrain investors from overreaching or panicking. For example, if the IPS determines that earning 8 percent annually is sufficient to accomplish your goals, you'll be less tempted to jump on a highflying stock just because it might earn 90 percent (or, conversely, lose 90 percent).

Does the investment risk you're willing to take (really defined as how much of a loss can you stomach) match your goals? Say you want or need a ten-percent return to accomplish your goals, but you don't want to invest in anything but except certificates of deposit and short-term bond funds. Historically, these types of investments have not provided that high a return over the long run, whereas stocks have. Consequently, you'll have to either adjust your goals or your willingness to take risk.

What role will taxes play in your investing? Do you want to harvest tax losses in order to minimize tax gains, or will you be invested primarily in tax-favored accounts? What is your investment time horizon—retirement 30 years away, college in 10? All these factors need to be incorporated into the policy statement.

Now it's time for the IPS to identify what asset classes and investment vehicles are most appropriate for your needs. Here you may want to prescribe certain limits—for example, no more than 65 percent in equities, with that broken down by large cap, small cap, international, real estate and so on; 25 percent in bonds; and 10 percent in cash. You might want the IPS to specifically state that you will not invest in certain types of investments, such as initial public offerings, junk bonds, commodities and emerging markets.

What percentage of your total equities do you want to limit to company stock? What method will you use to rebalance the allocation when it gets out of whack? What benchmarks will the portfolio be measured against?

If you plan to use mutual funds, state whether you want to use primarily index funds, more actively managed funds, or a combination. Do you plan to pick individual stocks? Do you prefer growth or value stocks? Do you prefer government bonds or corporate?

Just the act of writing down these issues and factors forces you to clearly think out your investment strategies and stay on track, versus floating along with no particular plan, which is what most investors do.

Although a written document, an IPS is not carved in stone. You can revise it when appropriate. In the meantime, it will see you through volatile times and minimize those swings of greed and fear.

May 2003— This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Investor's Capital Management LLC.