SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Shortfalls

Achieving investment goals requires clear definition of goals, investment horizons and manageable portfolio risk. Given the levels of uncertainties associated with each key favorable, risks associated with achieving each outcome are high. Three investment goals sought by many investors are saving for a house purchase downpayment, accumulating funds for a college education, and building reserves to support retirement living objectives. Many investors face the pursuit of one or more of these goals at the same time. A review of the impact of time, return and risk can provide perspective on achieving important life goals.

PERSPECTIVE

The old adage of starting investing sooner is so true. Importantly, it is the one key parameter over which an investor has much control. The ability to recover from the late start of an investment program can be overwhelming. Chart I shows recovery funding multiples for a 10-year house down-payment program and a 20-year college education funding program. For example, if funding the house down-payment program did not begin until year 5, the annual savings would have to be maintained at twice the original level for the final 5 years to achieve the original goal. The same outcome would occur if the 20-year college savings program was deferred for 11 years. Full and timely savings levels are critical for funding these life goals.

While market returns will determine portfolio outcomes, an investor can set a level of portfolio risk that can seek a necessary level of return relative to goals. Accepting higher portfolio risk may help to offset but likely not overcome a shortfall resulting from the deferred start of an investment program. Chart II shows the combined impact from a late start to a house down-payment program and an investment return that falls short of expectations. For example if the program was deferred for 5 years and investment returns fell 25% short of expectation (here 6% versus 8%), the total available down-payment could fall short by 33%. In the absence of other funding sources, the result likely would be purchase of a house with much different features than desired.

Allocations reflect expectations for combinations of portfolio returns and risks. Expectations are forecasts and actual outcomes reflect the interplay of the two measures. With these expectations comes a range of potential portfolio outcomes per allocation mix. In most circumstances, higher expected returns are associated with higher expected risks. Chart III shows the ratio of portfolio returns to portfolio risks over the full range of portfolio equity allocations. For the data shown here, portfolio risk increases at a faster rate than portfolio return, resulting in diminishing returns from taking more risk. Investors must determine their own tolerance for return shortfall and the resulting impact of any such shortfall.

INVESTMENT IMPLICATIONS

Shortfalls in investment goals can arise from a range of factors. A goal must be identified clearly so that the reasonableness of factors used can be determined. Time horizons may be too short as the whole process was launched belatedly. Trying to make up for lost time with higher return and/or lower risk expectations adds new risks. Return estimates may be at odds with current market realities or risk estimates may be inconsistent with current market volatilities. While not an exact science, portfolio outcomes can be enhanced and shortfalls reduced with a disciplined process applied over time.

CHART I

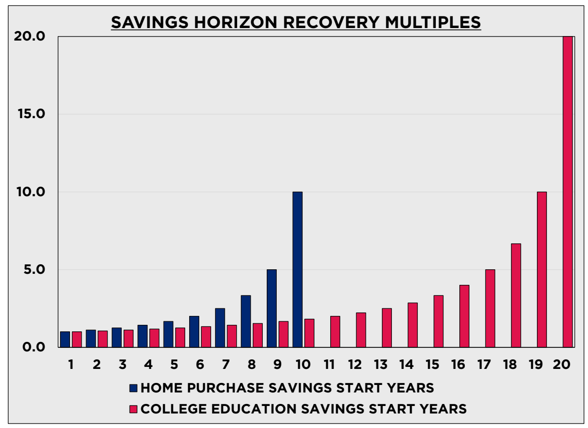

CHART II

CHART III