

# PREDICTABLE INVESTING

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**HISTORY LESSON – November 2006.**

**THE PREDICTABLE INVESTING USER'S MANUAL.**

## **Part 2- USING PI TO MANAGE YOUR PORTFOLIO:**

**1.00 INTRODUCTION:** Last month in **Part 1** of the PI User's Manual, we explained the basic philosophy of our technique, followed by definitions and explanation of terms. We explained how to determine an Asset Allocation that matched your individual needs and risk tolerance, and then explained how to pick the best stock and bond mutual funds for your portfolio. For completeness, we have re-attached Part 1 at the end of this article.

In **Part 2** this month, we describe how to use the Predictable Investing website for setting up and managing an investment portfolio.

**2.00 HOW TO START FOLLOWING THE PI SYSTEM:** Investors usually end up with too many investment accounts, such as leftover 401K's or 403B's at previous employers. They also are likely to have IRA's, and individual taxable investment accounts at different fund companies or banks.

The first step is to determine the **desired** Asset Allocation as explained in Part 1. Next calculate the **actual** allocation from the investments in the investor's portfolio, but do not include Real Estate.

Add up all the equities (stocks, stock mutual funds), and all the fixed income (cash, money market funds, CD's, bonds, bond funds). The total portfolio value is the sum of equities and fixed income. The Stock% is the amount of equities as a percentage of the total portfolio value. The Bond% is the amount of fixed income as a percentage of the total portfolio value. The **actual** asset allocation is the %stocks and the %bonds in the portfolio.

If the **actual** asset allocation varies significantly from the **desired** one, you may wish to rebalance the stock to bond mix to bring it more in line. This is best done once every year, preferably at the end of January, when fund statements from the previous year are available. You can also sell appreciated funds for a profit at this time, and yet not have to pay taxes till the following year.

## **3.00 PORTFOLIO MONITORING & TRACKING:**

Almost all of our time is spent in monitoring and tracking the portfolio, during which we observe, but do not have to do anything. There are however three separate scenarios for which action is required. These are:

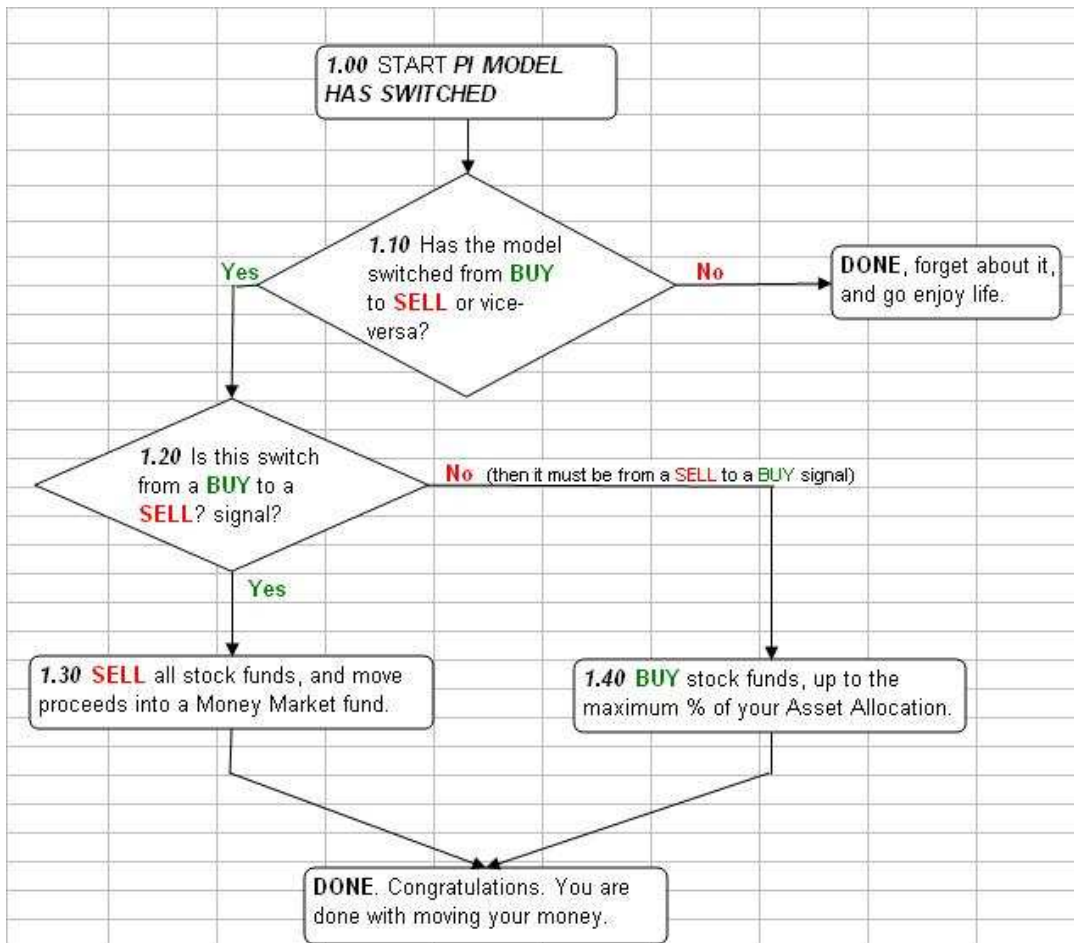
### **Scenarios requiring action:**

1. The Predictable Investing model switches from a BUY to a SELL, or vice-versa.

2. It is time to perform annual Rebalancing of the portfolio.
3. You have new money available for investing in the markets.

**Each of these scenarios is simply diagrammed as a flowchart in the next 3 sections.**

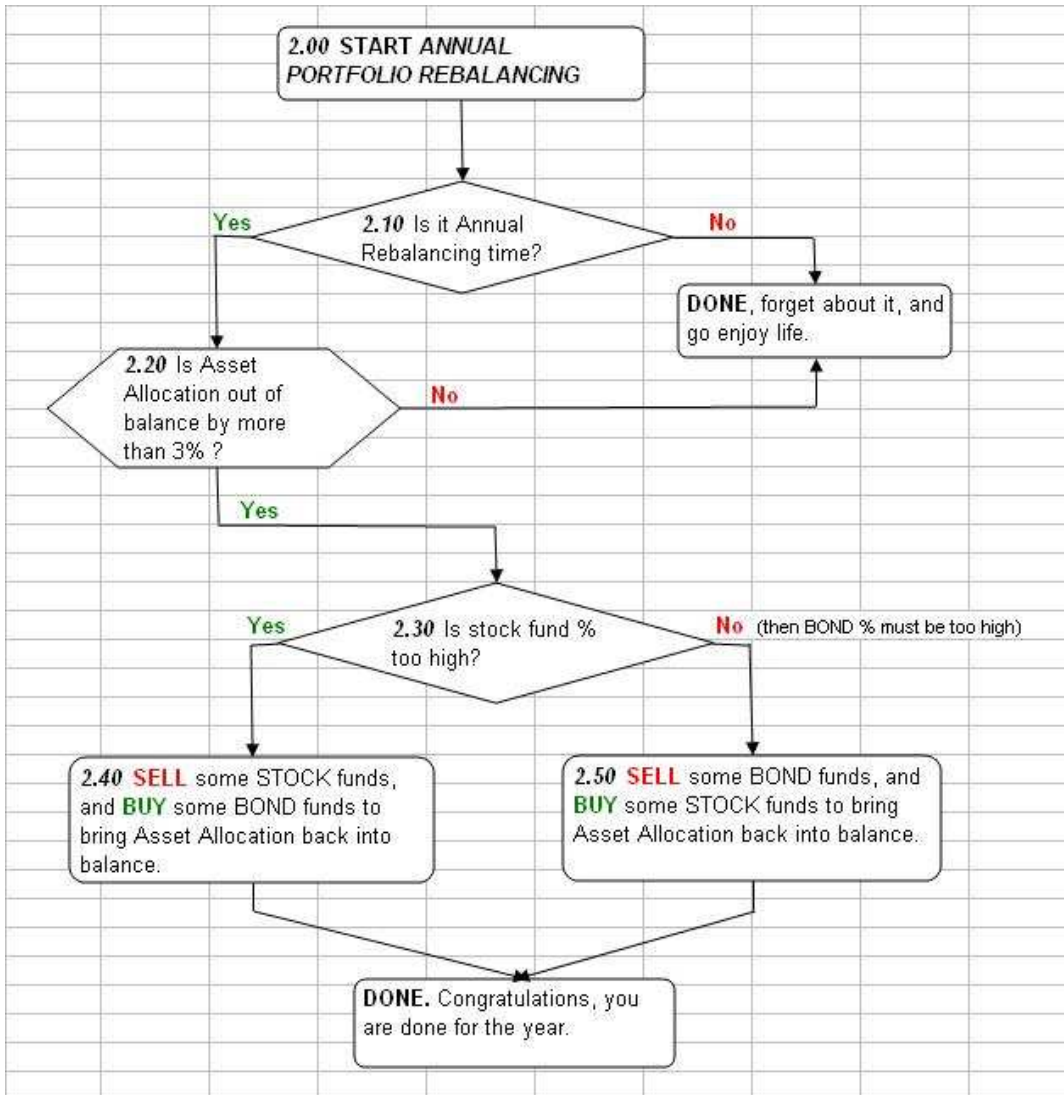
**3.1 Scenario 1:** The Predictable Investing model switches from a **BUY** to a **SELL**, or vice-versa.



**NOTES:**

1. If the model switches from a BUY to a SELL, follow the "Yes" branch down from block 1.20 to block 1.30. This tells us to SELL all stock funds and place the proceeds into a money market fund, where it will stay until another BUY signal is generated.
2. If the model switches from a SELL to a BUY, take all the funds in the money market fund and buy stock funds. Do not of course exceed the stock % of the desired asset allocation.

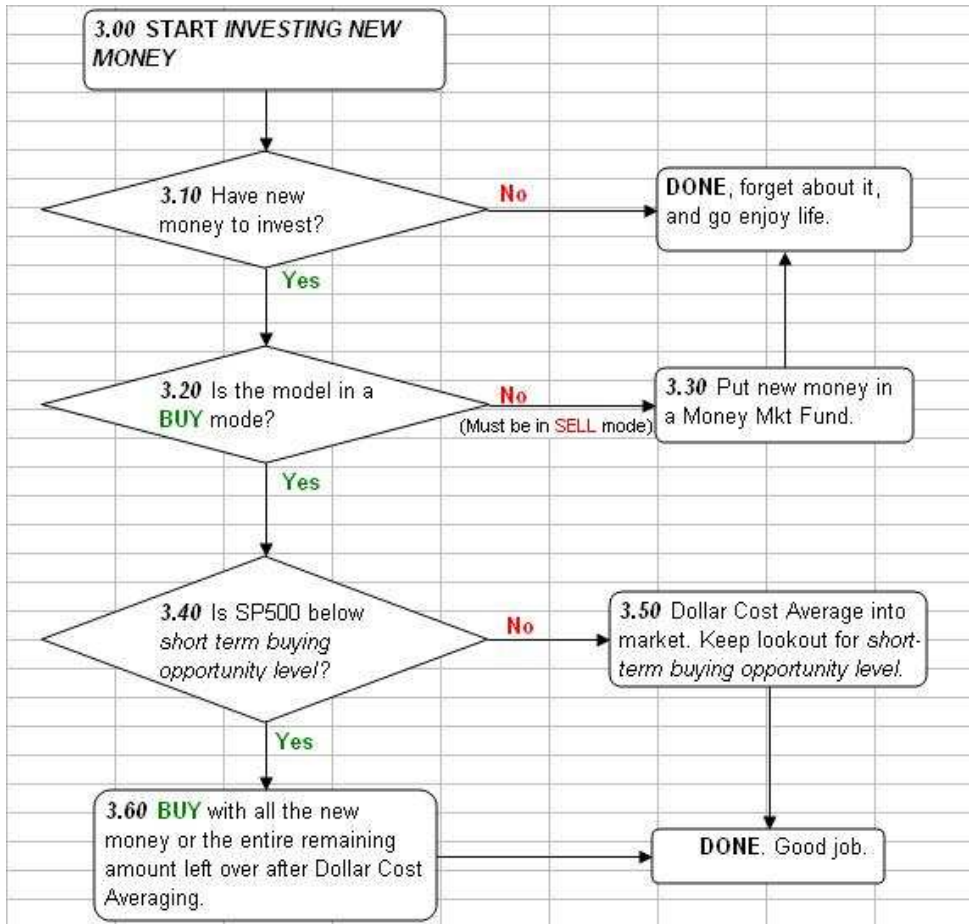
**3.2 Scenario 2:** It is time to perform annual Rebalancing of the portfolio.



### NOTES:

1. For example, assume a **desired** asset allocation of 50% stocks and 50% bonds, and an **actual** asset allocation of 65% stocks and 35% bonds. Since the stock fund % is too high in the decision block 2.30 in the flowchart above, we follow the "Yes" path, which is the left branch down to block 2.40. This tells us to SELL some stock funds and BUY bond funds.
2. The amount of stock funds to SELL, is **half the difference between the actual and desired stock fund percentages**. In this example, this is  $(65\% - 50\%)/2$  or 7.5%. So to rebalance we would SELL 7.5% of the stock funds and BUY 7.5% bond funds. After we are done, our asset allocation would end up at the desired 50% stocks and 50% bonds mix.
3. If instead the Bond % is too high, we end up on the right branch of block 2.30 and end up at block 2.50 which tells us to sell the excess bond funds. The amount of bonds to sell is half the difference between the actual and desired bond funds.

**3.3 Scenario 3:** You have new money available for investing in the markets.



#### NOTES:

1. During falling markets and when the model is BULLISH, we occasionally forecast a **short-term buying opportunity level** for the S&P500, such as in mid-June 2006 at an S&P500 value of 1243. We have added this line item as part of the "CURRENT ADVICE" section in the "CURRENT OUTLOOK" page of the website.
2. If there is new money to invest, and the model is in a BUY mode, we end up in block 3.40. If the S&P500 is **above** the short-term buying opportunity level, then follow the right branch to block 3.50 which tells us to Dollar Cost Average (DCA) the money into the market. This means take the total amount available for investing, divide it by 12, and buy stock funds with one-twelfth of the money every month.
3. If sometime in the next few months the market falls **below** the short-term buying opportunity level, we end up at block 3.60. This tells us to take the rest of the money remaining after the months of DCA, and **BUY stock funds with the entire remaining amount.**

#### 4.0 CONCLUSIONS:

These 3 flowcharts should clearly explain the process of monitoring and tracking an investment portfolio using the techniques developed by Predictable Investing. Please send us an email with questions and comments.

Part 1 of the PI User's Manual from last month is attached below.