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Investment Answers from the Gnomes of Zurich

By Alan Snyder
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Investing in general, and specifically for retirement, triggers so many daunting questions. What should I look for in an investment? Who should I go to for advice? How much do I need? If I want to leave money for my family after I have passed, is there a best way?

In this article, I would like to focus on the first question because it is a foundational element for any plan. And, the answer can help in the selection of an adviser and to evaluate any existing efforts. For this, imagine you are like one of the Gnomes of Zurich!

No, they are not some creatures living on Pandora, the planet of Avatar, but are famous as financial experts of *nonpareil* capabilities. The Swiss are not always happy about being likened to the diminutive gnomes who hide out beneath the ground measuring their wealth against all others. Yet, with $3,000 worth of riches for each Swiss person, one bank per 1,300 people, a gold-backed currency, "numbered" bank accounts and a reputation for financial acumen and privacy, one could be accused of far worse.

Therefore, in the spirit of the long-running Swiss financial success, we recently asked a group of investors to imagine themselves as Gnomes of Zurich and describe what the characteristics of their ideal investment would be. We sought inspiration on what is important in these confounding and uncertain times. They obliged:

Attractive and consistent long-term returns
Expectations were not foolish after the drubbing of 2008 but still robust. The clearing bid approximated 7% with the usual outliers, 3% to 16%. Our 16% bidder was intensely kidded about being unrealistic.

Low risk
Most were willing to accept a 10% downside exposure, albeit not happily, with a few gusts to 20%. When asked how to measure this criterion, the common answer was yearly loss; more sophisticated investors preferred drawdown, ie, maximum peak-to-valley historical exposure.

One participant liked standard deviation, which when defined caused several to clamor: "who cares about upside volatility," eg, we explained Sortino ratios, standard deviations of downside volatility, which were a bridge too far. Ultimately, it was agreed that risk is best measured by volatility, as defined by standard deviation and drawdowns.

Liquid
Meaning, "I want my money out without lockups or high surrender charges like those in public variable annuities."

Tax advantaged
Everyone appreciated the wide gap between income taxes on earned income and short-term capital gains versus long-term capital gains taxes or even no taxes.

Estate advantaged
Some folks were in retirement and thinking hard about how to most efficiently pass money to their heirs.

Safety
Given Madoff and the blowups in many mutual funds, everyone wanted peace of mind that their money would not evaporate due to chicanery or foolish management.

Easy
Expressed as a bunch of desires: simple to buy/sell, flexible for adding additional money or taking money out to live on, understandable, little work for accounting and tax preparation and direct/clear performance tracking.

Leveragable
One participant rabidly insisted this was a way she wanted to increase her returns. Another wanted the investment to be collaterizable for further flexibility.

Low fees
Many felt that low fees regardless of all of the other attributes were important albeit controversial, while others said what difference if I, capital I, get what I want. However, the low-fees cohort unconvincingly countered this was a relative measure as compared to what others charged and thus important.

Transparency
People want to know what's happening and where their money is invested.

This information is only one group's response to our question, but remarkably similar to what others have shared over the years. Most importantly, what is your list? The same? Missing something not shown here? Making the tradeoff between one attribute or characteristic and another is critical and a personal value judgment. Some might say that this is boringly detailed but isn't it a nifty way to refocus on substance rather than short-term "frou-frou"?

A new year cries out for evaluating each of our investments against an objective criteria-set, no matter how demanding our daily hurly-burly distractions might be. Given how important our nest eggs are to providing living benefits, retirement comfort and inheritance opportunities for those we love, such evaluation must be a priority.

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