COMPASS WATCH

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PERFORMANCE GOAL #1: HAVING THE MONEY YOU NEED WHEN YOU NEED IT

The primary performance goal for most investors is very simple - - to have sufficient funds when these funds are needed. Some call this a long-term "absolute" performance goal, and it applies whether the portfolio is a foundation, endowment, retirement plan, reserve fund for an institution, or an individual's general investment account. Yet, when performance is discussed these days, it is usually about short-term, "relative" performance; i.e., how a portfolio is doing vs. some other style or alternative approach, right now. Attention spans seem to be getting shorter generally, aided by many TV/radio programs and investment letters peddling short-term advice, sometimes in a nearly hysterical, "Cramerized"* fashion. Commissioned sales people and consultants are often criticized as well for providing short-term advice at the expense of long-term investment success. Short-term thinking is also apparent among 401(K) retirement savings plans, in which innumerable investment choices often leave participants confused and unable to decide, frequently ending up buying yesterday's winners as they become today's losers. As we have said, performance is supposed to be a matter of arriving successfully at one's long-term goal by investing sensibly and sticking with it. Hysteria is a poor substitute for good judgment and patience. At Compass, this means buying quality stocks and bonds when they represent good value, and then allowing these great companies/issuers time to deliver rising dividends, dependable interest payments and/or higher security prices. Nevertheless, even if one is investing sensibly, there are still three serious challenges to overcome:

1. Principal Preservation: The medical profession reminds its physicians, "first, do no harm." The investment equivalent to this is, "first, don't lose the money." This may sound obvious. However, during the "dot com" mania of the late 1990's, for example, many normally risk-averse investors forgot this adage, chased the high-fliers and lost their shirts. The same may be happening today with some hedge fund, energy and precious metal speculators. Putting principal at increased risk by chasing short-term performance leaders, be they "dot coms," hedge funds, or whatever, may seriously jeopardize achieving Performance Goal #1.

2. Inflation: Even if principal is preserved, however, there is another dangerous enemy - - inflation. As Gene Walden pointed out in a recent article in the Minneapolis Star Tribune (Sunday, May 14, 2006, p. D 3), although life expectancy in the U.S. was only 48 years a century ago, it is 78 today, and for those already 65, it increases to 84. This means many are going to be retired for over 20 years! Walden also found that over the last forty years, the price of bread was up ten-fold (1,000%), utilities up twenty-fold, and housing up thirty-fold! So, one's investments need to stay ahead of inflation if Goal #1 is to be achieved.

According to highly-regarded studies, the kinds of investments Compass uses for its clients - - quality stocks and intermediate-term bonds - - have historically outperformed inflation by a comfortable margin over a long period of time. Ibbotson Associates found that intermediate-term, quality bonds have outperformed the inflation rate (CPI) by over 2%/year on average from 1926-2005, and large-company stocks have outperformed inflation by over 7%/year on average during this time. ** So, if history holds, it simply isn't necessary to take undue risk in order to overcome the ravages of inflation.

3. Taxes: For some investors, taxes could represent the greatest threat to their long-term investment success. According to research by The Tax Foundation of Washington, D.C.***, in 2006, the average American worked from January 1 – April 26 just to pay federal, state and local taxes. Minnesotans, on average, worked through May 3, just to pay taxes. This significantly exceeds the days of work needed to pay for housing and health/medical care combined. Although most investors are willing to pay their "fair share" of taxes, a good advisor will help investors manage their tax burden prudently, by emphasizing the favorable treatment of long-term capital gains, qualifying stock dividends and tax-free municipal bond interest.

With war in the Middle East, global terrorist threats, skyrocketing energy prices and increasing volatility in stock/bond markets, it can be difficult to maintain a steady, long-term perspective. Nevertheless, the rules of successful investing haven't changed. Preserving principal and overcoming inflation and taxes are still three of the major hurdles. This can be done if one minimizes short-term relative performance distractions and focuses instead on the absolute performance goal of having the money you need when you need it - - long term.

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*Jim Cramer, "Mad Money", CNBC TV, for example.

** Ibbotson Associates, Stocks, Bonds, Bills, and Inflation, 2006 Yearbook, p. 31.

*** www.taxfoundation.org

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