



TO YOUR WEALTH Update

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Is absolute safety all relative?

In my line of work, I frequently come across terms that are used as if any one just naturally understands them. Words like "fiduciary" keeps coming to mind as an example based on the many different interpretations I'm hearing lately. With President Obama's appointment of Mary Shapiro to head the SEC, I think we'll be seeing even more latitude on what does and does not constitute a fiduciary since she's a backer of the big brokerage houses who don't seem to be able to spell fiduciary let alone uphold the standards that responsibility demands. I'll have much more on that topic at a different time. Today, I want to take a closer look at the terms "absolute safety" and "relative safety."

In the financial industry, "absolute safety" refers to the portion of your investment portfolio held in fixed income investments that are guaranteed by the US government or an agency such as the FDIC. "Relative safety" refers to fixed-income investments such as corporate bonds, mortgage-backed securities, municipal bonds or corporate commercial paper. Compared to stocks, these investments typically are less risky, hence the relative safety description.

Since nothing is ever absolute, many people find comfort in feeling at least relatively safe in their investment strategy. In fact, investments offering relative safety bring the appearance of higher returns than their absolute counterparts, which brings added joy.

Unfortunately, joy and comfort are, at risk of confusing the issue, relative themselves. The fact is with a relative safety investment strategy higher returns are achievable as long as nothing goes wrong like mortgage backed securities hitting the skids, for example, or corporate bonds losing upwards of 20 percent in 2008. Those who invested heavily in relative safety are hurting now because at the time when safety is needed most, it isn't there. Relative safety strategies



only offer safety when things are on the upswing. In downturns, safety goes out the window, making the losses you experience more than relative to you as an investor.

In regards to the absolute safety side of the story, using US government bonds did not eliminate the losses in a balanced portfolio in the economic bloodbath of 2008 but it certainly reduced the losses. For comparison, the S&P 500 stock index lost 37 percent in 2008. A portfolio of 60 percent stocks and 40 percent government bonds lost less than 19 percent. A relative safety strategy lost over 24 percent by replacing the government bonds with corporate bonds.

I guess the moral of my story is that there's no such thing as a free lunch. The higher returns one gets in a relative safety portfolio are at the expense of much greater risk such as a decline in market value or the implosion of mortgage-backed bonds.

Keep in mind, the brokerage industry makes five to ten times more revenue from a corporate bond sale than on a US government-backed instrument. It'll be a rare thing indeed to find a brokerage house offering government bonds where there's so much money to be made in the relative safety approach.

Because our clients' peace of mind is always on the top of our minds, FSG helps ensure financial safety by primarily using absolute safety strategies for bond investments. This allows us to assume more risk with stocks which have an unlimited growth potential. Compare this to using fewer stocks but more corporate bonds. The maximum return earned on the corporate bonds is their interest payments, assuming the underlying company doesn't go bankrupt before the bond matures.

We already know nothing is for certain except for uncertainty. Looking for the absolutely right thing to do is relative given the times we live in. However, by using a holistic approach we can help plan for the certainty of uncertainty and mitigate what could be devastating losses.