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Wenning Investments, LLC

Wenning Advice

Vol. 1 - Issue 2

December 2008

Dear Brenda,

Thank you for your interest in "Wenning Advice," our new monthly newsletter for clients and friends. If you would like to be taken off our list, please reply here. If you have a friend who might benefit from "Wenning Advice," please [reply here](#).

Brenda P. Wenning, *Principal*
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Revisiting Diversification

In theory, diversification can reduce losses, increasing long-term returns. In practice, it is not always effective.

Of course, no investment method is - but, given recent market activity, a closer look at diversification is warranted.

For diversification to prevent losses, investments need to have a "negative correlation" to each other - that is, when the value of one investment goes down, the value of the other goes up.

For example, value stocks may perform well when growth stocks do not, and vice versa.

But today's financial crisis is making diversification a challenge. Virtually all types of investments have fallen in value, so having investments with a perceived negative correlation has not saved investors from experiencing significant losses.

One problem is that not all risk can be eliminated by diversifying. Risk sometimes results from fluctuations tied to various aspects of the general economy, such as the business cycle, inflation, interest rates and exchange rates. None of these macroeconomic factors can be predicted with certainty, and all affect the rate of return. This market risk or *non-diversifiable* risk remains even after extensive diversification, no matter how many stocks you own.

Going Global

So does having a global portfolio, which exposes the investor to many different markets, overcome this problem?

In the past, holding a combination of U.S. and international stocks helped reduce market risk. Today, though, global markets are more interdependent than they were in the past. Today's financial crisis is a worldwide phenomenon. In fact, some other countries are in even worse financial shape than the U.S.

So should investors abandon diversification? Not at all. While it may be worth revisiting how your assets are allocated to ensure that they are properly diversified, don't give up on diversification if you want to manage risk.

Sometimes diversification works. The lesson to be learned from today's economy is that other methods of managing risk are also needed.

Diversification is the foundation of risk management for those who rely on a "buy and hold" strategy. Active management, of course, takes a more proactive approach to investing that is designed to both manage risk and increase long-term returns.

In other words, you not only need to diversify your investments, you need to diversify your risk management strategies, too.

Returns From Active Management

The current financial crisis has made many investors recognize that a "buy and hold" investment strategy has expensive consequences.

In recent months, active investors have pulled most of their money out of the market. Sitting on the sidelines, they have watched the Dow Jones Industrial Average drop by thousands of points.

While active investment managers use different criteria for advising their clients when to buy and sell, they have generally sat out the 14 bear markets that have taken place since the Great Depression.

What impact can that have on an investor's portfolio? The chart below tracks returns gained by active management against returns gained by the market as a whole.



Past performance does not guarantee future results. This is a hypothetical illustration only and its performance is not indicative of any particular investment strategy.

Those who have remained invested have seen their investments drop in value by 20 percent, 30 percent or maybe even 40 percent. Investments have also been subject to extreme volatility, with swings in the Dow Jones Industrial Average by hundreds of points per day.

Learning From Your Investing Mistakes

We all learn from our mistakes, but when your financial future is at stake, it's best to know what mistakes to avoid.

In this and future issues of *Wenning Advice*, we will discuss the investor mistakes we encounter most frequently.

Mistake #1: Unclear Financial Goals. You can't achieve your goals if you have no goals. But having unclear goals is almost as bad as having no goals at all.

If your goal is to save for your children's college education, will you be saving for a state college or prep school and four years at Harvard? The difference in what you'll need to save can run to six figures.

What about your retirement? Will you be saving for a retirement home in Cabo San Lucas or in Kansas? Include the price of a mandatory yacht and the difference can run to seven figures.

Consider all of your financial goals in as much detail as possible. Of course, no one knows with certainty what it will cost to live in Cabo 20 years from now or what college will cost when your children are ready to attend, but the more detailed your goals are, the better you can project your costs.

The more accurately you can determine how much you will need and when, the more likely you will be to achieve your financial goals.

Keep in Touch

Have an idea for a future issue of Wenning Advice? Are you interested in active investing or would you like to refer a friend who may be interested?

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