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Saturdays with Jim: Need-Based Investing

Saturdays with Jim

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John Howard is a go-go kind of guy. He plays everything in his life to the max - handball, business, games - he's a risk taker and competitor in everything he does. He has a net worth (what he owns minus what he owes) of about \$5 million. He comes to us looking for investment management. What do we tell him? Do we indulge his risk taking proclivity? Do we tell him what we think he wants to hear?

Janet Spiegelman is a careful, conscious person who has served humanity all of her life. As a consequence, she has neglected to do much retirement planning and has just \$40,000 in net worth. She's a very cautious person. She's also about 55 when she comes to us. Do we engage her conservative side? Do we encourage her to remain conservative in her investments as she has in her life?

Risk Is Just One Dimension of the Investment Puzzle

Why invest? That's the very basic question as we search for the perfect investment portfolio for everyone. It may seem surprising to you, but risk is actually the smaller (though important) part of the investment puzzle. We need to define risk - it's not what you think.

Risk is not the sickening feeling you feel when your portfolios drop suddenly, nor the elation you feel when they rise just as suddenly. That is volatility, folks. Risk is something far more consequential. Volatility tends to move securities in a range - more volatile securities just have a broader range. Risk, on the other hand, is the probability of permanent, non-recoverable loss. Risk, therefore, poses potentially devastating consequences.

But risk is intimately associated with reward. We assert that the "reward" side of the investment puzzle is the dominant characteristic that one should target when designing an investment portfolio.

Reward Leads To Need Fulfillment

Let's assume that risk can be managed. We can now move to advising John and Janet.

John's needs are modest. His \$5 million net worth includes \$3 million in investments. His retirement income need is only \$150,000 a year (he lives modestly). If he gets a 2% return on his \$3 million investment portfolio, he is one happy camper, assuming that he can stay ahead of inflation. He can invest in our most conservative

investment option, a blend of municipal bonds, Treasury Inflation Protected Securities and quality corporate bonds. We can indulge his risk-taking sensibilities by devoting maybe 10% of his invested funds to riskier, more volatile areas. So John is a happy camper, able to sleep at night knowing his needs are met and his money is safe.

Janet is another case. She needs a retirement income of \$50,000 a year and her invested funds total only \$30,000. We are going to have to show her a road map to a portfolio of about \$1,000,000. To get where she wants to go, she will need to work until age 70 (15 more years). Furthermore, she will need to contribute a whopping \$20,000 a year to her retirement program. Her salary is \$60,000. Contributing 1/3 to retirement is a stretch, but it's do-able. But will the \$20K a year even be enough? Frankly, it will be a stretch. We will need to aggressively manage her funds in very high yielding securities - 10% yield or higher. If we are careful to buy only at the point others are selling, we can accomplish the task. Janet's portfolio has fewer guarantees and is far more volatile than John's, but with proper risk management techniques she can get what she needs.

Needs-Based Investing

John and Janet illustrate the importance of investing to meet goals, not to fit risk tolerance or for any other reason. As goals change, investment policy may change with it. Are you meeting your goals? Have you even set goals? Food for thought.

Thank you for investing with us.

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