It's Quality Over Quantity in Eisenberg's 'The Number'

Lee Eisenberg's *The Number* is not your typical book on investing. The key takeaways we have chosen to highlight are not necessarily the central premise of the book, but the author does introduce several concepts that resonate with us here at Crawford. It's a fun read, and it's certainly oriented more toward private investors who are contemplating retirement. With that being said, woven into its narrative is an exploration of financial concepts alongside life lessons, both of which we feel apply to individual and institutional investors.

Both the title of the book and its subtitle, *A Completely Different Way to Think About the Rest of Your Life*, imply that this book will help investors determine just how much money they will need to live securely for the rest of their lives. This is a major theme of the book, but Eisenberg falls short of truly helping his readers answer this question or providing them with "the number." Instead, the purpose of this book is to point out what is really important: placing quality of life considerations over the quantity of resources available to fund a lifestyle.

Again, the book actually falls short of defining "the number," but offers a variety of ways to help people determine how much money they will need to retire. With regards to this, the 4% rule is a key principle that is examined throughout the book. This rule suggests that one can spend 4% of principal annually without running out of money or losing purchasing power, which can erode with inflation. Similarly, many endowment funds, intended to last into perpetuity, have spending policies of 5%. We agree that these are achievable spending rates for individual and institutional investors, but we are also cognizant of the fact that excess downside volatility can significantly disrupt spending rates and terminal portfolio values. This is important because a regular pattern of withdrawals designed to meet spending needs exacerbates declines in portfolio values, limits upside capture, and means a portfolio's realized returns and market value growth can be diminished by more than just the spending rate.

Let's examine a scenario wherein a given year, an investor experiences a negative 10% return and has a spending rate of 4%. This manifests in a 14% decline in the portfolio value, not including inflation, which we assume typically runs approximately 2% per year. Assuming the investor withdraws the same dollar amount the next year, the portfolio must earn approximately 25% to get back to the prior inflation-adjusted level. One must understand that if a portfolio does not fully recover, annual spending can lead to more permanent erosion of capital. In other words, it's not exactly what you earn but how you earn it and the pattern of those returns that matter. This kind of asymmetry, where a 10% decline and 4% withdrawal rate requires a return of 25% to fully recover to its inflation-adjusted value, is something we feel that investors need to fully appreciate.

There are anecdotes covering many investment concepts, but we especially relate to Eisenberg's words of caution on overdiversification, abandonment risk, value versus growth, and the impact of investment costs on realized return. We offer thoughts on each below:

Overdiversification: Eisenberg includes a letter from a professional money manager that characterizes this as the single biggest mistake made in managing assets. That is, many portfolios include too many unique funds or different investment strategies. As a result, these portfolios sacrifice return and dilute risk reduction. At Crawford, we tend to agree with the contents of the letter. We prefer more streamlined investment programs with less complexity and the consistent ability to provide strong, risk-adjusted returns.

Abandonment: Sometimes brought on by excess diversification, abandonment occurs when an investor changes strategies or managers. Seldom is a shift of this nature made after a period of strong relative performance. As a result, when this happens the investor is essentially "locking in" underperformance. At Crawford, we take a long-term approach to investing, and we attempt to provide our clients with a "sleep well at night approach," designed to provide attractive returns over full market cycles. This combination helps keep our investors invested and reduces abandonment risk.

Value Versus Growth: We feel that a quote from the book says it all, "Almost all great long-term investors are value investors." We agree, and we will highlight that price sensitivity, dividends, and value orientation are all important tenets of Crawford's investment approach.

Investment Costs and Turnover: Cost and turnover exact very real costs on investment returns over time. Most investment programs and portfolios are engineered to produce compound returns that range between 6 and 9%. As a result, higher turnover and higher cost strategies and managers are at a significant disadvantage, even in semi-efficient markets. With mid-to-high single digit return objectives for most diversified investment programs, one cannot afford to pay excess fees to have their assets managed. And there are few high turnover strategies that "trade" their way to successful outcomes. Crawford's holding period tends to be in the 3-5 year range, with many investments remaining in our portfolios for much longer. We find this gives us and our investors the best chance for success.

To conclude, we recommend Eisenberg's book, among others, for investors seeking to better understand the ramifications of living off of an investment portfolio in retirement. For pension funds or endowments and foundations that have spending needs, the same principles often apply. We feel that the book can serve as a guide to help us all be thoughtful about our most precious resource: time.