



## Investment Vertigo

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It was 1955 and a team of Forest Service civil servants was inspecting my dad's new creation, the air tanker. This original squadron of seven airplanes consisted of one Stearman and six N3N open cockpit biplanes that were nothing more than a skeleton of metal tubing covered with canvas. Upon looking into one of the cockpits, the federal bureaucrats were shocked, and more than a little concerned, that there weren't any gauges. Turning to Ray Varney, pilot of one of the deficient crafts, a bureaucrat blurted out, "It isn't safe to fly this plane. It doesn't have any instruments." Varney replied, "What do you mean it doesn't have any instruments, can't you see the metal nut attached to the floor by a string?" The confused civil servant could see it but couldn't figure out what it was for. Varney explained, "When you're flying along and the nut hits you between the eyes, you know you are upside down and you need to turn over."

Knowing up from down is easy when you're standing on the ground, but in an airplane even the most experienced pilot can become disoriented. This sensation, known as vertigo, is "a state of temporary spatial confusion resulting from misleading information sent to the brain by various sensory organs," according to the Pilot Friend website. This misleading information is the result of centrifugal force that your body cannot distinguish from gravity. If you are in a situation where you cannot see the ground or establish visual references, your body may come to believe you are flying straight and level when, in reality, you are flying in downward circles. As your airspeed increases, you think you are in a level dive and pull back on the controls. This only increases the tightness of the turn, resulting in an aptly named "graveyard spiral."

The solution to vertigo is to use and trust your instruments. However, the website warns, "The most difficult adjustment that you must make as you acquire flying skill is a willingness to believe that, under certain conditions, your senses can be wrong." Investors also must be aware that under certain financial conditions, they cannot trust their senses. As a matter of fact, the research would suggest that we all suffer from terminal investment vertigo and need instruments that will override our faulty senses. Rebalancing maybe the most important of these instruments.

Rebalancing is nothing more than selling securities that have risen in value and buying ones that have fallen. For example, assume your portfolio held only two securities, a stock mutual fund and a bond mutual fund. Assume also, that the target allocation was 60% stocks and 40% bonds. If the stocks had a bad year and dropped to 50% of the portfolio value, you would sell bonds and buy stocks to rebalance the portfolio back to the 60/40 target. However, rebalancing is simple to understand but difficult to do because your senses will always want to buy high and sell low, which is the opposite of what you should do. According to Gordon Murray in his book, *The Investment Answer*, rebalancing is the remedy for this financial disorientation. "[It] is the automatic [pilot] way to buy low and sell high, without your emotions getting in the way."

During the recent market crash and resurgence, investors who rebalanced have experienced a full recovery and then some. That is significantly better than the ones who didn't rebalance and enormously better than the ones who bailed out. Just as spatial disorientation occurs most often in bad weather when pilots cannot see the ground, so is investment disorientation at its worst during financial storms when investors lose sight of hope. It is precisely at those times when the world is upside down that both pilots and investors need a good smack between their eyes to remind them it is time to realign their airplanes or rebalance their portfolios.

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