



FIVE KEY CONCEPTS FOR FINANCIAL SUCCESS

GETTING A HANDLE ON RETIREMENT LIKE NEVER BEFORE



DECHTMAN
Wealth Management



Letter from Jordan Dechtman

Many people today are facing difficult choices in achieving their financial goals and are asking serious questions, as well they should. Our goal with *Five Key Concepts for Financial Success* is to help you see through the noise of the marketplace in order to systematically make smart decisions about your money.

Because educated investors are the most successful investors, we are presenting *Five Key Concepts for Financial Success* to show you a Nobel Prize–winning approach crafted to optimize your investment portfolio over time. This paper has been designed not only to support you in your efforts to preserve what you already have, but to also increase the growth of your investments while effectively managing your risk.

In addition, because we recognize that reaching your financial goals requires more than just good investment management, we have also described an approach—comprehensive wealth management—that systematically addresses your entire range of financial issues.

We believe in empowering people to make the best decisions for themselves or, if they wish, to astutely choose a financial advisor who can implement sound wealth management principles. And we believe in sharing our own financial knowledge with everyone who wants to make wise decisions about his or her money.

Dechtman Wealth Management is pleased to present *Five Key Concepts for Financial Success* to our clients and prospective clients. We sincerely hope that it will provide you with a framework for an intelligent approach to making financial decisions that will help you to achieve all your most important dreams.

Sincerely,

Jordan Dechtman

Founder & CEO

Dechtman Wealth Management



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Five Key Concepts for Financial Success

WHILE INVESTING CAN AT TIMES SEEM OVERWHELMING, THE academic research can be broken down into what we call the *Five Key Concepts to Financial Success*. If you examine your own life, you'll find that it is often the simpler things that consistently work. Successful investing is no different. However, it is easy to have your attention drawn to the

wrong issues. These wrong issues—the noise—can derail your journey.

In this section, we'll walk through these five concepts and then explain how successful institutional investors incorporate each of these concepts into their investment plans. These plans both meet their fiduciary responsibilities and achieve their financial goals.

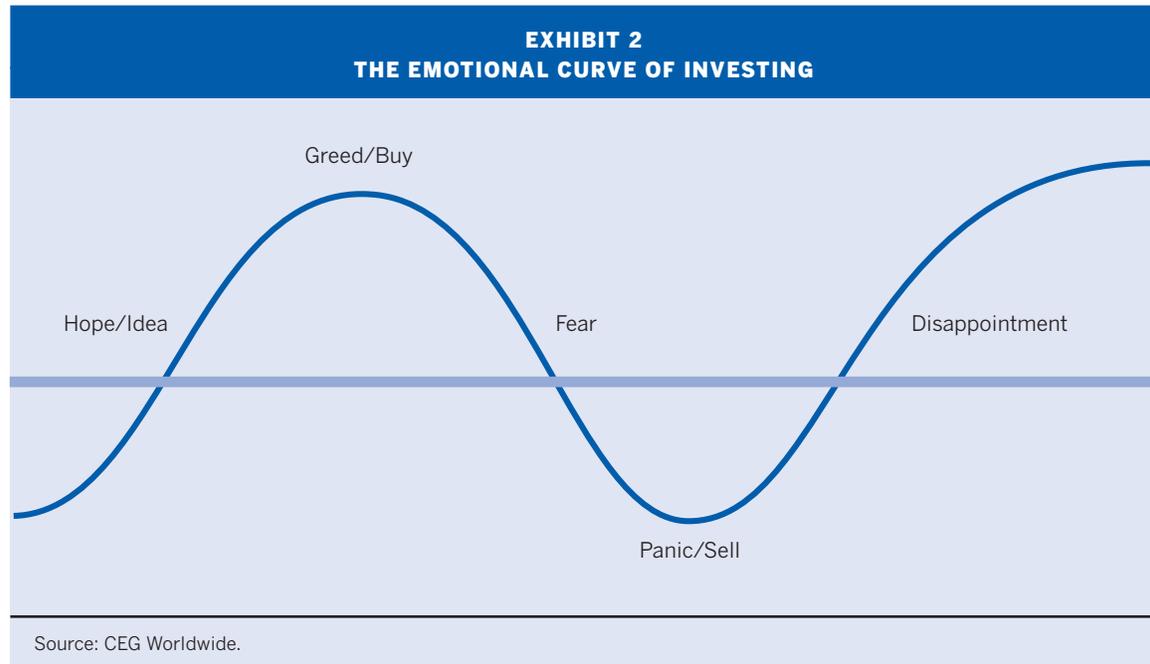
It's important to note here that while these concepts are designed to help maximize return, no strategy can eliminate risk, which is inherent in all investments. Whenever you invest, you have to accept some risk. It's also important to remember that you're responsible for reviewing your portfolio and risk tolerance and for keeping your financial advisor current on any changes in either your risk tolerance or your life that might affect your investment objectives.

Concept One: Leverage Diversification to Reduce Risk

Most people understand the basic concept of diversification: Don't put all your eggs in one basket. That's a very simplistic view of diversification, however. It can also get you caught in a dangerous trap—one that you may already have fallen into.

For example, many investors have a large part of their investment capital in their employers' stocks. Even though they understand that they are probably taking too much risk, they don't do anything about it. They justify holding the position because of the large capital gains tax they would have to pay if they sold, or they imagine that the stocks are just about ready to take off. Often, investors are so close to particular stocks that they develop a false sense of comfort.

Other investors believe that they have effec-



tively diversified because they hold a number of different stocks. They don't realize that they are in for an emotional roller-coaster ride if these investments share similar risk factors by belonging to the same industry group or asset class. "Diversification" among many high-tech companies is not diversification at all.

To help you understand the emotions of investing and why most investors systematically make the wrong decisions, let's look for a moment at what happens when you get a hot tip on a stock. (See **Exhibit 2**.)

If you're like most investors, you don't buy the stock right away. You've probably had the experience of losing money on an investment—and did not enjoy the experience—so you're not going to race out and buy that stock right away based on a hot tip from a friend or business associate. You're going to follow it awhile to see how it does. Let's assume, for this example, that it starts trending upward.

You follow it for a while as it rises. What's your emotion? Confidence. You hope that this might

be the one investment that helps you make a lot of money. Let's say it continues its upward trend. You start feeling a new emotion as you begin to consider that this just might be the one. What is the new emotion? It's greed. You decide to buy the stock that day.

You know what happens next. Of course, soon after you buy it, the stock starts to go down, and you feel a new combination of emotions—fear and regret. You're afraid you made a terrible mistake. You promise yourself that if the stock just goes back up to where you bought it, you will never do it again. You don't want to have to tell your spouse or partner about it. You don't care about making money anymore.

Now let's say the stock continues to go down. You find yourself with a new emotion. What is it? It's panic. You sell the stock. And what happens next? New information comes out and the stock races to an all-time high.

We're all poorly wired for investing. Emotions are powerful forces that cause you to do exactly the opposite of what you should do. That is, your

**EXHIBIT 3
CONSISTENCY BEATS VOLATILITY**

Year	Consistent Investment		Volatile Investment	
	Rate of Return	Ending Value	Rate of Return	Ending Value
1	8%	\$108,000	30%	\$130,000
2	8%	\$116,640	-20%	\$104,000
3	8%	\$125,971	25%	\$130,000
4	8%	\$136,049	-20%	\$104,000
5	8%	\$146,933	25%	\$130,000
Arithmetic return	8%		8%	
Compound return	8%		5.39%	

Source: CEG Worldwide.

This example is provided for illustrative purposes only and is not intended to reflect an actual investment.

emotions lead you to buy high and sell low. If you do that over a long period of time, you'll cause serious damage not just to your portfolio, but more important, also to your financial dreams.

But truly diversified investors—those who invest across a number of different asset classes—can lower their risk, without necessarily sacrificing return. Because they recognize that it's impossible to know with certainty which asset classes will perform best in coming years, diversified investors take a balanced approach and stick with it despite volatility in the markets.

**Concept Two:
Seek Lower Volatility to
Enhance Returns**

If you have two investment portfolios with the same average or arithmetic return, the portfolio with less volatility will have a greater compound rate of return.

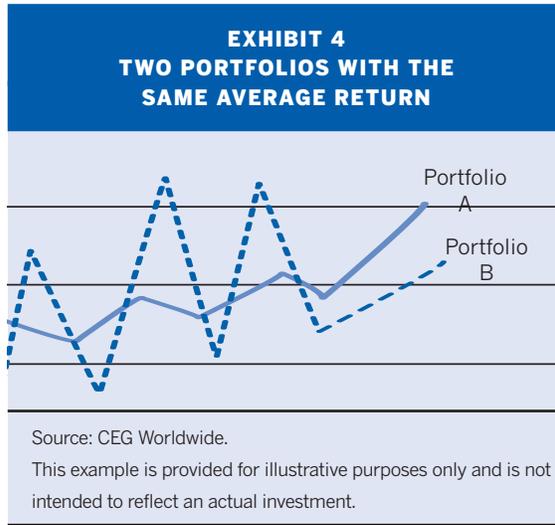
For example, let's assume you are considering two mutual funds. Each of them has had an aver-

age arithmetic rate of return of 8 percent over five years. How would you determine which fund is better? You would probably expect to have the same ending wealth value.

However, this is true only if the two funds have the same degree of volatility. If one fund is more volatile than the other, the compound returns and ending values will be different. It is a mathematical fact that the one with *less* volatility will have a *higher* compound return.

You can see how this works from **Exhibit 3**. Two equal investments can have the same arithmetic rate of return but have very different ending values because of volatility. You want to design your portfolio so that it has as little volatility as necessary to achieve your goals.

Exhibit 4 shows two portfolios with the same average return. As a prudent investor, you want the smoother ride of Portfolio A not only because it helps you ride out the emotional curve, but more important, also because you will create the wealth you need to reach your financial goals.



Concept Three: Use Global Diversification to Enhance Returns and Reduce Risk

Investors here in the U.S. tend to favor stocks and bonds of U.S.-based companies. For many, it's much more comfortable emotionally to invest in firms that they know and whose products they use than in companies located on another continent.

Unfortunately, these investors' emotional reactions are causing them to miss out on one of the most effective ways to increase their returns. That's because the U.S. financial market, while the largest in the world, still represents less than half of the total investable capital market worldwide.² By looking to overseas investments, you greatly increase your opportunity to invest in superior global firms that can help you grow your wealth faster.

Global diversification in your portfolio also reduces its overall risk. American equity markets and international markets generally do not move together. Individual stocks of companies around the world with similar risk have the same expected rate of return. However, they don't get there in the same manner or at the

same time. The price movements between international and U.S. asset classes are often dissimilar, so investing in both can increase your portfolio's diversification.

Concept Four: Employ Asset Class Investing

It is not unusual for investors to feel that they could achieve better investment returns, if they only knew a better way to invest. Unfortunately, many investors are using the wrong tools and put themselves at a significant disadvantage to institutional investors. It's often the case that using actively managed mutual funds is like trying to fix a sink with a screwdriver when you really need a pipe wrench. You need the right tools, and we believe that asset class investing is an important tool for helping you to reach your financial goals.

An *asset class* is a group of investments whose risk factors and expected returns are similar. Originally, institutional asset class funds were not available to the great majority of investors. Often the minimum investment for these mutual funds was in the millions of dollars, effectively keeping them beyond the reach of all but large pension plans and the wealthiest individual investors. Fortunately, these institutional asset class funds are now accessible to all investors. You can gain the same advantages previously enjoyed only by large institutional investors.

Four major attributes of asset class funds make them attractive:

1. Lower operating expenses
2. Lower turnover resulting in lower costs
3. Lower turnover resulting in lower taxes
4. Consistently maintained market segments

We'll look at each factor in turn.

² McKinsey Global Institute, *Mapping the Global Capital Market* 2006.

1. Lower Operating Expenses

All mutual funds and separately managed accounts have expenses that include management fees, administrative charges and custody fees. These are expressed as a percentage of assets. According to the Investment Company Institute, the average annual expense ratio for all stock funds is 1.54 percent.³ In comparison, the same ratio for institutional asset class funds is typically only about one-third of all retail equity mutual funds. All other factors being equal, lower costs lead to higher rates of return.

2. Lower Turnover Resulting in Lower Costs

Many investment managers do a lot of trading, thinking that it adds value. This is costly to shareholders because each time a trade is made there are transaction costs, including commissions, spreads and market impact costs. These costs may amount to more than a fund's total operating expenses, if the fund trades heavily or if it invests in small-company stocks for which trading costs are relatively high.

Institutional asset class funds generally have significantly lower turnover rates because their institutional investors want them to deliver a specific asset class return with as low a cost as possible.

3. Lower Turnover Resulting in Lower Taxes

If a mutual fund sells a security for a gain, it must make a capital gains distribution to shareholders because mutual funds are required to distribute 98 percent of their taxable income each year, including realized gains, to remain tax-exempt at the corporate level.⁴ They distribute all their income annually because no mutual fund manager wants to have his or her

performance reduced by paying corporate income taxes.

In one study, Stanford University economists John B. Shoven and Joel M. Dickson found that taxable distributions have a negative effect on the rate of return of many well-known retail equity mutual funds. They found that a high-tax-bracket investor who reinvested the after-tax distribution ended up with an accumulated wealth per dollar invested of only 45 percent of the fund's published performance. An investor in the middle tax bracket realized just 55 percent of the published performance.

Because institutional asset class funds have lower turnover, the result is lower taxes for their investors.

4. Consistently Maintained Market Segments

Most investment advisors agree that the greatest determining factor of performance is asset allocation—how your money is divided among different asset categories. However, you can accomplish effective asset allocation only if the investments in your portfolio maintain a consistent asset allocation. That means your investments need to stay within their target asset classes.

Unfortunately, most actively managed funds effectively have you relinquish control of your asset allocation. On the other hand, because of their investment mandates, institutional asset class funds must stay fully invested in the specific asset class they represent.

Concept Five: Design Efficient Portfolios

How do you decide which investments to use and in what combinations? Since 1972, major

³ 2006 Investment Company Fact Book.

⁴ Subchapter M, Internal Revenue Code.

institutions have been using a money management concept known as Modern Portfolio Theory. It was developed at the University of Chicago by Harry Markowitz and Merton Miller and later expanded by Stanford professor William Sharpe. Markowitz, Miller and Sharpe subsequently won the Nobel Prize in Economic Sciences for their contribution to investment methodology.

The process of developing a strategic portfolio using Modern Portfolio Theory is mathematical in nature and can appear daunting. It's important to remember that math is nothing more than an expression of logic, so as you examine the process, you can readily see the commonsense approach that it takes—which is counter-intuitive to conventional and overcommercialized investment thinking.

Markowitz stated that for every level of risk, there is some optimum combination of investments that will give the highest rate of return. The combinations of investments exhibiting this optimal risk/reward trade-off form the efficient frontier line. The efficient frontier is determined by calculating the expected rate of return, standard deviation and correlation coefficient for each asset class and using this information to identify the portfolio with the highest expected return at each incremental level of risk.

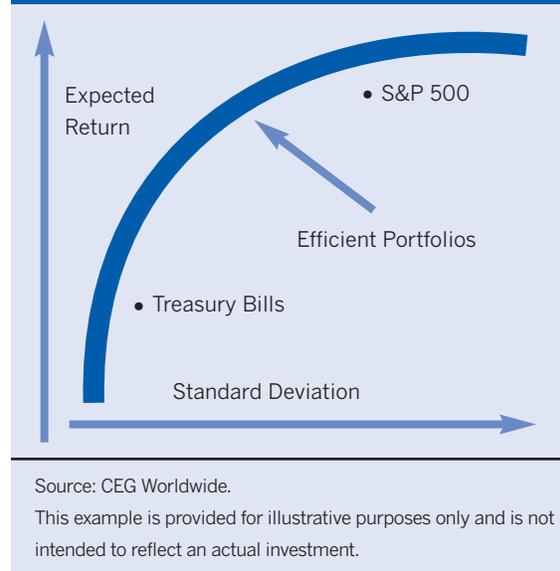
KEY DEFINITIONS

Expected rate of return is typically calculated as the risk-free rate of return plus the risk premium associated with that equity investment.

Standard deviation is a description of how far from the mean (average) the historical performance of an investment has been. It is a measure of an investment's volatility.

Correlation coefficients measure the dissimilar price movements among asset classes by quantifying the degree to which they move together in time, degree and direction.

**EXHIBIT 5
THE RANGE OF EFFICIENT PORTFOLIOS**



By plotting each investment combination, or portfolio, representing a given level of risk and expected return, we are able to describe mathematically a series of points, or “efficient portfolios.” This line forms the efficient frontier.

Most investor portfolios fall significantly below the efficient frontier. Portfolios such as the S&P 500, which is often used as a proxy for the market, fall below the line when several asset classes are compared. Investors can have the same rates of return with an asset class portfolio with much less risk, or higher rates of return for the same level of risk.

Exhibit 5 illustrates the efficient frontier relative to the “market.” Rational and prudent investors will restrict their choice of portfolios to those that appear on the efficient frontier and to the specific portfolios that represent their own risk tolerance level. Our job is to make sure that for whatever risk level you choose, you have the highest possible return on the efficient frontier so that we can maximize the probability of achieving your financial goals.

Your Next Steps

AS WE DISCUSSED AT THE BEGINNING OF THIS GUIDE, YOUR financial dreams may require a wealth management approach.

This means more than just taking care of your investments. It also means addressing your advanced planning needs, including wealth management,

wealth transfer, wealth protection and charitable giving.

Such a wide range of financial needs requires a wide range of financial expertise. Because no one person can be an expert in all these subjects, the best wealth managers work with networks of experts—financial professionals with deep experience and knowledge in specific areas.

Effective wealth managers, then, are experts at relationship management—first building relationships with their clients in order to fully understand their unique needs and challenges and then coordinating the efforts of their expert teams in order to meet those needs and challenges. Wealth managers must also work with their clients' other advisors—such as attorneys and accountants—in order to ensure optimal outcomes.

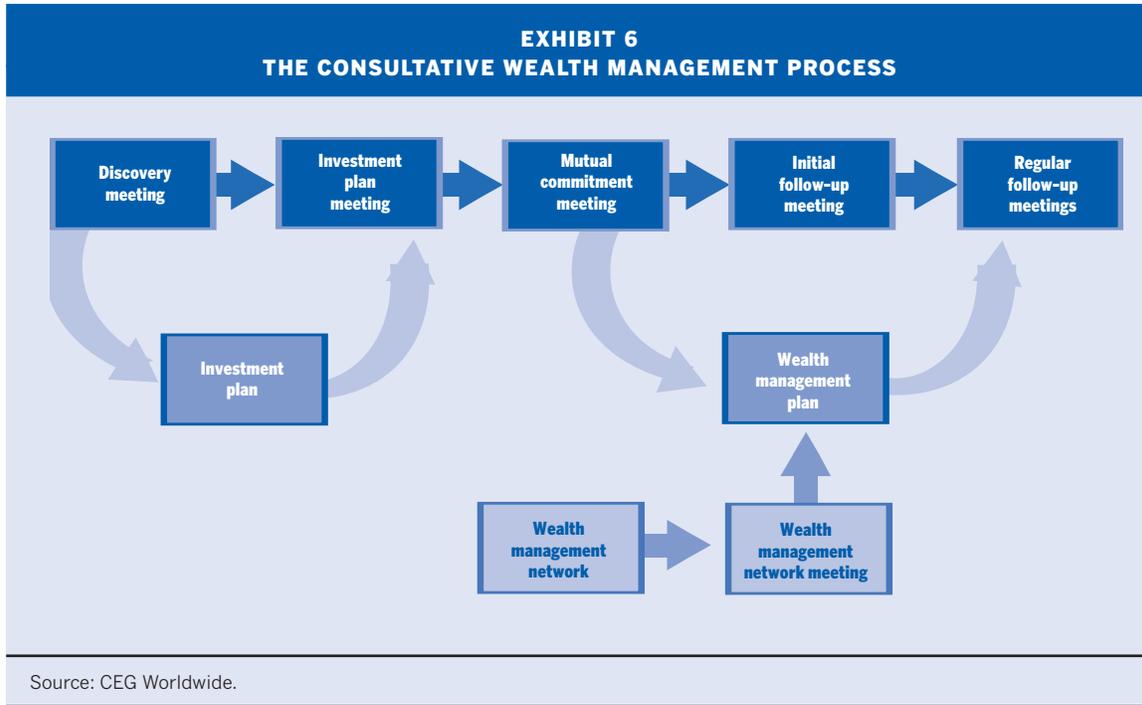
Many in the financial services industry today call themselves wealth managers but may offer little more than investment management. How then will you know whether you are dealing with a true wealth manager?

First, the advisor should offer a full range of financial services, including the four areas of advanced planning that we mentioned above. As we've said, the wealth manager should be backed up by a network of experts to provide these services.

Second, the wealth manager should work with you on a consultative basis. This allows the wealth manager to uncover your true financial needs and goals, to craft a long-range wealth management plan designed to help meet those needs and goals, and to build an ongoing relationship with you that ensures that your needs continue to be met as they change over time.

This consultative process usually unfolds over a series of meetings:

- At the **discovery meeting**, the wealth manager determines your current financial situation, where you want to go and the obstacles you face in achieving what is important to you.
- At the **investment plan meeting**, the wealth manager, using the information he or she gathered at your first meeting, presents a



complete diagnostic of your current financial situation and a plan for achieving your investment-related goals.

- At the **mutual commitment meeting**, assuming that the wealth manager can truly add value, both you and the wealth manager decide to work together. You now officially become a client.
- At the **initial follow-up meeting**, the wealth manager helps you to organize your new account paperwork and answers any questions that may have arisen.
- At **regular progress meetings**, which are typically held quarterly, the wealth manager reports to you on the progress you're making toward achieving your goals and checks in with you on any important changes in your life that might call for an adjustment to your investment plan. In addition, at the first regular progress meeting, the wealth manager presents to you a wealth management

plan—a comprehensive blueprint for addressing your advanced planning needs that has been developed in coordination with the wealth manager's network of experts. At subsequent progress meetings, you and the wealth manager decide how to proceed on specific elements of the wealth management plan. In this way, over time, every aspect of your complete financial picture is effectively managed.

Exhibit 6 shows an overview of the consultative wealth management process.

In addition, you should always expect outstanding service from any financial advisor you choose. Your phone calls should be returned on the same day, you should receive quick and complete responses to all your questions, you should be able to meet with your advisor as often as you wish, and your advisor should always take your unique needs and preferences into account. In short, you should expect to be

treated like who you are—a very important client.

If you are currently working with a financial advisor and are unsure whether he or she is using the consultative wealth management approach we've discussed here, we recommend that you have another advisor complete a diagnostic of your situation so that you have a second opinion.

You owe it to your family and yourself to make sure that your investment plan—and overall wealth management plan—is designed to effectively address your very specific financial needs in order to help maximize the probability that you will achieve all your financial goals.

We wish you nothing but success in achieving all that's important to you.

RETIREMENT

LET US HELP YOU CONNECT THE DOTS.

Connecting the dots to form a successful retirement requires tremendous effort. It takes hard work leading up to retirement, careful planning after retirement, and diligent execution of a suitable investment strategy throughout retirement. Don't leave your retirement to chance.

Let us help you connect the dots.

*Let our team help you!
Call us today
303-741-9772*

