# The Sensenig Capital **Advisor Letter**

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***Providing clients with peace of mind, through smart financial decisions.***


## **Key Investment Strategies Hidden in Plain Sight –** Strategy #1: Being There

If you've ever dabbled in graphic design, you are familiar with the concept of white space. When viewing an illustration, we typically pay the most attention to the visible ink on the page, such as a paragraph of text, a bar chart or an entertaining illustration. White space is the essential empty areas in between that are hidden in plain sight. We barely notice them … until they're not there.

When making investment decisions, most people likewise assume that the most eye-catching ink matters the most: an alarming economic forecast, an exciting Initial Public Offering, hot trading tips. But there's a catch. This evident assumption does not hold up under evidence-based scrutiny. In reality, you have little or no control over how the most obvious news impacts your investments. The most exciting action has already been priced into any trade you might make well before you decide to make it.


Instead of fixating on the headline news, consider that liberating financial white space. There, hidden in plain sight, you'll find a number of powerful investment strategies that are freely available and far more within our control. In this series, we'll introduce three of our favorite "plain sight" investment strategies:

1. Being there
2. Managing for market risks
3. Controlling costs

We emphasize these – and we think that you should too – because (1) they're simple enough to apply once you know they're there, (2) they can have a significant impact on your investment experience, and (3) we see too many investors ignoring them at their peril.

### Plain-Sight Strategy #1: Being There

**To receive a return on your investment, first you must invest (and stay invested).**

Bottom line, you cannot expect your stash of cash to grow when it is lying fallow. It's hard to imagine a more basic principle than that, so why do so few investors manage to embrace it? The answer is found in a sentiment you may have heard before: **Investing is simple, but, it's not easy.**

It's relatively simple to accept the notion of no pain, no gain. To earn returns, you must put your assets at risk in ventures that are expected to compensate you for your faith that they will succeed … if they do. Then you must patiently await the desired success, knowing that it is expected but not guaranteed. The riskier the ventures, the less certain the outcomes, but the more you can expect to earn for enduring the uncertainty … if you do.

Instead, many investors panic when market risk arises and move their money to the proverbial sidelines. They also fret that they're going to miss the boat when the market surges, so they pile into whatever is the latest success story. To cite just one of many analyses of these tendencies, a 2014 Federal Reserve economic synopsis looked at performance from 1984–2012 and found annual damage of up to 5 percent attributable to return-chasing behavior. The report concluded: "[P]oor investment timing caused by return-chasing behavior has a significant impact on portfolio performance."

By chasing and fleeing hot and cold markets, you're undesirably buying high and selling low. You're also disregarding decades of empirical evidence that informs us that one of the best ways to capture long-term market growth is to build a solid, individualized plan, and to then stick to your plan by riding out the market's near-term ebbs and flows.

With this simple strategy, you're trusting that the market will continue to do what it has done for many decades when viewed from a long-term perspective: It has grown.

Why is it that so many investors ignore this common-sense strategy – ***be there and stay there*** – and instead cut the cord during turbulent times?


*For questions or to request a consultation, please contact us at **info@sensenigcapital.com** or **(610) 584-9700.***

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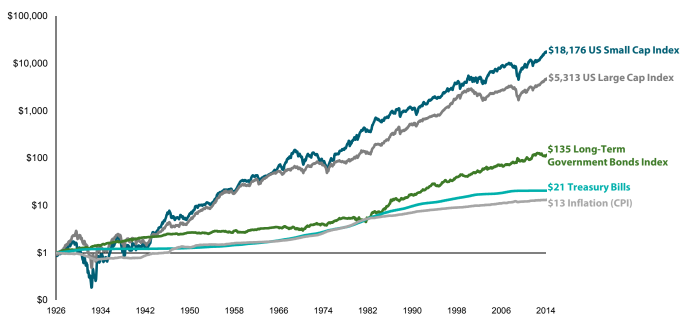
To echo our aforementioned sentiment, it's simple to understand how the market's gains and pains are so closely related. But it's never easy to endure the pain when it occurs – whether that's in the form of plummeting markets or tempting trends. Like a first-time skydiver, you cannot know how you're going to feel and what you're going to do about a free-fall until you're in it. Behavioral finance informs us that, thanks to our most basic instincts, we're subjected to a host of financially damaging biases – loss aversion, recency, herd mentality and many others – that lead us astray during these sorts of "fight or flight" market conditions.

The Capital Markets Have Rewarded Long-Term Investors

Monthly growth of wealth ($1), 1926–2014




In US dollars. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. **Past performance is no guarantee of future results.** US Small Cap Index is the CRSP 6–10 Index; US Large Cap Index is the S&P 500 Index; Long-Term Government Bonds Index is 20-year US government bonds; Treasury Bills are One-Month US Treasury bills; Inflation is the Consumer Price Index. CRSP data provided by the Center for Research in Security Prices, The S&P data are provided by Standard & Poor's Index Services Group. University of Chicago. Bonds, T-bills, and inflation data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

This is why you want to prepare for your investment leaps well in advance, preferably with an evidence-based adviser at your side to help you maintain your resolve. In our next newsletter, we'll introduce our plain-sight strategy for managing challenging market risks and temptations, so you can be best equipped in your quest for long-term investment success. S

## The Best Plan to Drive Your Retirement Needs

Excuse me, can you tell me what kind of car is best for me? It is impossible to answer that question without getting more information…how will the car be used? What is the budget? For fuel efficiency and driving in a crowded downtown area, maybe a Smart Car is best. Hauling heavy loads of construction materials? Perhaps a truck makes sense. Have kids that need to be shuttled from one activity to another? Maybe the less-stylish but ever-so-practical minivan is the perfect solution.

The same is true when selecting a retirement plan. Although there aren't as many makes and models, there are some significant variables, and the most appropriate option depends on some of the same factors. How will you use the plan and what is your budget?

### Lease or Purchase?

There are two general categories of retirement plans: defined benefit and defined contribution. Unlike "crossover SUV," these names give a pretty good indication of the fundamental characteristics of each. Here is a quick summary.

- **Defined Benefit (DB) Plan:** A DB plan specifies the benefits provided to each participant at retirement via a formula that considers items such as compensation and length of service such as 1% of average pay for each year of service. Each year, an actuary calculates the benefits due each participant, determines how much money is needed to fund those benefits and compares that amount to actual asset levels to arrive at how much the company must contribute. A DB plan is kind of like buying a car…you commit to making the payments over a period of years until your obligation is paid.

- **Defined Contribution (DC) Plan:** A DC plan sets parameters for the amount that employees and the company contribute each year. Add investment gains or losses to determine the amount of retirement benefits each employee ultimately receives. Think of a DC plan as a series of one-year leases…the participants and the company decide each year (and sometimes more often than that) how much to contribute, and whatever is done in one year can be changed the next year.

DB plans allow for larger benefits (as much as $200,000+ per year), but the fixed nature of the contributions makes them a bigger commitment. DC plans offer greater flexibility and discretion in determining annual contributions, but the maximum annual contribution is capped at the lower of $53,000 or 100% of pay per employee. Although it is not uncommon for companies to sponsor both DB and DC plans, the remainder of this article will focus on DC plans.

### The Car Lot

In addition to the well-known 401(k) plan, Congress created several other types of DC plans. The Simplified Employee Pension (SEP) and the Savings Incentive Match Plan for Employees (SIMPLE) are meant to be easy for small businesses to set up and maintain. The SIMPLE comes in two models—the SIMPLE IRA and the SIMPLE 401(k).

As with different types of vehicles, these different plan types are suited to different purposes. SEPs and SIMPLEs require minimal documentation, no annual testing and limited (if any) ongoing government filings; however, they also impose more limitations than other plans.

The 401(k) plan, which is really a profit sharing plan with the employee contribution package added, offers maximum flexibility. There is also the 403(b) plan for not-for-profit organizations which is similar to a 401(k) plan but has its own nuances not addressed in this article.

Let's take a look at some of the specific differences. Keep in mind that these descriptions are meant to be general. There are exceptions to many of these general rules, but you would be reading for as long as a cross-country drive if they were all covered here.

## Eligibility

401(k) plans and SIMPLE 401(k) plans are allowed to have eligibility requirements as strict as attainment of age 21 and completion of one year of service (a 12-consecutive-month period in which an employee works at least 1,000 hours).

By contrast, neither SEPs nor SIMPLE IRAs can limit eligibility the same way. In a SIMPLE IRA, the maximum is to limit eligibility to those employees who earned at least $5,000 in compensation in the two prior years and are expected to again in the current year.

## Employee Deferrals

Salary deferrals are generally not allowed in SEPs. SIMPLEs and 401(k) plans allow deferrals but there are some critical differences. First, a 401(k) plan allows deferrals up to $24,000 per year ($18,000 plus an additional $6,000 for those age 50 or older). A SIMPLE caps deferrals at $15,500 ($12,500 plus $3,000)…a whopping $8,500 less. For a business owner seeking to maximize his or her deferrals, the tax savings alone can more than offset any additional cost of having a regular 401(k) plan.

## Matching Contributions

SIMPLE plans require a company contribution, which can be either a match or profit sharing contribution. For the match the required formula is 100% of the first 3% deferred, and no additional matching contributions are permitted.

A 401(k) plan can include a discretionary matching feature, allowing the company to decide each year whether to make a match and, if so, how much. Since SEPs do not allow deferrals, they also do not provide for matching contributions.

## Profit Sharing Contributions

The profit sharing version of the SIMPLE must be 2% of compensation for each eligible employee. No additional profit sharing contributions are permitted.

SEPs and 401(k) plans allow discretionary profit sharing contributions of up to 25% of pay in total. That discretion provides business owners with flexibility as to if/how much they wish to contribute.

> For a business owner looking to maximize his or her deferrals, ***the tax savings alone can more than offset the cost of having a regular 401(k) plan.***

With a SEP, each employee must receive a uniform contribution (as a percentage of pay). So, if the owner contributes 10% of pay for him or herself, each employee must also receive 10% of pay. In a 401(k) plan, there is much greater flexibility to provide larger contributions to those who earn more than the taxable wage base (referred to as Social Security integration) or target contributions based on job classification, e.g. owners and non-owners.

## Conclusion

Similar to Smart Cars, SUVs and luxury sedans, each type of plan suits different needs. SEPs and SIMPLEs can be extremely effective tools for meeting the retirement plan needs of small businesses that want to offer a plan but don't have the bandwidth to deal with details; however, those plans also offer less flexibility.

A 401(k) plan offers many more optional add-ons but comes with more involved maintenance. At the end of the day, it is important to first understand the goals for the plan and then select the option that fits best and can adapt with your business over time. ***Regardless of how simple or complex your needs, working with an experienced professional is invaluable to the decision-making process.*** S

**Source:** Markley Actuarial. In 1985, John Markley followed his dream and founded Markley Actuarial Services, Inc. The early days were tough – 1 desk, 1 file cabinet containing 1 file for 1 client – his dad! Fast forward almost 30 years and John has been joined in ownership by Lisa Showalter & Lisa Pfautz, a staff of 16, cutting edge technology and a lot more clients! But some things haven't changed, such as a passion for helping businesses create successful retirement programs.

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