KEATING
WEALTH MANAGEMENT

NEWSLETTER

4th Quarter 2017

Investing a Lump Sum by Nightfall

If you suddenly inherited $1 million, with the only stipulation that it had to be invested in the stock market, would you invest it all by nightfall or invest some of the money now and gradually invest the rest over time? Would your answer be different if the windfall were only $1,000 instead of $1 million?

For the first question, the better choice is to invest the entire amount immediately. Simple logic, probability, and empirical evidence all dictate that this is always the correct answer, as we will explain.

With respect to the second question, many people answer differently based on the amount involved. This is, of course, logically inconsistent, and we will explain the behavioral psychology underlying such erroneous thinking.

Logical Proof: Immediate Investment Enjoys Upward Trend for Longer Time

From 1926 to 2016, the S&P 500 index had a total positive return in 67 years, or 74% of the time. The average annual total return has been about 10%.

The expected return on an asset class represents the sum of the current risk-free rate (i.e., inflation plus the 30-day Treasury bill rate) and one or more historical risk premia as compensation for each element of risk. Historically, and based on an average risk-free rate of about 3.5% (consisting of 3% inflation plus a 0.5% premium for cash), the risk premium for large-cap equities has been about 6.5%.

To withhold money from immediate investment in equities is to implicitly assume that, over the long-term, there is no premium return available from the asset class. This is wrong. One may debate about the amount of premium available at any particular moment given the valuation of equities, but a premium must always exist to induce investors to own risky assets such as stocks and bonds.

Therefore, as long as one assumes equities will continue to provide a positive risk premium above cash, investing immediately must provide better portfolio returns on average than holding cash.

Empirical Proof: Immediate Investments Outperform Systematic Investments

In a 2016 study, "Invest Now or Temporarily Hold Your Cash," Vanguard concluded that history and theory support immediate investment, stating, "On average, an immediate lump-sum investment has outperformed systematic implement strategies [i.e., dollar-cost averaging] across global markets. This conclusion is consistent with finance theory, as

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immediate investment exposes cash to (historically) upward-trending markets for a greater period of time."

The Vanguard study compared the historical performance of immediate and "systematic" investing across three countries: the United States, the United Kingdom and Australia. For the systematic plan, Vanguard invested in a 60% stock/40% bond portfolio in 12 equal installments, and then evaluated the results over rolling 12-month historical periods, finding:

- "In each market, immediate investment led to greater portfolio values approximately two-thirds of the time."
- "On average, immediate investment outperformed systematic implementation by a high of 2.39 percentage points in the United States and a low of 1.45 percentage points in Australia."

Vanguard repeated the process for 100% stock and 100% bond portfolios. The following table shows the remarkable consistency of outperformance two-thirds of the time across countries, ***regardless of asset allocation***. In the case of a 100% allocation to U.S. equities, immediate investment outperformed the systematic plan in 67% of rolling 12-month periods over the 90-year time horizon of the study (1926-2015).

	United States (1926–2015)		United Kingdom (1976–2015)		Australia (1984–2015)	
Immediate investment outperformed with greater frequency	Immediate	Systematic	Immediate	Systematic	Immediate	Systematic
	68%	32%	70%	30%	68%	32%
Average magnitude of outperformance	▲ 2.39%		▲ 2.03%		▲ 1.45%	
Asset allocation didn't matter						
100% Equity	67%	33%	70%	30%	65%	35%
50% Equity/50% Fixed income	68%	32%	70%	30%	69%	31%
100% Fixed income	65%	35%	63%	37%	62%	38%

Source: Vanguard, "Invest Now or Temporarily Hold Your Cash?"

Why Market Timing Doesn't Pay

Based on annual returns, the equity market is up far more often than it is down—about 75% of the time, in fact. This means that the chances that the market will rise in any given year after you invest are 3 to 1 in your favor. Conversely, the chances that it will fall in the ensuing year are only one in four. So the longer you wait to invest in equities, the more likely it is you will miss out on opportunities for your money to enjoy the premium return associated with the asset class.

Countless studies quantify the powerful concept that investor returns from equities are ultimately determined by the ***amount of time in the market***, demonstrating that trying to time the market is a fool's errand.

As just one recent example, consider the years 2010 to 2016, when the total return of the S&P 500 index was 132.8%. The best 18 trading days out of the 1,762 trading days in this period produced an 83.1% gain. Thus, just 1% of the trading days in those seven years were responsible for 63% of the index's total return. Miss those days and you miss the return associated with the asset class.

Loss Aversion

Psychological research and behavioral evidence have demonstrated that humans typically regret losses ***at least twice as much*** as they appreciate similar-sized gains. We are "loss-averse."

Because the chance of experiencing negative returns is higher in the short term, the more frequently investors evaluate their portfolios, the more likely they are to see losses and develop loss aversion. By the same token, the less frequently they evaluate their portfolios, the more likely they are to see gains.

Daniel Kahneman, a Nobel laureate and one of the founders of the field of behavioral economics, expressed it this way:

> *The attractiveness of the risky asset depends on the time horizon of the investor. An investor*

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Comprehensive Financial Services Defined

Has any financial adviser ever offered to provide you with "comprehensive financial services?" What exactly does that mean?

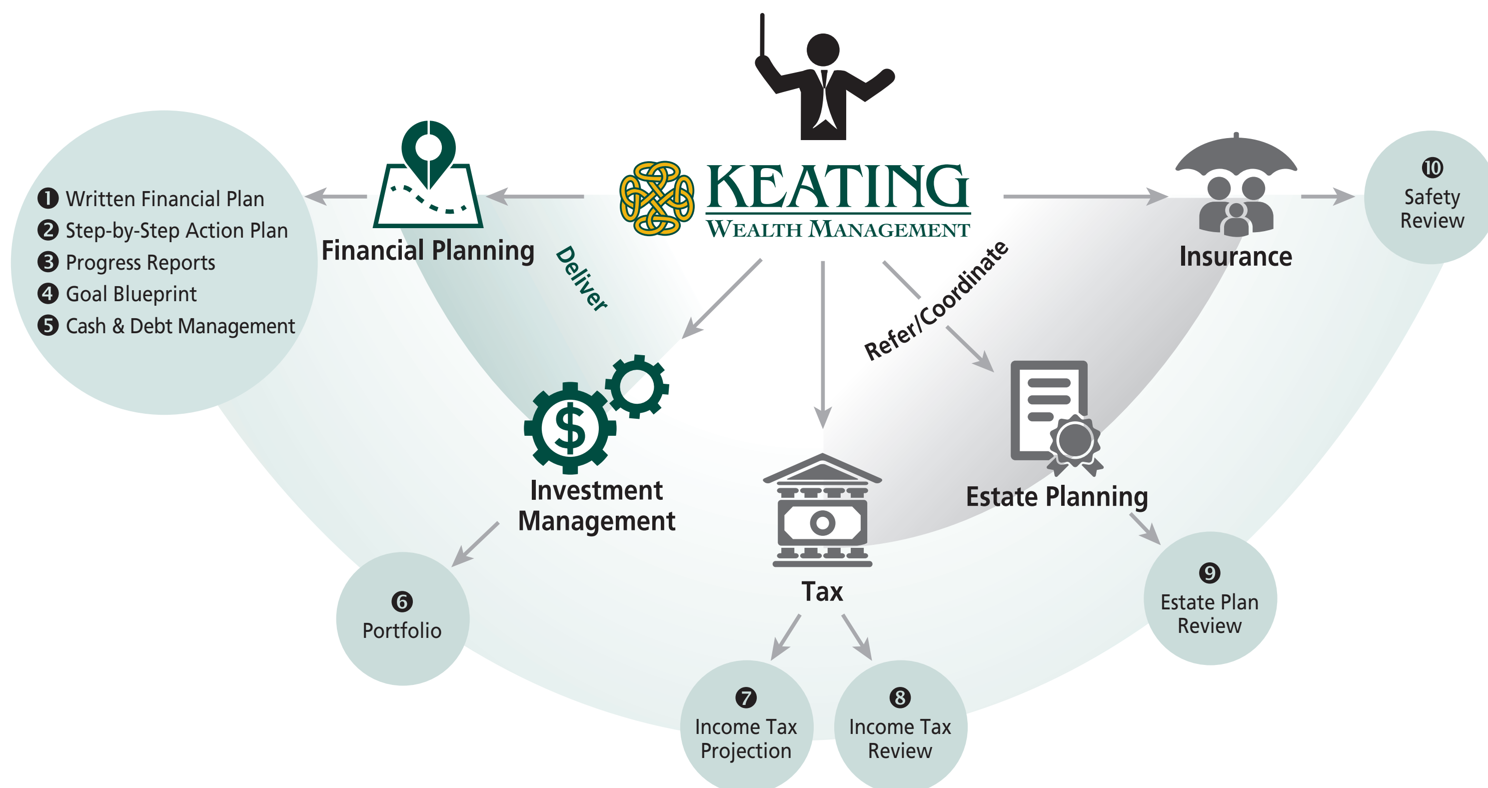
Consider some of the mystifying jargon that has entered the financial services lexicon in just the last decade: robo-advisers, smart beta, target date funds, clean (or "T") mutual fund shares, and so on. What do those terms mean? Do you need to understand them? Should you even care? The short answer is that you don't need to know or care about any of this bewildering lingo.

Despite the noble work of about 300,000 well-trained, highly competent and caring financial advisers in the United States, Wall Street can be a dangerous—and expensive—place to learn, for the uninformed. So we thought it would be instructive to cut through the Wall Street fog machine and define some potentially perplexing terms in a way that will make sense to anyone seeking financial planning and/or investment advisory services.

Below, we present a list of 10 specific deliverables across five disciplines—financial planning, investment management, tax, estate planning, and insurance—that we believe are necessary for truly comprehensive financial services.

Depending on its size, scope, and range of services, a financial advisory firm may deliver some or all of these services directly or through a coordinated approach with a client's other professional advisers in areas such as tax, insurance, and legal matters.

10 Client Deliverables Across 5 Disciplines



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who is prepared to wait a long time before evaluating the outcome of the investment as a gain or a loss will find the risky asset more attractive than another investor who expects to evaluate the outcome soon.

Minimizing Potential for Regret

Although research and history clearly show that immediate lump-sum investments consistently outperform a dollar-cost averaging approach over time, many people choose some variation of the second option, and the long odds against them, because they fear the potential downside of a sudden drop in portfolio value associated with an immediate investment. This irrational fear far outweighs any logical understanding of the 3 to 1 odds in their favor that stock prices will be higher in the ensuing 12 months, and dramatically higher odds still over a decade.

Unfortunately, when fear wins out over logic—as it often does, people attempt to minimize the chances of regretting their decisions by investing windfalls slowly over time.

But no matter what happens in the markets, the economy, politics or the world, in the long term, you will be better off by investing that lump sum by nightfall, whether it's $1,000 or $1 million. Go forth and prosper.

Behavioral Takeaway

Although loss aversion is part of our psychological wiring as human beings, the frequency of evaluations is a choice that investors (and their investment advisers) can control. And since most investors are accumulating assets in preparation for a multidecade retirement—or longer, in the case of planned transgenerational transfer of wealth—it makes sense to adopt evaluation periods that correspond with these time horizons. When you have a lump sum to invest, act by nightfall and put it to work immediately. Then once invested, think in decades, not days.

Planning, Advice & Accountability

Keating Wealth Management is an investment adviser that provides comprehensive financial planning and investment counsel to financially successful people and families who want to do something else with their valuable time besides managing their money. This is an overview of the services we provide.

✔ **Coordination.** We will orchestrate the activities of all your financial, tax, insurance and legal professionals on your behalf so that they work in concert, ensuring you get the best advice from each.

✔ **Consolidation.** You may have more accounts with more institutions than is necessary to achieve your goals. We will consolidate your financial affairs, reducing the complexity, so you can easily understand it all.

✔ **Comprehensive service.** We will address any gaps in your planning and take care of whatever important tasks need to get done so that your financial house is in perfect order.

✔ **Simplification.** We will create a clear, actionable plan that will simplify your life, so you can focus on more important things than managing your money.

✔ **Accountability.** We will hold your advisers accountable to give you the best advice for your financial situation, and we will hold you accountable to do your part by implementing their recommendations.

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