Creating a Clear Path Forward

A message to investors from the Head of RBC Wealth Management, John Taft

In many ways, we have all been given a once-in-a-lifetime gift.

The financial and economic crisis of the past year has given us the opportunity (in some cases, has forced us) to look into what we were becoming as a society, what we were focusing on as individuals, and to ask ourselves some basic questions about who we are and what is important to us.

I recently met a gentleman who was on US Air Flight #1549 — the plane that made an emergency landing in the Hudson River in January. He heard the engines go quiet and the pilot come on the intercom. He thought what he believed were his last thoughts and he braced for impact. And, when it was all over, he stood out on the wings with the freezing water lapping at his feet, passengers screaming, realizing … he had survived.

It occurred to me that his experience is an analogy for what many of us are going through: an emergency landing of our wealth management airplane. The first hint of trouble coming was when Bear Stearns failed. The realization the day Lehman Brothers declared bankruptcy and the Reserve Primary Fund broke the buck that something was, in fact very, very wrong.

The feeling after September 15 and through October and November was that we were in a free fall, about to crash. Then, in December and earlier this year, the hope was that this might, "just" be a down 40 percent emergency landing rather than a total disaster.

Today, we're standing on the airplane's wings. We're shaken, dazed and confused. We're surrounded by an unbelievable mess. We're still worried about many things — like about fire breaking out, or the plane sinking. Our plans and our schedules are turned upside down and we don't have a clue about how we're going to get to where we were headed just a short time ago.

But we're pretty sure we're going to survive.

Because of what we've just been through and what we are still going through, we've had a glimpse into our tolerance for risk; our real tolerance for risk … now that we have had a fresh taste of what life-altering portfolio losses feel like.

We've been given a glimpse into the fragility of the modern financial system and the global economy, which, as it turns out, is more vulnerable than ever expected. This financial system shocks us because of its complexity and interconnectedness.

We've been given a glimpse into the fact that reality is more random than we would like to admit … That extreme events really can and do happen. As much as the media, politicians and regulators love to play the "should have, could have" blame game afterwards — and as much as we knew that housing prices were inflated, that risk was under priced, that financial firms were overly leveraged and that hedge fund managers were paid unsustainable sums of money — it didn't matter. Black swans cannot be foreseen or predicted.

Most importantly, we were offered a glimpse into our core values and what is truly important to us. We were offered a glimpse into what we'd be left with if everything we've worked for — all our wealth and material possessions — were to go to the ground.

What have we learned and how can we use it going forward? Please allow me to share my own experience.

Personally, I've learned that my emotional tolerance for loss is less than my intellectual tolerance for loss. I've learned I need to dial my asset allocation down a notch or two on the model portfolio scale. I've learned that peace of mind, particularly during periods like this, is worth a whole lot of foregone future returns.

I've learned that I was worrying about the wrong things in my investment portfolio. I spent a lot of time focusing on tactical tweaks — like whether to add more large cap exposure (vs. small cap) or more value exposure (vs. growth) — instead of basic, fundamental wealth preservation concerns like: Do I have enough liquidity to make it through a crisis like this? I mean, literally, do I have a way to pay my day-to-day living expenses for a couple of years if the credit markets freeze up and stay frozen?

As Barton Biggs points out in his book Wealth, War and Wisdom, as bad as last year felt, the world has served up periods of social disruption and market volatility way beyond anything we've just experienced — for example, World War II — and probably will again. I bet there are very few people who haven't thought in recent months about what they will do in the future to prepare for the possibility that, as Biggs puts it, "the Four Horsemen… ride again."

I've also learned I have certain core beliefs and convictions about how the financial markets operate — like mean reversion, like the predictability of asset class returns over long periods of time, like the value of diversification, in spite of the media's harping about the failure of modern portfolio theory and about there being "no place to hide."

I keep repeating these beliefs to myself like some kind of wealth management version of the Lord's Prayer. In the process, I'm learning that as long as I act on the basis of those core beliefs, not only am I willing to accept the consequences, to go down with the plane, so to speak, but I actually feel better, more in control, than I do just watching crisis unfold.

Finally, I am embarrassed to say, I've learned that I was probably worshiping some false gods — including the God of Accumulation. I was reminded the hard way that accumulating wealth is by itself, an empty and unsatisfying pursuit. That the best things in life don't cost money; that true wealth lies in relationships. I've learned that the best way to make it through a crisis is to stop focusing on your own problems and to start helping others with theirs.

So I guess insights such as these are the silver lining extreme experiences sometimes offer. The financial crisis of 2008/2009 has enabled us to re-connect with these kinds of core values. Over the past year, we've learned some fundamental lessons about ourselves and about what's truly important to us. And we've been given a tremendous opportunity to act on the basis of what we've learned.

I've chosen to seize this moment for what it is: an appropriate time to begin creating a clear path forward. Based on what I've learned about myself, I'm doing a few things differently. And I'm doing many things the same. But most importantly of all, I'm taking action with a heightened sense of awareness — both of myself and the world around me.

That's the gift the guy standing on the wing of US Air Flight #1549 was given.

That's the gift we've all been given. What we do now, as individuals, will determine what kind of life we lead today, what kind of choices we'll enjoy making tomorrow and what kind of legacy we leave to our children and grandchildren.

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For assistance creating your clear path forward, contact your RBC Wealth Management® Financial Consultant. He or she can help you assess and stabilize your situation, and take steps to help you recover and prepare to excel once again.