

Northern Lights Edition 6
March 18, 2011

Japan: Our thoughts and prayers are with the Japanese people and everyone affected by the tragic events that are still unfolding there. Let's all pray and hope for the best possible outcome.

“What I’ve learned from 17 years in this business”

“The investment business is about being confident enough to know that you’re right and everyone else is wrong. Yet you have to be humble enough that you recognize when you’ve made a mistake. Earlier in my career, I think I had the confidence part pretty solid. But the humbleness part I had to learn.”
~Bill Ackman

Bill Ackman is a well known hedge fund manager, and I think that every experienced person in the financial industry can relate to his statement. It doesn't matter if you invest in stocks or bonds, Mr. Market has an uncanny way of finding people who have gotten too big for their britches and taking them out to the woodshed! Since I don't like going to the woodshed, I think it's worthwhile to look back and share what I've learned after experiencing one of the greatest bull markets in the 1990's followed by two of the worst market drops in the last 50 years.

The financial business is just like life itself, the older you get and more experience you have, the more you realize:

- how much you don't know,
- how important it is to keep learning and be flexible, and
- how important it is to have a plan ahead of time.

Having a plan and the discipline to stick to it are the most important factors I know of when it comes to successful long-term investing - no matter whether you invest in stocks or bonds. The people that got hurt the most in the financial crisis of 2008 were the ones who didn't have a plan and/or the discipline to stick to it. They let their emotions take over and sold near the bottom of crisis, locking in their losses and not realizing the gains that came afterwards. I knew a few people who did that and they have done irreparable harm to their finances. The people who followed their plan did much better, they might have been lucky enough to get out before the worst hit them or they rode out the crisis and are now likely back where they were before, albeit with more gray hair!

A plan helps you identify what your limits are before your emotions take over. When you execute your plan, you will have taken into account your personal tolerance of risk. Think about that.

Before I continue with a list of “lessons learned”, here are a few of my favorite quotes that seem appropriate for this topic:

“It's never paid to bet against America. We come through things, but it's not always a smooth ride.”
~Warren Buffett

"Markets are never wrong, only opinions are"

~Jesse Livermore

"The great thing about knowing you're wrong is the moment you realize it, you're right"

~Vanna Bontaare

Here are the rest of my observations and lessons that I think are worth remembering:

Before the Crisis:

- **Be careful who you listen to.** Be aware that most tips to buy come from sellers and most tips to sell come from buyers. Be wise and recognize the fact there are no disinterested people in the world of finance! This is certainly true on the Internet as well, whether you are in a chat room or just surfing. Be skeptical of everything you hear, but don't get cynical. Question everything stated as a fact without facts to back it up.
- **Have a plan before the crisis hits.** It's hard to stand losses when you're experiencing them. It's even harder to think clearly at that time. You must have a plan before the crisis hits you and the plan should include an extreme financial event every few years - and what you will do when it occurs.
- **Be careful who you trust and always conduct your own due diligence.** You can't rely on regulators or analysts to provide due diligence; and keep in mind that many products failed to perform as anticipated or advertised.
- **Disregard advice that violates your common sense and experience,** no matter who the source is.
- **Find your real tolerance for risk.** Most people believe that their tolerance for risk and losses is much higher than it actually is.
- **Realize that averages rarely happen.**
- **Comparison may be the root of all evil.** Consider this example: If the boss gives you a new BMW as a year-end bonus, you're thrilled...right up until you find out he gave everyone else 2 BMW's! Instead of comparing your investments to the market or your friends, focus on your needs and goals.
- **Chart a course.** "Hope" is not an investment strategy and a lottery ticket is not a retirement plan. Chart a course. Plan ahead. Have the lifeboats ready at all times.

During the Crisis:

- **Normal isn't anymore.** The problem with extreme downturns is that what was normal is not anymore. You can't play by the rules when they cease to exist. Hedges, preservation strategies, and credit ratings cannot be relied upon in extreme situations.
- **Use technical indicators when in doubt,** they don't lie or have hidden agendas.
- **It is better to lose opportunity than money.**

- **Plan for the worst.** In extreme circumstances, like we had in the 2008 financial markets, virtually all assets can and likely will go down. Bonds are often used to reduce risk to portfolios but in extreme situations they tend to act like stocks. Expect it and have a plan to deal with it.
- **Always have a sell strategy.**
- **Don't hang around losers.** When you have a losing stock or bond, sell it, forget about it, and re-allocate the money to something better. Don't "hold and hope" where you're taking all the risk of ownership but getting no return for it.
- **Investment strategies need to be flexible.** Pie charts and Modern Portfolio Theory (which was created in 1952, hardly modern now) do not work in extreme markets, and possibly not at all anymore.
- **Never get over-leveraged,** which is Wall Street's way of saying don't borrow more than you can pay. If the big banks had followed this simple banking rule, 2008 probably would have been a quiet year.

After the Crisis:

- **You don't need to rush in to buy right away.** It's not like a concert or football game where you need to line up early or you don't get the ticket. The market will always sell you another "ticket", take your time.
- **Don't be in a hurry to buy the "bargains".** Wait out the storm, don't set sail while lightning is still striking, don't be fooled by the calm in the eye of the hurricane.
- **Great opportunities usually present themselves when the fear is greatest.** Don't wait to "feel good" before you begin to buy. This advice may seem in contrast to the previous paragraphs but that's the way it is, and that's why experience matters.
- **If something seems too good to be true, run away!**

Thank you for taking the time to read my newsletter. I hope you enjoyed it. And remember, the future will be clearer tomorrow! As always please call or email us with any questions, comments, or concerns you may have. If you're not currently a client and would like a second opinion or need to re-visit your financial plan, please give us a call. We'll be happy to meet with you and discuss your concerns.

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