RIA Profile: Asset Planning Management & Research

Asset Planning Management & Research of Columbus, Ohio, oversees $110 million in assets. Chuck Ballou founded the firm 23 years ago and his three children, all Certified Financial Planners, now work for him; his brother-in-law manages the operations. The family nature of the business mirrors the history of APM&R's client relationships – many of the firm's 100 clients are second and third generation clients. We spoke with Ballou about his firm's unique and unconventional investment strategy.

The Practical Limit of Risk

Ballou describes his approach as "not coming from the Greek letter math side of things," yet he employs sophisticated tools to evaluate his client's financial needs and construct the optimum portfolio. Financial planning begins with an analysis of each client's resources and financial needs, ultimately leading to a determination of the rate of return needed to bridge the gap. Ballou's approach is based on constructing a portfolio that delivers the required rate of return, while simultaneously adhering to a defined risk tolerance, which he terms "the practical limit of risk."

The practical limit of risk is whether the fund (or portfolio) can weather a 20%-25% decline (inclusive of withdrawals), even if the client is in the de-accumulation phase and withdrawing 5% per year. Since 1972 there have been three 40% declines in the Dow Jones, each followed by a strong recovery. Ballou's goal is to insure that his clients could weather a storm of this magnitude without adversely impacting the client's cash flow.

Ballou tests each fund he uses against historical data, relying primarily on data since 1998, which encompasses the dot-com crash earlier this decade. Each fund is assigned a risk score based on how well it fared over this time period. (For newer funds without enough historical data, Ballou will look at the track record of the individual manager).

Once the practical limit of risk has been determined, Ballou looks at a series approximately a dozen "factors and influences" to define his investment strategy. Ballou describes these factors and influences as "catalysts for financial change," and they include investment seasons, the business cycle, and other dynamics we discuss below.

Investment Seasons

Looking back over 81 years, Ballou has identified four investment seasons:

Deflation 1926-1939
Stability 1950-1966
Inflation 1966-1982
Disinflation 1982-1998

Seasons play a critical role in the management of client assets, in that Ballou has identified which of six asset types (cash, notes, bonds, stocks, real estate, and tangibles) perform best in each season. More importantly, Ballou looks at the behavior of asset types during transitional periods between seasons. Ballou's data shows patterns of significant migration of capital between asset

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classes corresponding to seasons. For example: in disinflation, capital shifted from money markets into bonds and stocks; during inflation, commodities delivered exceptional returns; in stability, real estate is attractive, primarily because of low interest rates.

Since 1998, Ballou believes we have been in a season of stability, and cites as evidence inflationary rates that are at their lowest levels since 1965, as well as continued economic growth.

Ballou rejects traditional approaches based on rolling five- and 10-year historical periods. He believes that seasons last 15-16 years, and see us entering the next season in 2013 or 2014, or perhaps later because globalization may prolong the current levels of stability. “There is no such thing as the average,” says Ballou, articulating one of his core beliefs. “Looking at rolling five- and 10-year histories ignores the vastly divergent economic characteristics that exist during different investment seasons.” Along similar lines, Ballou does not base decisions on average market returns over long periods of time, preferring to look at market returns and dynamics within an investment season.

Portfolio Construction and Rebalancing

Ballou relies almost exclusively on actively managed mutual funds for client portfolios, and will invest in REITs and commodities for their diversification value, dependent on the investment season and business cycle. No index funds or ETFs are used, although Ballou may begin using ETFs as hedging tools (which would relegate them to fairly high risk levels in his framework). Some funds which employ a long-short strategy are used. He is affiliated with Raymond James Financial Services, Inc., member FINRA/SIPC and relies on the research department for approximately 60-70% of the funds he selects, with the remaining funds being identified through quantitative screening, with an initial emphasis on whether the fund has outperformed its peer group.

To justify his use of actively managed funds, Ballou notes that “after seven-plus years the S&P 500 is still below its March of 2000 peak. A 50% decline means that a 100% increase is required just to get back to even. I am quite sure if our client accounts were below their 2000 account valuation levels that I would not have many remaining clients - in fact as a fiduciary I would have to recommend that they fire us an advisor.”

Ballou does not use a defined set of model portfolios. Portfolios are constructed individually for each client, based in part on the timing of the client’s contributions.

Portfolios have a value bias as well as an international bias. The value bias stems from one of Ballou’s fundamental beliefs about wealth creation. “Wealth is created by the ownership of a growing business over time,” notes Ballou, and this leads him to select funds with core strategies that attempt to identify such businesses. Ballou also favors mid- and small-cap stocks, which he believes are relatively overlooked by institutions because they cannot commit sufficient capital to them. Ballou does not utilize alternatives, partly because of a philosophical conflict – he believes these funds are more about making money than about the ownership of a growing business over time – and partly because of the lack of transparency in these investment types.

Under Ballou’s risk measurement model, some global portfolios have the lowest risk levels, and he cites the Sogen First Eagle (FESOX) as an example [Ed. Note: FESOX is among the most popular mutual funds in the Advisor Perspectives Universe]. By utilizing funds such as this, client portfolios can have significantly more equity holdings than a typical 60/40 equity/fixed income mix. “Some equity funds have risk characteristics comparable to bonds,” says Ballou, “which means we use less fixed income, which is unattractive now because of low interest rates.”

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Between 20 and 30 funds are used in a typical portfolio in order to achieve adequate diversification, and Ballou insures that the overlap in underlying securities is minimized. Rebalancing is triggered when a fund's weighting in a portfolio exceeds its target, although Ballou does not adhere to rigid limits. "When we believe a manager is on a roll, we do not want to take out money too quickly," notes Ballou. "Overall, our goal is total return with global diversification and risk reduction."

"Every good manager will have a period of underperformance," Ballou notes, "so we employ a 'make-up period' to allow performance to recover." But if a manager does not recover, they will not stay on Ballou's list. "People who chase performance do the opposite," notes Ballou, adding that "reversion to the mean does work."

Economic and Market Forecasts

"Understanding 'factors and influence' continues to be a good challenge," Ballou notes. He categorizes factors and influences as either driving or resulting factors, depending on whether they are leading or trailing market indicators. For example, Ballou studies demographic data, and contends that an "infinite supply of cheap labor" is one factor that is contributing to the current season of stability. Fiscal and monetary policies are other examples of factors and influences, but Ballou is hesitant to offer any predictions as to whether they are currently acting as driving or resulting factors.

Ballou notes that there is also an "infinite supply of new financial vehicles" and the challenge for the advisor is to figure out which will and will not work. "If the marketing department can think of it, they will come up with a sales presentation to sell it. Sales presentations will always be better than the outcomes."

"There is more wealth creation going on than at any time in history," Ballou notes. He describes the current business cycle as Juglar, where the economy is capital- (and not consumer-) driven. He believes that the next season for the economy will be inflationary, unless an "accident" occurs that causes the leverage in the financial markets to be unwound. Ballou sees the market at a level of 17,000 to 18,000 by the end of the current business cycle, based on a P/E of 17-18 and Dow earnings that are expanding "with write-offs behind us." Ballou adds that "these are not big increases, but they are increases, and it is driven by a stable season through the end of the decade."

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