

There are many different choices that must be addressed when evaluating an investment opportunity. Sometimes potential investors can be overwhelmed with all of the information, leaving them confused and often frustrated. They are bombarded with advertising, cold calls, and seminars from the financial services industry and often leave these experiences with more questions than answers.

The following 10 Principles can help all investors understand how to evaluate an investment opportunity. These principles pertain to both those individuals who are still accumulating their assets and those who are faced with the challenges of generating income from their assets after a lifetime of work.

Principle #1

Potential for Greater Return Means Potential for Greater Risk

When evaluating an investment opportunity understanding this principle is a must. Terms like “safe,” or “risky” are too vague and can often be quite misleading.

Investors should utilize this simple formula when determining whether or not an investment is appropriate for their portfolio.

$$\text{(Anticipated Return on Investment)} - \text{(Ten-Year Treasury Interest Rate)} = \text{Additional Relative Risk}$$

For example, if the potential return on investment X = 10% and the current ten-year treasury is paying 5%, and investors is assuming twice the risk in investment X as opposed to the ten-year treasury.

Investors must ask themselves if they can accept that risk. As an investor you should know the level of risk involved in every investment and determine whether your portfolio can accept that risk.

Although this principle may sound straightforward it is very often overlooked by the lure of high double digit returns.

Principle #2

Every Investment Decision Has Risk

Many investors define risk as the possibility of losing the principle put into an investment. While this is an example of a type of risk it only illustrates the potential **Capital Risk**. There are other types of risk as well.

In fixed income investments there is **Interest Rate Risk**. If an investor locks in an interest rate for a specific length of time and interest rates rise, the value of the

investment can go down. Furthermore, if an investor is locked into that investment they cannot take advantage of the higher rates.

In addition, all investments are subject to **Inflation Risk**. Are your investments returns outpacing inflation rates? If not, you run the risk losing “buying power” and in effect are losing money.

Principle #3 **There is No Free Lunch**

Many investors and investment professionals alike focus on the “cost” of an investment. Debates between “load” and “no-load” mutual funds can sometimes cloud the picture when evaluating a particular mutual fund.

While it is an important factor in determining the overall merit of an investment, decisions should never be based solely on cost. Investors limit their investment choices by basing their investment decisions on cost only.

It is important to realize how transaction costs and fees will cut into your overall returns and to weigh the investment opportunity accordingly.

There are always costs associated with your investments. The challenge is being able to know what those costs are and how they can affect your return.

Principle #4 **True Diversification can Reduce Risk of Losing Principle**

A truly diversified portfolio avoids being overly concentrated in any one asset class, recognizing that all asset classes have the potential to increase or decrease in value.

By properly diversifying a portfolio investors can spread out their risk while also participating if another asset class performs well.

No one can accurately and consistently predict when shifts in market leadership will occur or how long they will last.

Principle #5 **True Diversification Reduces Potential Gains**

If an Investor A decides to invest his/her assets in Large-Cap Growth equities exclusively, and it is the best performing asset class for a given period of time, their portfolio will grow accordingly and will outperform other asset classes.

However as asset class leadership changes, Investor A is also exposing him/herself to a severe downtrend in Large-Cap Growth. You give up some upside potential to protect yourself on the downside.

**Principle #6:
Sell High and Buy Low**

Conventional wisdom suggests “buy low and sell high.” Conversely, our philosophy of selling high and buying low addresses the practice of effectively rebalancing diversified portfolios.

According to *Principles #4 and #5* investors should consider diversifying their portfolios with a plan to systematically rebalance them. This doesn’t mean trying to pick the next hot asset class; rather it refers to working with an advisor to identify the right number of asset classes to build the appropriately diversified portfolio.

Quarterly, semi-annually, or annually a portfolio must be rebalanced to reflect its original breakdown. This practice forces investors to sell their “winners” and buy the under performers. (Investors often have a very difficult time staying disciplined to this practice.)

History shows us that very rarely do asset classes repeat as the top performer from year to year. More importantly, rebalancing helps to prevent a portfolio from becoming over-weighted in a particular asset class.

**Principle #7:
Invest All You Can with Before Tax Dollars and/or in a Tax-Deferred Vehicle**

Take full advantage of 401(k) plans, IRA’s, and other tax-deferred vehicles. Money grows significantly faster in tax-deferred investments.

For example, suppose an investor contributes \$10,000 to their IRA and decides to invest an additional \$10,000 outside of their IRA in a taxable account. If both accounts grow by 10% in the first year, the IRA account value will be \$11,000 while the taxable account will be worth only \$10,700 (\$11,000 – investor’s 30% tax bracket).

Over time, because the investments have the opportunity to grow tax-deferred and the investor has been able to take full advantage of compounding interest, their portfolio will positively reflect their investment decision. It is also important to examine and understand how making pre-tax contributions to a qualified plan can reduce your taxable income.

Principle #8

Regression to the Mean

Each asset class has a very long history and can be analyzed to determine its historical return.

For example, the Dow Jones Industrial Average (DJIA) has averaged approximately a 10% return for the last 60 years. An investor must understand that a 20% return on the DJIA is atypical. Over time the average will return to the mean or in this case back to 10%.

Investors must be careful not to chase the “hot” stock or asset class and be disciplined enough to properly diversify and rebalance their portfolios. These practices will help investors take advantage of the “regression to the mean” and not be hurt by their investment choices.

Principle #9

An Investment Decision is a Good One if you know the “Risk and Reward”

When investors are faced with investment decisions they must determine if the true risk and the potential rewards are appropriate for them. Investors must find the proper balance between the two, which will help them weigh each investment opportunity to ensure that it fits within their overall plan.

Remember that there is no guarantee investments will perform as expected, but knowing the potential risks and reward involved give you the best opportunity to invest and succeed.

Principle #10

When traveling through the Investment Forest you will encounter:

- **Many Trees**
- **Trees of all sizes**
- **Constantly changing weather**
- **A lot of wind**

Andrew Guzzetti has been coaching people his entire professional life.

Mr. Guzzetti has 24 years of experience in wealth management. Currently he is the Managing Director at DLG Wealth Management, LLC and is responsible for building and overseeing the private client group.

Prior to founding DLG, Mr. Guzzetti spent 20 years at Smith Barney and its predecessors. He was a financial consultant in the Shearson Lehman Brothers office in Utica, NY for 5 years before stepping into management positions in Chicago, IL, Sarasota, FL, Clearwater, FL and Mt. Laurel, NJ. During his 14 year tenure in management Mr. Guzzetti was instrumental in training new financial consultants and branch managers for Smith Barney. In 2001 and 2002 he was asked to speak to Citigroup Managers from over 15 countries. He also served as an adjunct instructor at Temple University, teaching an Entrepreneurship course at both the graduate and undergraduate levels.

In the world of sports, Guzzetti was a football and baseball coach at both the high school and college levels. His 13 year coaching experience includes being the Head Football Coach at T.R. Proctor High School in Utica NY, and the Assistant Football Coach and Head Baseball Coach for Hamilton College in Clinton, NY. In this capacity he coached young people by teaching the skills and techniques of each sport, until each athlete was able to perform at the level of his individual potential. Although these two sports are “team” sports, he coached them as individuals, recognizing each one’s talents and needs.