Reprinted from: **The Patriot-News** – Business & Your Money Monday, August 13, 2001

CONSULTANT'S CORNER

E. JEFFREY ROOF

Investors willing to alter tactics can succeed

Most sailboat races are held on a triangular course, with each leg of the race having markedly different conditions. The successful skipper needs continually to respond to the invariable changes in wind and current to complete the course effectively.

The objective - winning the race - doesn't change. The necessary strategy to reach that goal remains relatively constant. But the tactics needed to complete the planned strategy will vary significantly as the race progresses.

So it is with investing. To successfully execute the strategies necessary to accomplish your overall investment objective, tactics will periodically need to be modified to adjust to changing conditions. However, investor inertia often stands in the way of effective tactical change.

You may recall that inertia is a property of physics stating that objects at rest will tend to remain at rest and objects in motion will tend to move in the same direction unless acted upon by an outside force - i.e., a conscious change. Human nature often applies this same concept to investment decisions.

As an example, a few months ago, while attending an annual meeting for local shareholders of a company that was merged with a larger entity, there was a striking difference between the type of company the attendees had originally purchased and the type of company they owned shares of now.

Many local shareholders originally purchased the stock because the company was here, was conservative, focused on central Pennsylvania business needs, and had its employees, officers, and directors as an integral part of the community. The stock now represented ownership in a large, truly international concern that does approximately 25 percent of its business in the United States, reports annual financial results in a foreign currency, and has targeted Poland as one of it's fastest growing market segments.

While there is certainly nothing wrong with holding stock in this type of multinational corporation, many investors in that room would probably not have directly purchased the volume of shares they hold today in a company with that profile. This is one reason why it is critical for investors to periodically assess portfolio holdings to assure their decisions are based on continued investment appropriate-ness and not investor inertia.

Another form of inertia has investors repeating tactics that were previously successful, but that now may be out of sync with current market conditions. Several analysts of the semiconductor industry stated in August 2000 that the microchip company stock prices had dipped and were now poised for a turnaround. Many short-term investors were tempted to buy, since the "buy the dip" tactic had often yielded quick gains for traders during the previous years when stock prices rebounded rapidly.

However, repeating the "buy the dip" tactic for microchip stocks last August would have instead resulted in being dunked. The economy and the market had changed significantly, making the tactic counter-productive.

Here are three areas where it may be appropriate to review your tactical approach in light of current circumstances:

Selectivity. In broad-based market upswings, momentum can often push most companies within a particular industry in the same direction. This is not the case when the economy and investment markets are under stress. In the current environment, two companies in the same business can have very different operating results and stock performance.

For example, a company that had been leveraged by growth by carrying a high debt load may suffer in a slow economy since slumping sales and lower revenues will make supporting that debt a greater burden, impacting corporate earnings and profitability. By contrast, a company that maintained a lower debt to capital ratio and continues to produce positive cash flow even when sales slow is typically better positioned to sail through rougher times.

Understanding a company's underlying strength and fundamentals is even more critical than normal. Some companies will weather the storm just fine, others will be out of business. Selectivity as a tactic is vital in today's market.

Downside protection. The old saying, "It isn't what you make, but what you keep" doesn't just apply to taxes. It is quite appropriate for investing, especially when the markets are being fickle in a lackluster economy. Maintaining appropriate portfolio diversification, assuring adequate asset allocation, and increased fixed income/cash positions can all be part of a portfolio's risk management strategy.

The tactical decisions used to implement these strategies should be examined carefully during an economic downturn.

For example, increasing a portfolio's percentage in bonds will often provide some downside protection when the stock market slides. However, adding high-yielding, long-term bonds of marginal companies in stressed industries (or fixed income mutual funds consisting of such) could have just the opposite effect. Carefully reviewing the underlying financial strength of each bond issuer will help protect your portfolio from possible defaults of companies who can't survive an extended sputtering economy.

Likewise, it may be prudent to increase a portfolio's leaning toward companies, industries and sectors not so sensitive to economic and market fluctuations. These often may be very different from the companies, industries and sectors that did well when the economy was booming.

Patience. It is doubtful that conditions in the current economy and market will improve so quickly that not investing on a particular day might be an opportunity lost forever. Remembering the euphoric one-day gains of the past bull market is one thing, expecting them to return any time soon is something else. Exercise patience and gradually increase stock exposure to desired levels as conditions improve.

However, recognize that patience needs to be applied within the context of current circumstances. Patiently waiting for Yahoo to return to $220 a share will be just as futile as that sailboat skipper racing into the wind with the same combination of sails that worked so well when the wind was coming from behind.

E. Jeffrey Roof is president of Roof Advisory Group, an independent investment management and financial planning firm based in Camp Hill. The firm is a fee-only Registered Investment Advisor that manages assets and preserves wealth for individuals & institutional clientele. The firm's e-mail address is roofadvisory@earthlink.net.