

# crisis & finding our way again

The global financial crisis touched us all. Many of us had to put retirement on hold or rethink education plans for our children. Some of us even began to question traditional approaches to investing such as diversification.

While many of the investing principles that have seen us through the past 50 years are still valid, we have gained two important insights from the current financial crisis which show how we can improve some of the traditional ways we manage our investments.

## **Preparing for the extreme**

Most investors are still painfully aware of the types of events—the 1987 crash, the 2000 tech bubble and the 2008 housing bubble—that are supposed to happen infrequently. What we've learned, however, is that extreme events happen much more often than we think—or than our established models forecast.

## **And the unexpected**

Another key insight is that under severe market stress, assets tend to become more highly correlated, meaning they start acting more alike than differently.

Most of you are familiar with the concept of diversification: By combining assets that perform differently during typical market volatility, an investor can reduce risk while targeting the same returns. For example, bond prices typically rise as stock prices go down. These assets have low correlation. The crisis showed that these assets don't always perform as expected.

These new insights call for a more dynamic, proactive approach to both investing and planning.

## **A disciplined but dynamic process**

It is still important to understand the crucial role a disciplined investment process plays in helping you through up and down markets alike. However, a more dynamic and flexible approach can help you:

### **Assess your risk profile more realistically**

- Consider different investment objectives and timeframes, as well as your cash flow needs
- Look at your ability to bear losses without abandoning investment discipline

### **Build in more short-term tactics**

- Make adjustments to your long-term strategy, which may not be optimal at any given point in time
- Consider current market conditions, opportunities and challenges

### **Rebalance as needed rather than on a set schedule**

- Keep your investments aligned with your original strategy
- Allows you to make appropriate adjustments as markets, your risk profile or life circumstances change

# Planning a more flexible approach

As you begin the process of rebuilding your wealth, creating or updating a financial plan can help guide your financial decisions and keep you on a steadier course. A recent study showed that 88% of clients with a financial plan believe they have a clear financial direction.\* However, the financial crisis has taught us that we need to take a more flexible approach to planning.

In developing a comprehensive plan, it is important to consider the timeframe for each of your major goals, rather than using just one time horizon for all your goals. For example, you may have children attending college in the next few years or plan to buy a new home. What about beyond the immediate future? Are you planning to launch a new business? Start caring for your parents? Retire?

## Planning for multiple goals

The point here is that we tend to have multiple objectives and each of those may have a different timeframe. Different timeframes, in turn, impact the kind of risk and return structure needed for the investment strategy we put in place to pursue those goals. For example, you may need to keep certain investments working toward your retirement, but also be able to access funds for upcoming college education costs.

This view goes against the traditional approach. In most cases, investors have been assumed to have had a single time horizon which was then attached to a single investment strategy. And remember, a plan isn't set in stone. It should be revisited and updated as circumstances in your life change.

\*Source: FPA® and Ameriprise® Value of Financial Planning study conducted by Harris Interactive, August 2008

## Let's have a conversation

I would be glad to discuss these topics with you further.

### Questions we can review together include:

- How do I know if I have too much of one particular stock or asset class?
- What can I do about a concentrated position?
- How often should I review my IRA and 401(k) plan strategies?
- How often should I rebalance my portfolio?
- What's the best way to involve my family in my financial plans?
- If I've been out of the market, what's the best time to get back in?

Feel free to write down any other questions or concerns you would like to discuss.

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