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CornerCap® Investor

Back to Basics

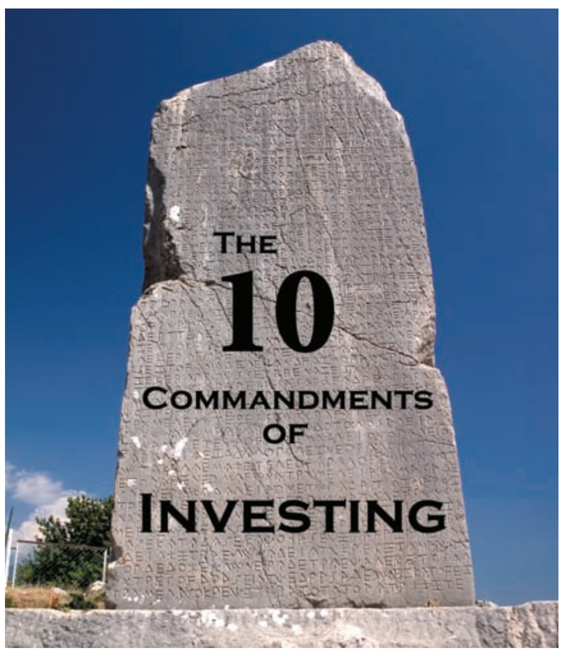
10 Basic Investment Principles to Follow, Especially When Times Are Tough

The legends of the investment world, such as Warren Buffet, John Bogle, Charles Ellis, Jeremy Grantham, and John Templeton, agree on certain basic investment principles. With so much volatility in the market and fears about the economy's outlook, it is time to look at these principles, with some annotations of our own. If the investment wizards are correct, these Ten Commandments of investing will ensure success when times are tough, as well as when they are lush. Reverse any of these principles and you have a commandment of failure.

1. The minimum investment horizon is 10 years.

The shorter your horizon, the closer you get to roulette! In normal times, particularly in a downward move of the market, everyone says, "I am a long term investor." But are you? As the drop becomes more sustained and severe and the gamut of emotions runs from fear to panic to despondency, your horizon becomes shorter and shorter, sometimes to a period of only weeks.

Peter Lynch, the legendary manager of the Fidelity Magellan Fund, fielded telephone calls several years ago from the listening audience of a NPR broadcast. Throughout his many answers, there was one consistent thread, "If you don't stay in the market for 10 years, don't get into it at all!" That's our advice to you.



CornerCap recommends 10 basic investment principles to guide investment strategy.

2. Have a disciplined and consistent investment philosophy and process.

The reverse of this commandment is to listen to CNBC, your friends and neighbors at social gatherings, and the other purveyors of "what to do now." If you have a disciplined investment approach with a good financial advisor, who can articulate his strategy clearly and understandably, stick with him. Our clients know CornerCap's philosophy and discipline, which we have maintained for three decades. They also know that we will not waiver. You have not been tested until you have traveled the rough road, and rough roads there will certainly be. That's why we have these rules.

3. The asset allocation in an investment portfolio controls most of the volatility in your investment returns.

Setting an allocation for yourself has nothing to do with stock selection, market timing, or strategy to vary with market conditions. It has everything to do with your personal goals, your income needs, your risk profile, and your ability to accept risk. Asset allocation includes periodic rebalancing as the market moves up or down to re-establish the allocation you set for yourself. If you have an allocation of 60% stocks and 40% bonds, and the stocks move down 20%, you must rebalance (as hard as that is to do) to re-establish the 60% stock mix.

It's like the toad
Ugly and venomous,
Yet, it wears a jewel in its head.

Never change your allocation for any reason other than a change in your personal circumstances. For example, you might change your allocation should you downsize your home, need to support a sick grandchild, or want to establish a college fund. Set your asset allocation only with a trusted financial advisor. Depending on your time horizon, an allocation to a balanced ladder of fixed income securities will reduce the volatility of the stocks in the portfolio.

4. Do not attempt to time the market or strategically allocate your investment mix because of what you think the market might do.

One thing is absolutely certain: the market is dominated in the short term by hope, greed, and fear! There is commonly a disconnect between a company's valuation and the current market jawboning.

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As John Bogle noted in his article, "Black Monday and Black Swans" (Financial Analysis Journal, March/April 2008, CFA Institute, Vol. 64), the S&P index stood at about 17 in 1950. Since then it has risen to a level of 1,526 in 2007. If you should subtract the 40 market days in which the S&P 500 had its highest percentage gain (40 out of 14,588 days), the level drops to 288! So much for timing the market. You probably have a better chance in Las Vegas. To time the market correctly, you have only to know where lighting strikes next.

5. Don't tinker.

Once you have established your asset allocation and your investment horizon, "don't tinker." You have started as you should, but now you see the market moving dramatically away from you, and it seems to be a bottomless drop. Your reaction: "I've got to do something to stop this! Maybe I should change my investment advisor. Maybe I should have a higher allocation to bonds, or get out of stocks altogether."

Getting out of stocks leaves you a helpless victim of inflation. Inflation over time is the giant killer and will erode your net worth as much as a bear market. Resist the temptation.

As stated in Commandment Two, never change your asset allocation unless your personal circumstances require it. Otherwise, stay with the plan. The same commandment applies when the market makes a major move on the upside. "I've got to have a higher allocation to stocks." Remember, you have a long-term investment horizon. When you tinker, you are, in effect, market timing. Don't do it.

6. Have a clear view of what financial success means to you.

Having a clear view will protect you in the short term in either an up market or a down one. Financial success does not mean, "I want the best returns I can get." It does not mean, "I'll give my financial advisor a couple of years to see how he will do." It does not include reacting to the current market environment.

As investment policy guru Charlie Ellis once said, tennis is not one game but two—one played by professionals and the other played by everyone else. "Professionals win points; amateurs lose points," i.e, they beat themselves. Consistency and discipline are the only ways to win a loser's game in the market.

It does not mean, in the short term, whether my advisor is beating a market index, such as the S&P index. Contrary to popular belief, comparing one, three, and even five-year returns to market indices is irrelevant to financial success.

What it does mean is for you to thoughtfully consider the total of your financial assets and your life's goals and objectives. Having done that, select a financial advisor with a long-term perspective to accomplish what you have in mind. That is the key to financial success.

Your goals and objectives should include an analysis of a budget for your lifestyle over time, an analysis of your plans as you age, the possible sale of non-financial assets in the future, the amount of inheritance you would like to pass on to your heirs, the tax consequences of your investment profile, and so forth.

Your financial advisor will help you to determine whether your life's goals and lifestyle are reasonable and to set an asset allocation to accomplish your needs.

The considerations of your life's goals are personally yours and you cannot delegate them. If you do your job here, you will have done much of what you need to do for financial success.

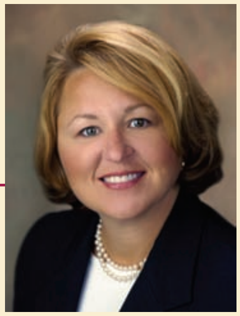
Your financial advisor may suggest a modification of your goals or a floor amount of assets you should have to accomplish them. You may find that you have more assets than you need, and this will enable you to comfortably give to charities, implement an estate plan during your life, or create an educational trust for your descendants. You will be financially successful.

7. Control your emotions.

This is asking an awful lot of you and others, including institutional investors, investment gurus, investment advisors, all of us.

We mentioned earlier that the market in the short term is dominated by hope, greed, and fear. Keep in mind that, in the short term, the market is a very dangerous place to be and that it can do anything it wants to do.

Anno Hardage Receives Highest Ranking in Client Satisfaction Survey



Anno M. Hardage, director of client services and a portfolio manager with CornerCap, has joined an elite list of metro area wealth mangers who scored the highest ranking in an independent, best in client satisfaction survey conducted by Crescendo Business Services of Minneapolis, Minn., in conjunction with *Atlanta Magazine*.

Ms. Hardage's inclusion as one of only 376 on the 2008 Five Star Wealth Managers list puts her in a group that represents less than three percent of the wealth managers in the metro Atlanta area. The list was published in the October 2008 issue of the magazine.

Stick with a disciplined investment approach and a good financial advisor who can articulate his strategy clearly and understandably.

Moreover, regardless of what you may read in financial publications, hear on television, or hear on the street, no one can predict the future, and there will be black swans out there (an impact of the highly improbable).

The only way to put the odds in your favor is to know that human emotions can cause you to do exactly the wrong thing at the wrong time. The market will reach new highs over time, because reason will prevail and the true value of companies will emerge.

At CornerCap, we try to control our emotions by making calculated investments as if there was a Chinese wall between our investment discipline on the one hand and what we hear on the street on the other. Our stock selections are based on valuations that we have developed, measured, and used for three decades.

Our valuation model has growth and value style attributes and ranks our universe of stocks as buys, holds, and sells. We use a qualitative evaluation of income statements, balance sheets, SEC filings and the like to test the accuracy of the calculated attributes, but we generally do not deviate from the quantitative offerings without good reason.

Moreover, regardless of the current hype, we avoid concentrations in any stocks or group of stocks, equally weighting all stocks in the portfolio. That's our shot at controlling our emotions. You may remember the legendary tennis professional, Vic Braden, who said that if you hit the same old basic forehand time and time again (meaning consistency), you will get tired of winning. We believe that consistency is the only way to win a losers' game in the market.

8. The home repair industry gets most of its revenue from those at home who try to fix it themselves.

Get an expert to help you implement your investment objectives. Get to know the investment firm well. Everything, including fees and costs, should be totally transparent.

There are four critical elements in selecting an investment advisor. The four "P's" are people, process, philosophy, and performance, all four of which must be weighed in selecting a manager. Get to know these four "P's" of the firm you select.

Also know the firm's succession plan for future growth. Many good firms are purchased by other firms or by banks only to disappear over time. So much for implementation of your long-term investment plan!

9. Do not retain an investment advisor who doesn't fully agree with and implement the commandments set forth here.

10. Having done all of this, the key to success thereafter is benign neglect.

This is one of the themes of Charles Ellis' book, *Winning the Losers Game*. Of course, this is an over statement but its thrust is a good one. It assumes you have done your work well and that you have selected a proper investment counselor. Having done all, the probabilities are greatly in your favor.

The 10 Commandments of Investing

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2 Have a disciplined and consistent investment philosophy and process.

3 The asset allocation in an investment portfolio controls most of the volatility in your investment returns.

4 Do not attempt to time the market or strategically allocate your investment mix because of what you think the market might do.

5 Don't tinker.

6 Have a clear view of what financial success means to you.

7 Control your emotions.

8 The home repair industry gets most of its revenue from those at home who try to fix it themselves.

9 Do not retain an investment advisor who doesn't fully agree with and implement the commandments set forth here.

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In This Issue:

CornerCap Named One of Top Financial Advisory Firms in Atlanta

At the close of 2008, CornerCap was listed by the Atlanta Business Chronicle as one of the top financial planning and advisory firms in metro Atlanta.

According to LS Local Search.com there are nearly 600 financial planning and advisory firms located in the greater metro Atlanta area.

Other news coverage about the firm in recent months has appeared in the online editions of the Atlanta Business Chronicle, AJC.com, the Charlotte Business Journal, Finance Industry Today, Forbes.com, GlobeInvestor.com, Dow Jones' Market Watch, MSN Money, Reuters, Triangle (N.C.) Business Journal and Yahoo Finance.

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