9 LESSONS FROM THE KUEH LAPIS SAGU (九层糕)

A SIMPLE GUIDE TO LAYERING YOUR FINANCIAL PORTFOLIO

DEXTER KOH, M.B.A., CFP®, SAMP

WHO THIS GUIDE IS FOR

KOPI 'C SIU DAI' is a black coffee served with evaporated milk and less sugar, commonly found in Singapore and parts of Malaysia.

I love my morning Kopi 'C Siu Dai' and I have been drinking at least a cup almost every day. I cannot remember when I first started drinking this but I do remember that an average cup costs $1 five years ago, and today the same cup costs me $1.50. Translated into financial numbers, my beloved Kopi "C Siu Dai" has grown at a Compound Annual Growth Rate (CAGR) of 8.4% per annum over the last 5 years!

Simply put, the same $1 that I had saved 5 years ago can no longer afford me the same cup of coffee today. What happened? Inflation my dear friends! Inflation erodes your purchasing power and hence wealth over time.

Not feeling the pinch of inflation yet? Let's look at the effects of inflation on local university fees. When I left university in 2007, the yearly fee of a local engineering degree was approximately $6,110, which amounts to a total of $24,440 for the

4-year course. Today, the same engineering degree costs about $32,200. An increase of 31.7% or a 2.79% growth per annum!

One may argue that the average household income should increase at a similar rate (if not more) and hence one should be able to save enough to surpass inflation. Theoretically yes. But ask yourself this, the last time you got a pay raise, what was the first thing you do? Save or spend? You see, we are all subject to various degrees of the hedonic treadmill; you desire for a better quality of life in the form of a better house, car, holidays, etc. This means that any increase in salary is likely to be channelled to these than saved for future needs.

Coming back to inflation, Singapore's inflation rate averaged 2.65% in the last 55 years and if you are happy with current bank savings account interest rate of 0.05%, I think it is time to be worried. Therefore, investing is cardinal in making sure your hard-earned money is well-protected against the 'evils' of inflation.

I have written this guide using the analogy of a Kueh Lapis Sagu to explain through 9 lessons how you can layer your investments

WHO IS THIS GUIDE FOR?

in your portfolio to protect your wealth against inflation and withstand the market volatility through the years. Each lesson can be read independently and in any sequence.

By the time you have reached the end of this guide, you will remember two simple key concepts: The Kueh Lapis Sagu risk/return layering; and Your destinations (financial objectives) and the vehicle (financial portfolio) you need to bring you there.

I will see you at the end of the road.

Best Wishes,
Dexter Koh, M.B.A., CFP®, SAMP

ABOUT THE AUTHOR

Dexter Koh runs Financial Coaching Academy to provide accessible, professional and unbiased financial education to raise the financial literacy standards via seminars and workshops. As someone who strongly believes in paying it forward by moulding the future generations, he is also an associate faculty at the Singapore University of Social Sciences.

He runs one of the top performing teams in a Financial Advisory Firm and uses an unique and systematic approach in coaching advisers to help individuals and families to enhance their financial performance by helping them first understand the strengths and weaknesses of their financial portfolios, and then make necessary structural improvements to meet their financial objectives through long-term investment strategies.

He comes with years of personal investment experience. He started doing his own investments since year 2008; using key investment principles such as investing in what you know and value investing. His portfolio spanned across 9 countries, comprising over 40 securities and returned 93.5% over the 11 years.

He has a Master of Business Administration (Dean's List) from the Singapore Management University and relevant investment certifications. He is a Certified Financial Planner (CFP®) and is currently pursuing the Chartered Financial Analyst (CFA) program.

DISCLAIMER

This guide was written solely based on the author's personal experiences and opinions. It does not represent any financial institutions nor related-industries. Figures used in this guide are for illustration purposes and should not be used for projection of returns. The figures illustrated are only accurate based on their time of citation and may be subject to changes over time.

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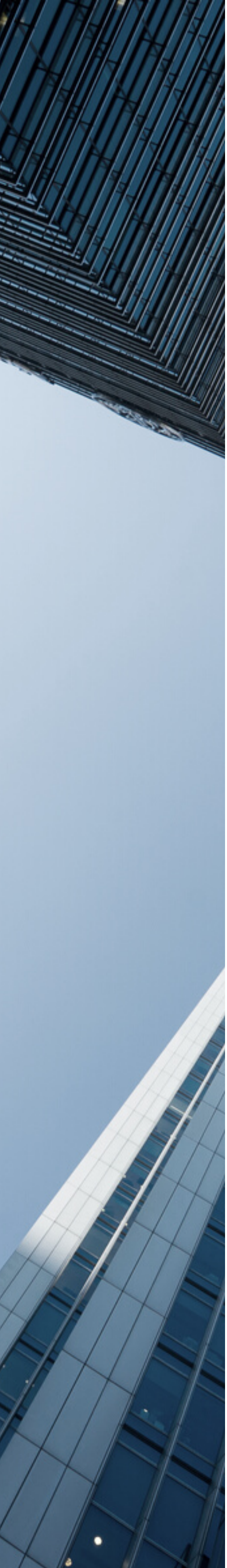


LESSON 1

SETTING YOUR DESTINATION

“IT IS JUST AS MEANINGLESS TO HAVE A VEHICLE WITHOUT A DESTINATION OR HAVE A DESTINATION BUT WITHOUT AN EXISTING VEHICLE. THE VEHICLE IN THIS CASE IS YOUR FINANCIAL PORTFOLIO AND THE DESTINATION IS YOUR FINANCIAL OBJECTIVE.”
- DEXTER KOH, M.B.A., CFP®, SAMP

Do you remember your exams or wedding? Do you remember that you had an idea of how well you hope to do for your exams or how you envisage the wedding would turn out, and thereafter you started making plans towards achieving it?

You see, in both the cases listed above, you already have a clear set of objectives and hence, it was easy for you to chart out the necessary resources to achieve it. Similarly, as I have highlighted above, it is important for you to have a clear set of financial objectives (destinations) to work towards and financial portfolio (vehicle) which you build over time to bring you there.

So, where does inflation fit in? Inflation, which we would use the average of 2.65%, will be the hurdle rate (minimum rate of return) that your first layer of your portfolio should achieve. I will elaborate more on this under Lesson #5 – Understanding Risk and Returns.

HOW DO I DETERMINE MY FINANCIAL OBJECTIVES?

A good financial objective should articulate clearly the financial requirement and meet the S.M.A.R.T criteria of being "Specific, Measurable, Achievable, Relevant and Time-bound". A good example is, "I want to upgrade my current property to a 3-bedroom apartment **(estimated cost $2.0M)** in the central location in 10 years' time". This allows you to ascertain the exact amount of resources needed and hence start making incremental steps to achieve it.

It is perfectly normal to have multiple financial objectives with different timelines and even "new" financial objectives inserted during our lifetime as our needs and thinking (risk appetite) evolves as time passes. Therefore, a robust financial portfolio should be able to handle these changes unless there are significant and sudden changes. More details on building a robust financial portfolio are covered in my other guide book – the 3-stage Personal Financial Planning Process.

HOW TO PROJECT THE FINANCIAL REQUIREMENTS:

Comparing past data and using current research reports will be sufficient to provide you a reasonable projection of the growth rate of the financial requirement.

Otherwise, you can approach a qualified financial planner who has ready access to the network of professionals to assist you in deriving the various financial requirements.

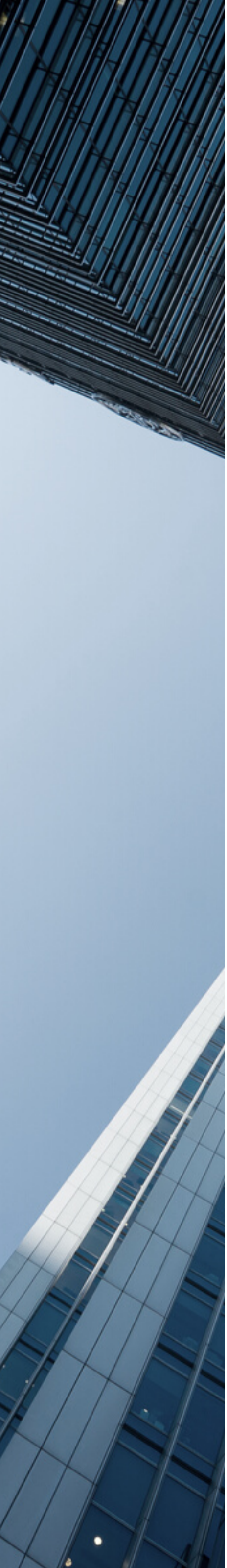
HOW DO I DETERMINE MY FINANCIAL OBJECTIVES?

When I speak to most people, they will tell me how they are planning to upgrade their cars, house or even save up for a nice holiday. But interestingly, most of them do not plan for what is going to happen at the end of the road – retirement, and here are the top three reasons I hear:

"Aiyah, life so short, plan so much is just a waste of time. Might as well enjoy while I can!" – The YOLO.

"Huh? What retirement? I am only 30 years old and still got a looooong way to go lah!" – Miss Still-too-early.

"Aiyoh, nowadays we live longer and Gahmen also expects us to work longer. You see, they keep increasing the retirement age. By our time, maybe the retirement age will be 75 already! I think I might be working till I die ah!" – Uncle Pessimistic.



LESSON 2

CONSTRUCTING YOUR VEHICLE

“HAVING A FINANCIAL OVERVIEW ENABLES OPTIMISATION TO ENSURE EFFICIENT ALLOCATION OF RESOURCES. IF THERE ARE TOO MUCH LIQUID ASSETS THAT ARE NOT REQUIRED IN THE NEAR TERM, THEY CAN BE RE-CHANNELLED TO INVESTMENTS TO GENERATE A POTENTIALLY HIGHER RETURN. CONSEQUENTLY, IF THERE ARE EXCESSIVE LIABILITIES, IT MAY BE PRUDENT TO PAY DOWN AND REDUCE THE DEBT HOLDINGS TO MINIMISE A DRAG ON FINANCES DUE TO INTEREST PAYMENTS."
- MR BRANDON LAM, SINGAPORE HEAD OF FINANCIAL PLANNING GROUP, DBS. PUBLISHED ON STRAITS TIMES ON 18 JUNE 2017

Congratulations! Now that you have listed down all your financial objectives, you have taken a small but extremely important step towards achieving them. The next step involves building your financial portfolio which allows you to understand your current strengths and weaknesses.

WHAT IS A FINANCIAL PORTFOLIO?

A financial portfolio as defined by Investopedia is “a grouping of financial assets such as stocks, bonds and cash equivalents, as well as their funds counterparts, including mutual, exchangetraded and closed funds. Portfolios are held directly by investors and/or managed by financial professionals." This is also more commonly known as one's investment portfolio.

However, if we were to construct our financial portfolio based on this definition, it will not serve our purpose completely as it does not show you the amount of liabilities that you have undertaken to finance these assets nor does it show you where your cash flows are channelled to.

Therefore, my definition of a more useful and complete financial portfolio will be almost similar to that of a business, activity or individual's record of financial activities and position – Financial Statements. To keep it simple to administer, we would only construct the Balance Sheet and Cash Flow statements, which will be sufficient to understand your financial portfolio.

CONSTRUCTING YOUR BALANCE SHEET AND CASH FLOW STATEMENTS

The Balance Sheet (BS) not only allows one to identify the strengths and weaknesses of his/her financial status and it also provides a structural approach to analysing and improving the financial status.

Before you can construct your BS, you will first need to understand some basic terms and their definitions:

A) ASSETS

An asset is a resource with economic value that an individual, corporation or country owns or controls with the expectation that it will provide future benefit and there are two categories of assets:

- Current Assets: Assets that can be easily converted to cash within a year without a significant drop in value; e.g. Cash, stocks, short term deposits, etc.
- Non-current Assets: AKA long term assets; Assets that cannot be easily converted to cash within a year; e.g. Property, Structured Deposits, Insurance Plans, etc.

B) LIABILITIES

A liability is a company's financial debt or obligations that arise during the course of its business operations and there are two categories of liabilities:

- Current Liabilities: Debts or obligations that are due within one year, e.g. Taxes, Car Insurance, etc.
- Non-current Liabilities: AKA long term liabilities; debts or obligations that are not due within the present accounting year, e.g. Long term borrowings from

bank, university fees, etc.

C) CASH FLOWS

Positive cash flow indicates that an individual's liquid assets are increasing, enabling it to settle debts, save or invest, pay expenses and provide a buffer against future financial challenges:

- Cash Flow (In): Income is the most common cash flow (in) followed by rental, investment income, stock dividends, etc.
- Cash Flow (Out): Living expenses, savings, taxes, etc. are common cash flow (out) for most.

D) NET WORTH

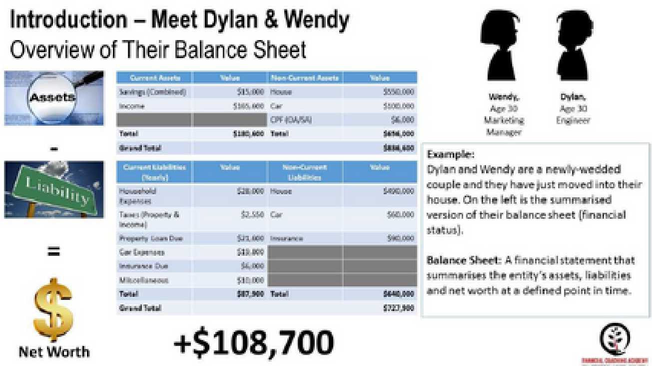
Net worth is the amount which assets exceed liabilities. Net worth is a concept applicable to individuals and businesses as a key measure of how much an entity is worth. A consistent increase in net worth indicates good financial health; conversely, net worth may be depleted by annual operating losses or a substantial decrease in asset values relative to liabilities. In the business context, net worth is also known as book value or shareholders' equity.

UNDERSTANDING THE LINKAGES, STRENGTHS AND WEAKNESSES OF YOUR VEHICLE

Now that you have some basic understanding about the key terms that are found in the BS and Cash Flow Statements, I will be explaining the linkages between them and some financial ratios that are important in determining your financial portfolio's strengths and weaknesses.

FINANCIAL PORTFOLIO ANALYSIS EXAMPLE

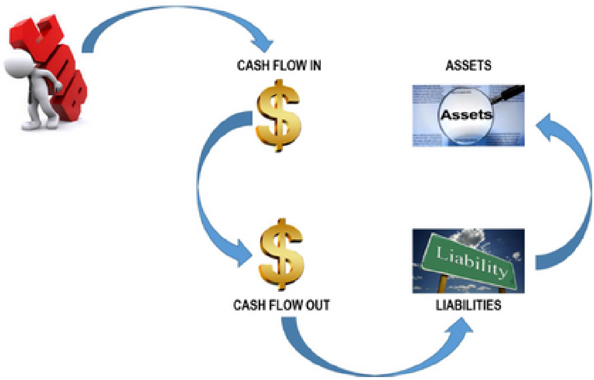
I will use a simplified real-life example of a young Singaporean couple, Dylan and Wendy.



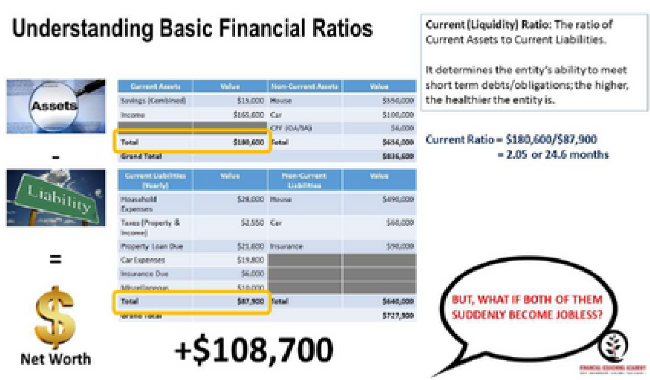
They are both age 30, with a combined yearly income of $165,600. They got married at 28 and moved into their newly-renovated HDB flat (non-current asset) recently when they turned 30. They have a combined savings of $15,000 (current asset).

Right now, part of their monthly income is used to maintain their lifestyle and pay for their current liabilities. Their total yearly expenditure (current liabilities) amounts to $87,900.

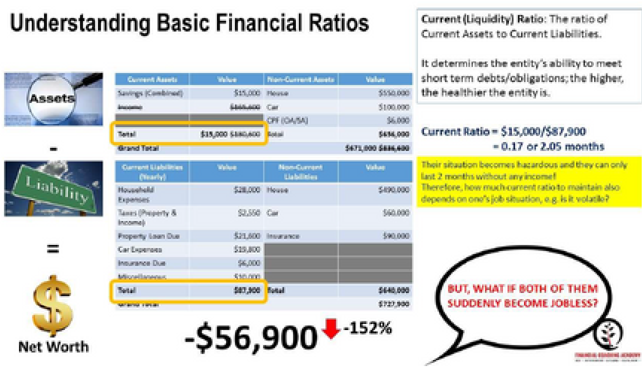
Part of their current liabilities (e.g. property loan due within this year) is used to pay off their non-current liabilities (e.g. property loan), which is used to finance their assets which includes both current and non-current assets (e.g. HDB).



CURRENT (LIQUIDITY) RATIO

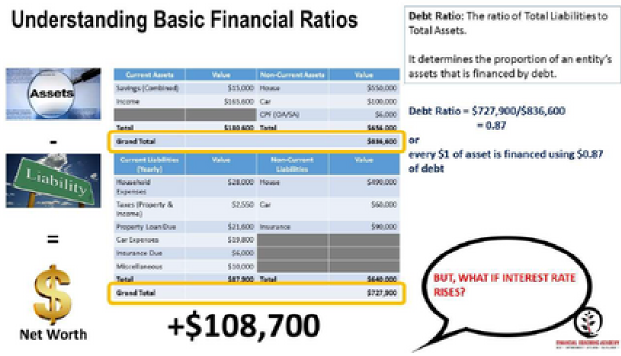


As shown above, given their current assets of $180,600 and current liabilities (yearly expenditure) of $87,900 their current (liquidity) ratio is 2.05 or 24.6 months. This means that at their present moment, they can afford to sustain this lifestyle for slightly over 2 years without working. However, this ratio plunges to 0.17 or 2.05 months if both suddenly become jobless for a year!

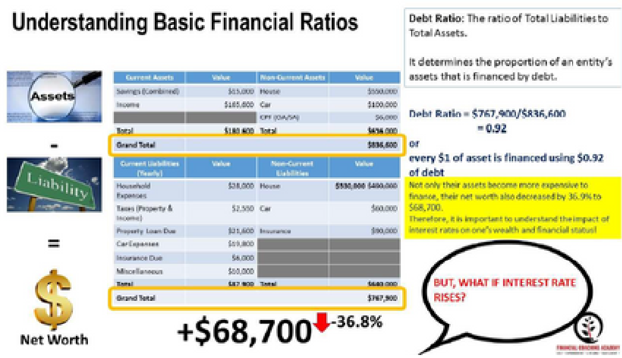


In general, the higher the ratio, the healthier a person is in meeting short-term obligations. Therefore, my advice is always to determine the appropriate ratio due to one's job nature; if the industry is highly volatile, one may want to have a higher current ratio as one may find himself/herself in between jobs for a few months!

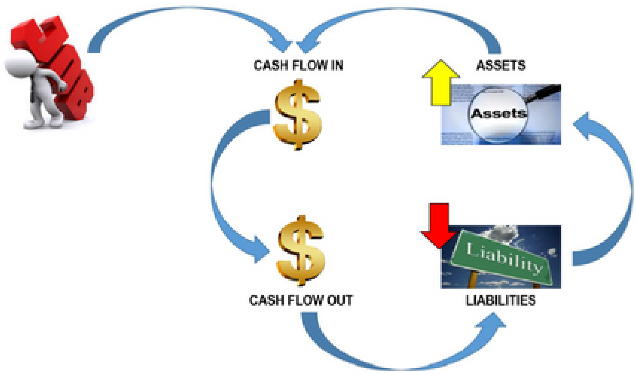
DEBT RATIO



As shown above, their debt ratio is 0.87; which means that every dollar of their asset is financed by $0.87 of debt. This is another weakness of their current financial status; if interest rates were to rise sharply, their debt ratio would increase further, causing their net worth to reduce significantly!



This ratio is important as it guides us in making sound investment choices throughout our lives. To explain, if the mortgage loan interest rate rises significantly causing the debt ratio to increase, one should channel more money to pay off the mortgage loan unless he is able to increase his assets by investing in some instruments that provides higher returns (see picture below).



Now when they decide to invest 10% of their yearly income into a basket of financial instruments which yields a certain percentage of dividend returns per year, you can see that their cash flow in position would improve and if they use the dividends to pay off part of their liabilities (e.g. property loan), their overall debt ratio would reduce further.

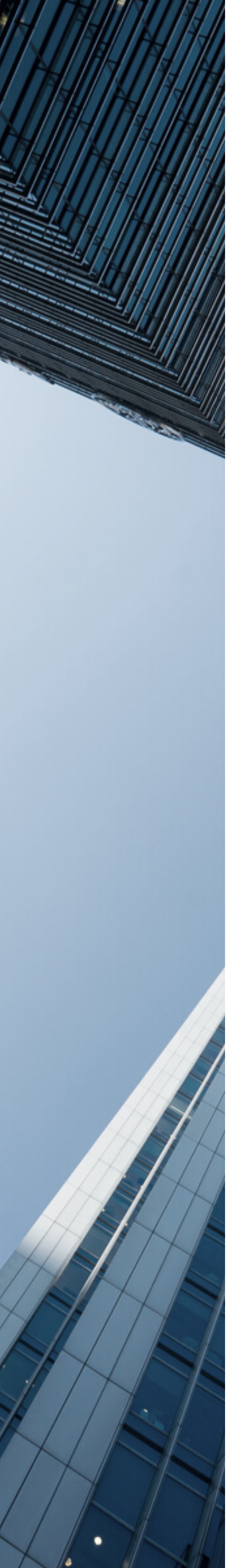
Finally, for them to be able to retire in the future, the assets must be able to generate/replace the cash flow in from their current income. Ideally, the assets should be fully matured (paid for) and the only liabilities left are short-term liabilities such as living expenses.

PUTTING IT TOGETHER

Now that you have a better understanding of your vehicle, you can begin to take steps to upgrade your vehicle to bring you through the various destinations in your life.

Remember, every destination (financial objective) is a financial requirement; with a reasonable projection of the rate of growth of that financial requirement, you can work out the amount needed to finance it.

Now there are generally two ways that one can finance it; one is to save and the other is to grow their asset via investments. We have already established that saving over long-term is not a financially sound method as you will need to compensate for inflation. Thus, I will be sharing on the second method in the following lessons.



LESSON 3

PREPARING YOUR VEHICLE FOR THE BUMPY RIDE AHEAD

“THE BEST WE CAN DO IS SIZE UP THE CHANCES, CALCULATE THE RISKS INVOLVED, ESTIMATE OUR ABILITY TO DEAL WITH THEM, AND THEN MAKE OUR PLANS WITH CONFIDENCE.”
– HENRY FORD

Now that you understand the strengths and weaknesses of your financial portfolio, you can take specific measures to enhance your vehicle in preparation for the bumpy road ahead due to unforeseen circumstances.

EMPLOYING RISK MANAGEMENT TOOLS TO ENHANCE YOUR VEHICLE

What is Risk Management (RM)? As defined by Financial Times Lexicon, RM involves identifying the types of risk exposure within the company (entity); measuring those potential risks, proposing means to hedge, insure or mitigate some of the risks, and estimating the impact of various risks on the future earnings of the company (entity).

WHAT ARE THE STEPS INVOLVED?

Let's go back to our young Singaporean couple, Dylan and Wendy. Their greatest asset is their HDB flat which is valued at $550k currently but there is an outstanding mortgage of $480k. Therefore, an immediate risk that one can identify is the risk of an unrecoverable loss when one of them passes away and the surviving spouse is unable to carry on with the monthly repayment of the outstanding mortgage. Therefore, to mitigate this risk, the government has implemented the Home Protection Scheme (HPS), a mortgage-reducing insurance that protects members and their families against losing their HDB flat in the event of death, terminal illness or total permanent disability. The HPS is an example of a risk-treatment.

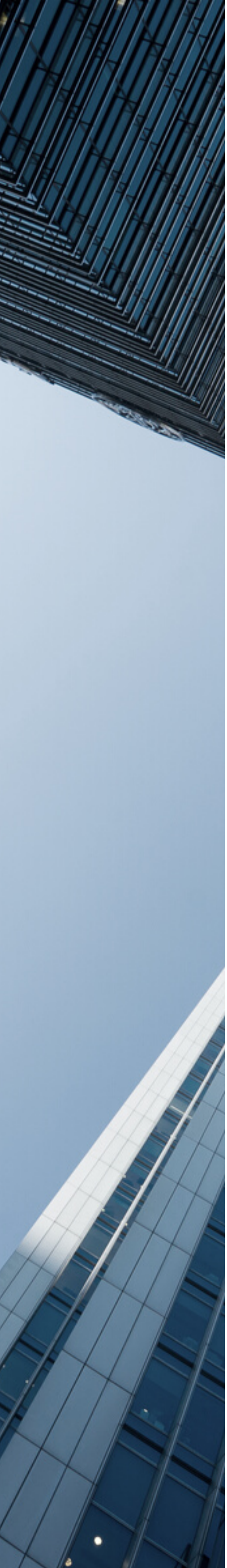
"Wah! Lidat so many risks, I will be broke if I identify and treat all! Where got money left to do other things? Lidat how?"

The answer to this is, it DEPENDS. It depends on one's perception of risk. While your financial adviser can help you identify the key risks at that point in time, ultimately, the decision to put the dollar to RM or investment use, depends on the individual's perception of risk.

Using the table below, you can be sure if you were to delete the data for likelihood and severity, and survey 10 different persons, the outcome and hence, risk ranking and treatment will be very different.

Risks	Likelihood (Probability)	Severity (Financial Impact)	Outcome	Risk Ranking	Treatment
Death of Spouse	Rare	Catastrophe	High	1	HPS & Life Insurance
Car Damaged Due to Accident	Possible	Moderate	High	1	Car Insurance
House Burnt Down	Rare	Moderate	Medium	2	Fire Insurance

Therefore, your financial adviser's role here is not to first prescribe a solution, but to work with you to identify the risks not just based on your current financial portfolio, but constantly monitoring and identifying the risks as your portfolio evolves. Thereafter, then he/she can recommend the necessary risk treatments based on the risk ranking as derived by you.



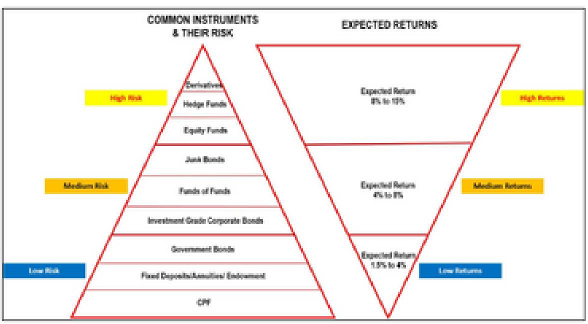
LESSON 4

HOW MUCH SHOULD I EXPECT TO EARN?

"TAKE CALCULATED RISKS. THAT IS QUITE DIFFERENT FROM BEING RASH."
– GENERAL GEORGE SMITH PATTON JR.

Is there such a thing as no risks and yet guaranteed returns? I am sure you know the answer to that. But does that mean that we should take any risk for any return? I'd refer you to the quote above. So, what kind of return should one expect for taking on a specific risk?

The picture below illustrates the various investment instruments and their risk and expected returns. As you can see, risk and returns are directly proportional. What it means is that one should expect a relatively higher return for taking on a bigger risk.



*The common instruments and their risk/returns shown here are for illustration purpose only; the exact percentage may be subject to changes due to economic and market conditions.

SIMPLIFIED EXPLANATION OF THE RELATION BETWEEN RISK AND RETURN

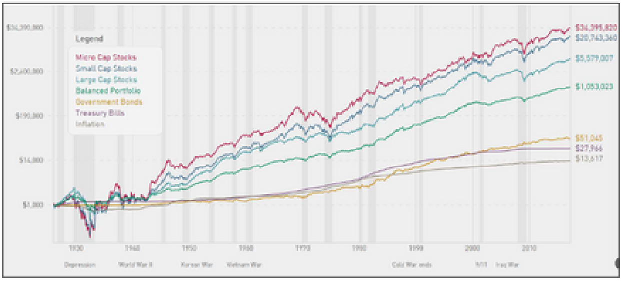
An investor needs to be compensated for two components when he makes an investment. First, one needs to be compensated for the Time Value of Money (TVM) which in this case, we can be more conservative and use the inflation rate as the hurdle rate (minimum required rate of return). The central idea behind the TVM is that the future value of money is worth less than the present value of money due to inflation. Therefore, the hurdle rate can be set at inflation to compensate investors for the opportunity cost due to time.

RISK-FREE RATE is the theoretical rate of return of a financial instrument with zero risk. Thus, the risk-free rate represents the minimum rate of return for any investor and he will not accept any additional risk unless the expected return is higher than this risk-free rate. The 3-month US T-bill is usually used as the risk-free rate as no one will expect the US government to default on their debt payment.

Second, whenever an investor invests into any financial instrument other than **risk-free** instruments, he is exposed to additional risks such as market risk, default risk, reinvestment risks, etc., and hence, his expected return should be higher than the hurdle rate to deem his investment worthwhile.

EXPECTED RETURNS FOR INVESTMENTS

So, what should be the expected return for investments?



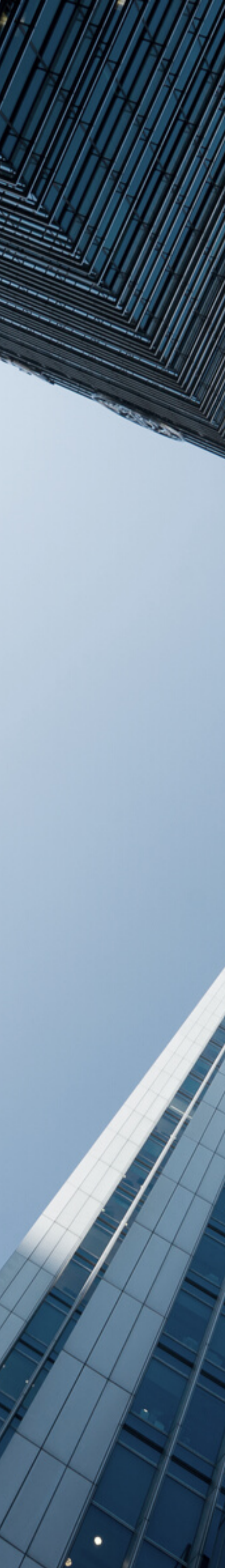
Source: Chicago Center for Research for Security Prices, http://www.crsp.com/

Using an 80-year investment horizon (graph above), a $1000 investment will reap an average 4.25% return per annum (p.a.) for Treasury-Bills (T-Bills), 5.04% for government bonds, and 9-11% for equity funds as shown in the table below.

Type of Investments	Starting Value (1926)	Ending Value (2016)	Return (p.a.)	Absolute Return
Inflation*	$1,000	$13,617	3.32%	1361%
T-Bills	$1,000	$27,966	4.25%	2797%
Government Bonds	$1,000	$51,045	5.04%	5105%
Balanced Portfolio	$1,000	$1,053,023	9.09%	105,302%
Large Cap Stocks	$1,000	$5,579,007	11.39%	557,900%

Comparing these to the average inflation of 3.32%, one can see that investors are compensated for higher returns for riskier investments. However, the key to achieving these returns is TIME. The longer the investment time horizon, the less exposed the investor will be to the short-term market volatility. Hence, lowering the risk and maximising the return (more on Lesson #6).

HOW MUCH SHOULD I EXPECT TO EARN?



LESSON 5

HOW DO I REDUCE MY RISK EXPOSURE?

“WIDE DIVERSIFICATION IS ONLY REQUIRED WHEN INVESTORS DO NOT UNDERSTAND WHAT THEY ARE DOING."
– WARREN BUFFET

Can all risks be diversified away and how diversified should a portfolio be? These are the common questions that I get. I will answer the second question first and my answer is again, “it depends”. It depends on at least in my opinion, a person’s risk profile which is shaped by: (1) Individual’s risk appetite and tolerance; (2) Perception of the economic conditions; and (3) Investment portfolio size.

HOW DIVERSIFIED SHOULD A PORTFOLIO BE?

Individual’s Risk Appetite and Tolerance

An individual with high risk appetite may not want to ‘over-diversify’ his portfolio and lose out on potentially huge rewards. Likewise, a person with a lower risk appetite may seek comfort in safer instruments.

AN INDIVIDUAL'S RISK APPETITE CAN CHANGE OVER TIME DUE TO HIS LIFE STAGE AND EXPERIENCE.

However, one must also note that a person's risk appetite can change over time due to his life stage and experience. A young working single might be willing to put a higher percentage of his income into riskier assets as compared to when he is older, married and have a family to support. Once a risk appetite is established, one should articulate clearly the capacity for assuming risk; also known as risk tolerance.

PERCEPTION OF THE ECONOMIC CONDITIONS

Without any prior experience in the market, a person's investment decision is largely shaped by the economic conditions or market outlook. The better the perceived economic conditions, the more likely one is to put money in riskier investments. Agree?

However, most people are likely to think the same as you and the result of the herd instinct? Over-market optimism and hence leading to overly high valuations in the market. What do you think happens next? They bought at a high, the stock underperforms and stock value plunges as investors lose confidence. The poor investor curses at his bad luck and vows never to invest again. Sounds familiar? As Warren Buffet always say, "It is far better to buy a wonderful company at a fair price than a fair company at a wonderful price".

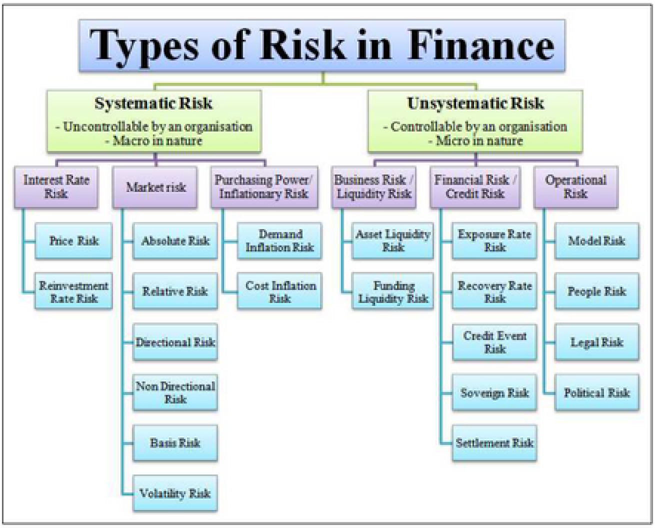
INVESTMENT PORTFOLIO SIZE

The investment portfolio size or in layman's term, a person's wealth, does affect to a certain degree the amount of diversification one can have for his portfolio. Compare a person with a $1,000, to a person with $100,000, the latter can have some diversification of his portfolio as he can meet the minimum investment requirements for the different financial products.

Additionally, one needs to know that investors are protected by regulators on the types of financial products he can have access to. For example, in Singapore, Accredited Investors (AIs) have access to a wider range of financial products as compared to the retail investors.

HOW DIVERSIFICATION REDUCES UNSYSTEMATIC RISKS

So, back to the first question. Can all risks be diversified and how does diversification work? As shown in the picture below, there are in general two types of risks: Systematic and Unsystematic.



Source: http://kalyan-city.blogspot.sg/2012/01/types-of-risk-systematic-and.html

Systematic risk is undiversifiable and is also generally known as market risk. This means that the risk affects the entire market in general and hence, it cannot be reduced through diversification.

Unsystematic risk, also known as residual risk, on the other hand, can be reduced through diversification. For example, when an investor holds stocks across various industries and countries, he is reducing the specific impact on an industry or country. A well-diversified portfolio should be negatively correlated; basket of two types of holdings that move in the opposite direction during different market conditions.

HOW CAN ONE ACHIEVE DIVERSIFICATION WITH LIMITED RESOURCES?

While diversification is necessary, one must find the ‘right’ balance in seeking diversification as a portfolio that is too diversified can end up being overly diluted to generate any return that is attractive enough.

Therefore, one of the ways that one can achieve significant diversification is through a portfolio of stocks but to achieve significant diversification for an individual investor means that he/she may have to diversify across 11 common sectors, numerous countries and at least 30 stocks[2].

Additionally, doing your own personal investments requires great amount of time, money and emotional discipline (Not to mention the required deep understanding of macro-/micro- economic factors and security analysis). To add on to the complexity, the investor undertakes additional risk during the stock selection process when often he/she has to select one company out of the many companies in the same sector.

Do not get me wrong here, the payoff can be extremely rewarding for those who can afford

THE MORE COMMON 11 SECTORS ARE: Healthcare, Real Estate, Energy, Information Technology, Consumery Discretionary, Consumer Staples, Utilities, Materials, Financials, Industrials & Telecommunications.

[2] The Volatility of a Large Portfolio, Chapter 11. Corporate Finance by Berk DeMarzo.

to do this right! Remember the risk/return trade-off we spoke about earlier?

The investor can be rewarded for taking on additional risks such as sectoral concentration risk when he invests in stocks from selective sectors.

As you read at the start of the guide, I started doing my own investments since 2008 and I spent many hours after work daily to screen through hundreds of stocks, examining their annual reports, tabulating their growth rate, analysing book value, etc. I have been handsomely rewarded for the efforts ploughed into understanding the companies' value and their earnings potential. Let me share one example here.

I still remember the Christmas of 2012 when I went shopping with my then girlfriend (now wife) for Christmas gifts and we went to this shop called Pandora. Immediately, I was fascinated by their endless stream of crowd and blown away by their remarkable idea of selling bracelets and charms. I went back did my research on this company and ended up with an eight-bagger over the next 4 years.

In his book, "One Up on Wall Street", Peter Lynch coined the term "ten-bagger" to describe a stock that has gone up in value ten-fold.

Source: Yahoo Finance. https://finance.yahoo.com/chart/PNDORA.CO

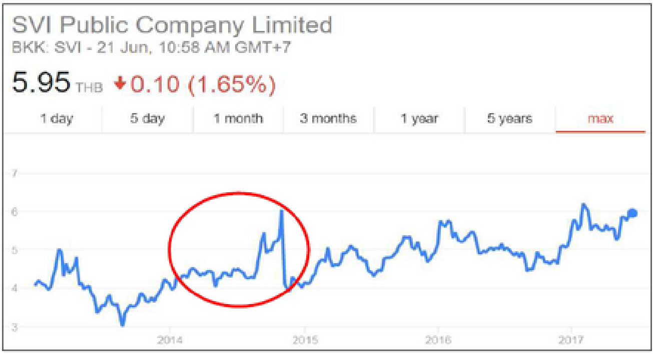
But I also learnt another lesson from managing my own investments. Ever heard of hubris? Hubris refers to the characteristic of an individual who becomes overconfident or arrogant especially after enjoying a period of success.

After bagging a few solid winners in my portfolio, I found myself going through another euphoria when a few of my Thai stocks started growing at double digits return in 2014. One may remember the extremely hot run in the Thai stock market during 2014 (see below). The index rose over 30%, from the low of 1224 to a high of 1615 just over a year!

Source: Google Finance. https://www.google.com/finance?q=INDEXBKK:SET

Now you may have guessed what I am going to say next. One of the few stocks I bought was SVI, a leading Electronics and Manufacturing Solutions provider in Thailand. My average holdings was around 4.3 baht and I sold them when SVI went up to 5.45 baht and came back down to 5.2 baht, recognising a gain of 20% in less than 6 months!

Then I got overconfident and forgot about my investment guiding principles. I sold some of my underperforming stocks, went in at a higher investment quantum and price (an average price of 5.45 baht) as I saw further upside in the company. I was ecstatic when the stock price went up to 6.05 baht on 7 November 2014. Unfortunately, a huge fire broke out on 12 November 2014 in one of their key manufacturing plants and causing the stock to plummet over the next few months to the low of 4 baht. I sold all my holdings and recognised a net loss of 18%!



Source: Google Finance. https://www.google.com/finance?q=BKK:SVI

Now if you see the performance of SVI, you can see that my analysis was right that this is a good company with low P/E, consistent earnings, etc. However, because I got carried away by my emotions and paid for my mistake dearly. The reason why I have decided to spend a few pages to share my experience is to highlight that doing your own investments is not easy and I cannot tell you how emotionally draining it was for me (Not even mentioning the amount of trading costs incurred over the years!). Another lesson that you can take away is that if you observe the chart of SVI, if you had invested in the company over a period since 2014, you would have made money and less the emotional stress. I will elaborate more in the next lesson.

HOW DO I REDUCE MY RISK EXPOSURE?

Another way is to invest in a portfolio of funds. For example, a person who invests in funds that focus on 2 or 3 countries will be able to participate in the potential upside of the specific countries while being diversified across different companies that represent different industries.

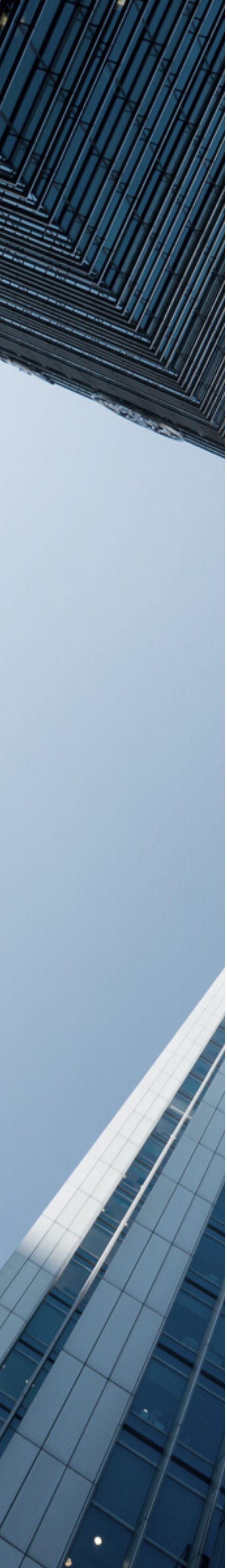
Also, the funds are managed by finance professionals and industry experts. For example, many of the funds that specialise in Healthcare sector are managed by finance professionals with Ph.D. in the healthcare field! So, what you get when you invest in funds is that you achieve diversification with professional management. However, there are also some downsides to investing in funds similar to doing your own investment. For example, the fund is also subject to market volatility and funds usually come with an initial sales charge and annual management fees which could be quite costly. I will cover more in detail on the different types of funds and basic fund selection criteria in Lesson #7.

SUMMING IT UP

This lesson is much lengthier than the rest of other lessons because I feel it is extremely important for one to understand and deal with the risks involved. Therefore, to sum it up, below are the few key takeaways from this lesson:

1. Degree of diversification of a portfolio depends on the individual's risk profile;
2. Only unsystematic risks can be reduced through diversification;
3. Recognising the pros and cons of direct investment in stocks vs funds (see table below)

Comparison	Stocks	Funds
Allows Diversification	Not easy to achieve	Yes
Easy to Manage	No	Yes
Cost-effective	Low for long-term investments; high for traders	Varies across funds; standard fees[15] are annual management fees, and platform and advisory fees if one transacts through an intermediary.
Liquidity	Yes (Except for OTC Stocks)	Not as liquid as the trading occurs at the end of day after the Net Asset Value (NAV) of the fund is priced.



LESSON 6

START EARLY!

"THE STOCK MARKET IS DESIGNED TO TRANSFER MONEY FROM THE ACTIVE TO THE PATIENT."
– WARREN BUFFET

For the trader or short term investor, he will tell you that timing is extremely crucial. But how many of us here are can be a full-timer trader or investor? Investment for most of us therefore, should be easy to administer and does not take you up and down the emotional roller-coaster daily as you monitor the stock market.

INVESTMENTS SHOULD BE EASY TO ADMINISTER AND DOES NOT TAKE YOU UP AND DOWN THE EMOTIONAL ROLLER-COASTER OF THE DAILY MARKET MOVEMENTS.

MAXIMISING RETURNS AND REDUCING RISK THROUGH LONG TERM INVESTMENT HORIZON

Therefore, for those of you who want to build a more sustainable investment portfolio, TIME is more crucial. Take a look at the Dow Jones index below. A person who has invested at the start of 2000 for 5 years would have lost about 10%.

Source: Google Finance. https://www.google.com/finance?q=INDEXDJX:.DJI

One may argue that timing is also important here as most of you would remember the Dotcom crash on 10 March, 2000.

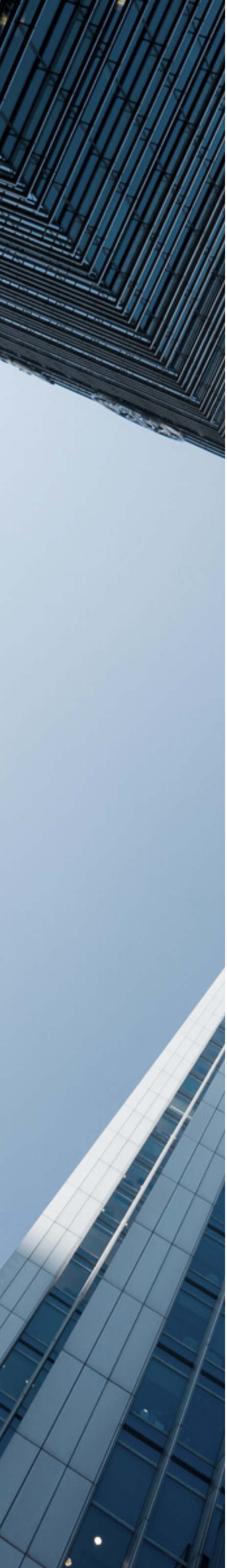
Now, let me take you through 2 financial crises, both the Dotcom and the subprime global financial crisis. The return for a person who had invested at the start of 2000 for 15 years, had netted a return of 52%.

Source: Google Finance, https://www.google.com/finance?q=INDEXDJX:.DJI

What does this tell you? The longer the investment time frame, the lower your risk and higher your potential returns. Still do not believe? Take a look at the returns when I increased the investment horizon to 30 years.

Source: Google Finance, https://www.google.com/finance?q=INDEXDJX:.DJI

Let's take a look at our Straits Times Index (STI) to further illustrate the point of reaping higher return over long duration. One may remember that the STI was reconstructed and began trading on 31 Aug 1998. Using the data from 1 Sep 1998 to 20 June 2017, the index returned 7.89% p.a. and total return of 393% within a span of 18 years even after two financial crises in 2000 and 2008!



LESSON 7

WHERE AND HOW DO I START?

"KNOW WHAT YOU OWN, AND WHY YOU OWN IT."
– PETER LYNCH

Before you get started, you should at least acquaint yourself with some general knowledge such as market outlook and you can easily obtain free market outlook reports from financial institutions such as Goldman Sachs, BlackRock, etc. on their websites. This allows you to have some general idea of some macroeconomic trends or growth potential in certain sectors/countries. For example, as countries start to grow from developing to developed economies, consumers' purchasing power and their habits will also evolve, i.e. from consumer staples to consumer discretionary.

In this lesson, I will briefly touch on the types of **common funds** available to most investors and a simple fund selection criteria that you can use to aid you in narrowing down your search.

This is a simplified overview of the types of funds available. Always look at the fund factsheet to better understand the details of the fund.

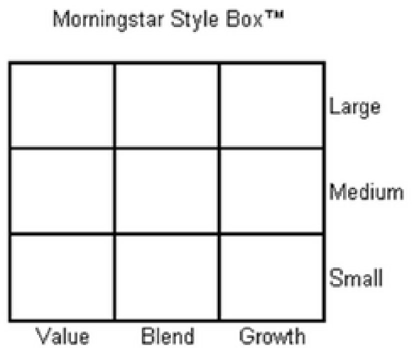
TYPES OF FUNDS

Generally, there are three main types of funds: (1) Equity (Stocks); (2) Fixed- Income

(Bonds); and (3) Balanced (Combination of Equity and Bonds).

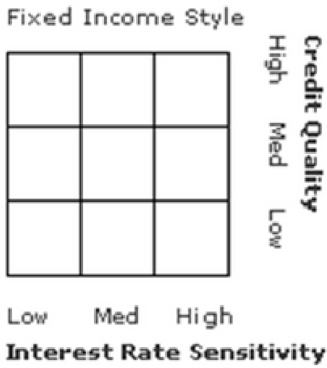
EQUITY FUNDS

The investment objective of this class of funds is to achieve long-term capital appreciation through the investment in stock holdings across different sectors and countries. Personally, I found this diagram (The Morningstar Equity Style Box) useful for classifying the different types of equity funds:



BOND FUNDS

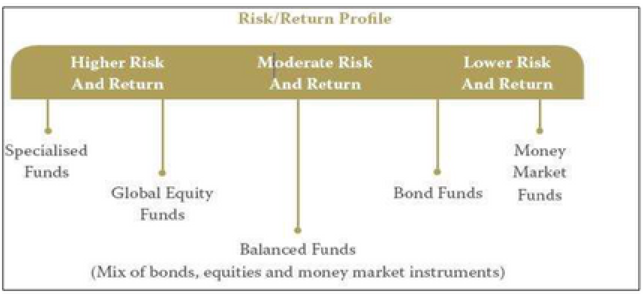
The investment objective of this class of funds is to generate income via bonds which pay regular coupons and seek to preserve capital. Similarly, the diagram (The Morningstar Fixed Income Style Box) below useful for classifying the different types of fixed income funds:



BALANCED FUNDS

The investment objective of this class of funds is to achieve both long-term capital appreciation and generate income. Because of the allocation to both equities and bonds, one can expect a lower return in exchange for a lower risk.

The diagram below summarises the risk/return for the different types of funds highlighted.



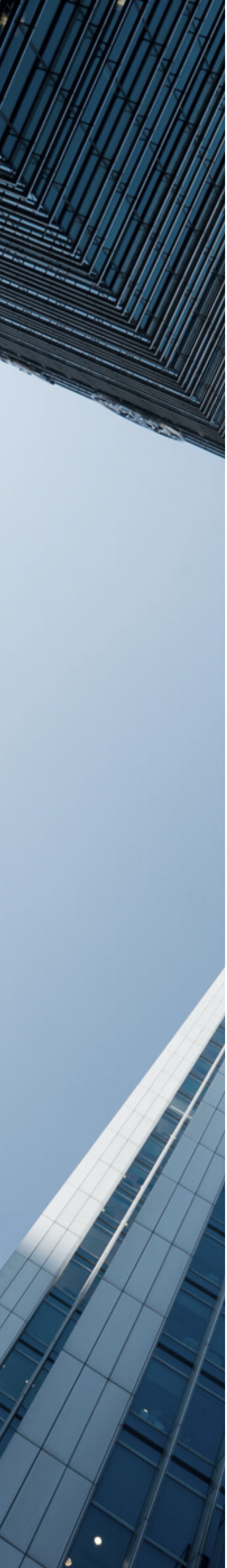
Source: http://www.moneysense.gov.sg/understanding-financial-products/investments/types-of-investments/unit-trusts.aspx

BASIC FUND SELECTION CRITERIA

I have listed down 5 simple criteria, and guiding questions that you can use to aid you in narrowing down your funds selection:

S/No.	Criteria	Question
1	Investment Objective	Is the investment objective for long-term higher return (equity fund), steady-income stream (bond fund) or preserve principal with a low yield return (money-market fund)?
2	Macroeconomic Trend	What are the macroeconomic trends and is the fund investment objectives aligned to these?
3	Fund's Performance	Does the Fund outperform the benchmark or even peers over the long term?
4	Fund's Expenses	Are the Fund's expenses higher than the peers?
5	Fund Manager(s) Track Record	Who is the Fund Manager(s)? What is his/her track record?

*These criteria are to be used as a general guide only.



LESSON 8

SETTING YOUR CRUISE CONTROL

"PASSIVE INVESTING WILL OUTPERFORM ACTIVE MANAGEMENT IN THE LONG RUN BECAUSE COSTS STRIP AWAY HIGH PERFORMANCE POSSIBILITIES"
– WARREN BUFFET'S THESIS OF "THE BET"

The last lesson is about setting your cruise control. Just like your car's cruise control, once you set the cruise control on, you let it cruise without interfering much except for the occasion tapping of brakes or changing of speed until you have reached your destination.

Similarly, for investments, it is about investing over a long-term horizon with occasional rebalancing of the portfolio to align to one's life stage.

PUTTING IT TOGETHER

Remember the Kueh Lapis Sagu?

In this lesson, we are going to talk about how you can layer your investment portfolio, structuring them to meet the different financial objectives that you have and reaping the full rewards of the systematic approach at the end.

To make things simple and feasible for most to construct, I will show how you can use 3 general layers to construct your portfolio: (1) First Layer(s) – Inflation Protection; (2) Second Layer(s) – Income Generation; and (3) Third Layer(s) – Capital Growth. A more sophisticated investor may further divide the three layers into sub-layers.

Additionally, the 'thickness' (composition) of the layers can be adjusted based on one's risk profile to meet evolving life stage's needs.

YOUR FIRST LAYER(S) – INFLATION PROTECTION

NEVER BELITTLE THE EFFECTS OF COMPOUNDING!

I believe one should always begin the initial layers with guaranteed return instruments that will offer some the basic protection against inflation. This will lay the solid foundation for your retirement many years down the road.

Remember that the lower the risk, the lower your expected return? Therefore, for extremely low risk instruments such as CPF Ordinary Account (OA) and Special Account (SA), which will eventually form the Retirement Account (RA) when you turned 55, you need to give it time to harvest its maximum return!

A $10,000 INVESTED IN THE CPF SA WILL BECOME $48,010 AFTER 40 YEARS! A GUARANTEED 480% RETURN!

This does not consider the extra 1% that is earned for the first $60,000 combined balances.

Under the current SA rate of **4% p.a.**, a $10,000 invested at the age of 25, will become $48,010 at the age of 65! An amazing 480% guaranteed return for putting money aside for long term.

Just to further illustrate my point on giving it time to maximise the return, the same $10,000 invested 3 years later will only become $39,461. That is a difference of $8,549, almost the amount of the principal! What a difference 3 years can make!

Did you know? You can make voluntary contribution to your CPF SA of up to $7,000 and enjoy tax relief at the same time?

However, do note that the earliest one can make a withdrawal under the CPF scheme is

An annuity is a type of life insurance policy, which is usually purchased to provide for our retirement needs. Annuity premiums may be payable as a lump sum or through regular payments for a fixed period of time.

at the age of 55, after meeting the Retirement Sum Scheme. Therefore, for anyone who wants to bring forward their retirement earlier than age 65 or even 55, can consider investing in an **annuity** which provide guaranteed yearly payouts at a pre-determined age.

YOUR SECOND LAYER(S) – INCOME GENERATION

The second layer comprises low-medium risk instruments such as bond funds to provide regular income streams via dividend (from coupons) distributions. The regular dividend distributions of the bond funds allow the investor two choices: (1) Collect as income distributions; or (2) Reinvest to grow the returns over long-term.

Apart from generating regular income streams, having bonds (funds) in one's portfolio allows for diversification; especially in short market cycles, there is a strong negative correlation between bonds and stocks. This means that during short-term market volatility, bonds (funds) offer some cushion to your portfolio.

YOUR THIRD LAYER(S) – CAPITAL APPRECIATION

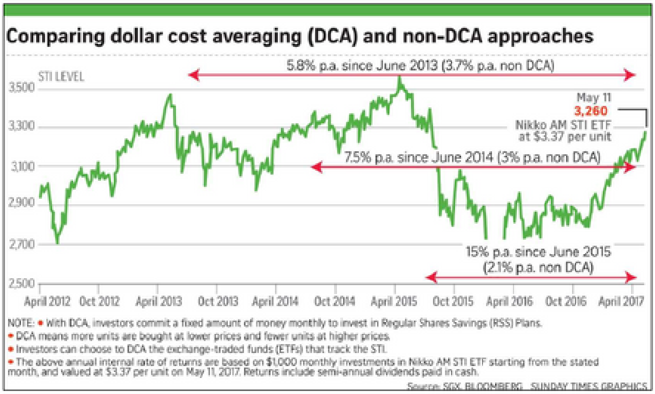
Finally, in the third layer, it comprises medium-high risk instruments such as equity funds (refer to Lesson #7) to give your portfolio the extra boost so that you can potentially have a more comfortable retirement.

As I highlighted earlier, for an investor to maximise his return and minimise his risk, he must invest over a long-term horizon to ride out the volatility. Additionally, he needs to diversify his investments to reduce the unsystematic risks.

So how can one do this and still capitalise on the market volatility to increase his potential return further? Introducing the DCA (Dollar-Cost Averaging) approach; where one invests systematically with a fixed amount of money over a period. In this way, not only can one achieve diversification and disciplined savings, one can also participate in the market volatility in the long term.

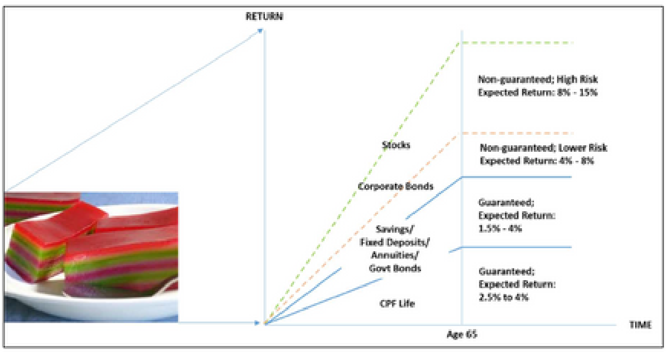
DOLLAR-COST AVERAGING (DCA) IS ABOUT INVESTING SYSTEMATICALLY WITH A FIXED AMOUNT OF MONEY OVER A PERIOD.

The illustration below from the Straits Times article shows that the DCA approach can potentially reap a higher return for the investor:

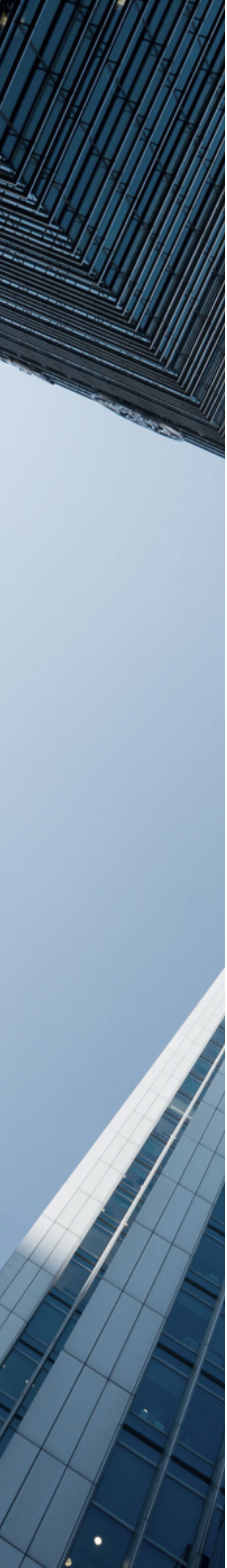


Source: http://www.straitstimes.com/singapore/how-not-to-put-it-all-in-one-basket

Finally, this is how the three layers add up. I have separated the first layer into two layers to show the 'base' layer for all Singaporeans and PRs, which is anchored by the mandatory CPF life.



* Figures shown are for illustration purpose only.



LESSON 9

I STILL CANNOT DO THESE! HOW?

"INVESTORS WHO ARE PREPARED TO PAY FOR A FEE FOR THE MANAGEMENT OF THEIR FUNDS MAY WISELY SELECT SOME WELL-ESTABLISHED AND WELL RECOMMENDED INVESTMENT-COUNSEL FIRM."
– EXTRACT FROM THE INTELLIGENT INVESTOR BY BENJAMIN GRAHAM

At the end of the day, if you find it impossible to set aside a couple of hours to do these or still feel uncertain about managing your own portfolio because you are worried about making emotional decisions, perhaps it is time for you to seek advice from a qualified professional.

I have read "The Intelligent Investor" three times over the last 10 years and each time I still glean new insights and find the lessons relevant. This last lesson talks about how you can screen the investment adviser before deciding to work with him/her for the long-term. This lesson is largely extracted from the commentary from Jason Zweig on Chapter 10 – The Investor and His Advisers of "The Intelligent Investor" by Benjamin Graham. I will strongly encourage you to read the entire chapter 10 and the commentary if you have the time to do so as there are so many wonderful things that Jason Zweig shared there.

SCREENING THE INVESTMENT ADVISER

In screening an adviser, you should aim to establish at least these three facts about the investment adviser if he/she:

1. Cares about helping clients, or just going through the motions;
2. Understands the fundamental principles of investments;
3. Is sufficiently educated, trained and experienced to help you.

Below is the list of questions that I have sieved out from the commentary, that you can use to further establish the quality of the investment adviser:

S/No.	Category	Questions
1	General	Why are you in this business?
2	Services Rendered	Do you focus solely on asset management, or do you also advise on taxes, estate and retirement planning, budgeting and debt management, and insurance?
3	Credentials	How does your education, experience and credentials qualify you to provide those kinds of financial advice?
4	Client Management	How can you help me achieve my goals?
5	Client Management	How will you track and report my progress?
6	Investment Knowledge	How do you choose investments?
7	Investment Knowledge	What is your investing philosophy? [Do you use market timing or technical analysis? A "yes" to either of these is a "no" signal to you]
8	Investment Knowledge	What investing approach do you believe is most successful, and what kind of evidence can you show me that you have achieved that kind of success for your clients?
9	Investment Knowledge	How high an average annual return do you think is feasible on my investments? [Anything over 8% to 10% is unrealistic]
10	Fees	How much, in actual dollars, do you estimate that I would pay for your services per year?
11	Track Record	How many clients do you have and how often you communicate with them?
12	Track Record	How long do clients stay typically stay with you?

CONCLUSION

Congratulations! You have come to the end of the guide and as I shared at the start, I sincerely hope that you have gleaned valuable insights on how you can manage your own financial portfolio through the understanding the two simple key concepts of the Kueh Lapis Sagu, the Vehicle and Destinations.

RE-CAP OF LESSONS

Below is a quick re-cap of the lessons:

(1) Lesson #1 – Setting Your Destination
(2) Lesson #2 – Constructing Your Vehicle
(3) Lesson #3 – Preparing Your Vehicle for the Bumpy Ride
(4) Lesson #4 – How Much Should I Expect to Earn?
(5) Lesson #5 – How Do I Reduce My Risk Exposure?
(6) Lesson #6 – Start Early!
(7) Lesson #7 – Where and How Do I Start?
(8) Lesson #8 – Setting Your Cruise Control
(9) Lesson #9 – I Still Cannot Do These! How?

Part 1
Part 2
Part 3

PART 1 – UNDERSTANDING THE BASIS OF FINANCIAL PORTFOLIO, OBJECTIVES AND RISK MANAGEMENT

In Part 1, I have explained how you can start to chart out your destination using financial objectives that is S.M.A.R.T. and thereafter, constructing your vehicle to bring you there.

The vehicle that you currently have may contain some inherent risks that you need to address before embarking on the journey and thus, I explained how one can use the 5-step RM process to mitigate the risks.

PART 2 – UNDERSTANDING THE TRADE-OFF BETWEEN RISK AND RETURN

Next, in Part 2, I have explained the fundamental concept behind risk and return, and this concept underpins the investment 'layering' concept in Lesson #8.

I went on to elaborate further in Lesson #5 how risk is made up of 2 parts; how one can reduce the unsystematic risks through diversification, and maximising return while minimising risk via a long-term investment horizon. Additionally, I highlighted that it is important to understand one's risk profile which could change over time to better align both investment strategy and instruments.

PART 3 – SIMPLE TOOLS TO GET YOUR VEHICLE GOING

Finally, in Part 3, I shared how one can set up the parameters for his investment portfolio that should be easy to administer (cruise-control mode). I reiterated the importance of starting early to allow one to gain maximum investment time horizon, and the pros and cons of managing a portfolio of stocks vs funds.

For those who are still unable to manage their own portfolio, I shared how one can engage professional help through an investment adviser. Together with the lessons learnt from this guide and the guiding questions in screening an investment adviser, one should be able to ascertain if he/she is the ‘right’ fit to walk with you through the long road ahead.

For those who you who are beginning to get ready excited about managing your own portfolio, I strongly urge you to read at least these two wonderful books that have shaped my investment principles: “One Up on Wall Street” by Peter Lynch and “The Intelligent Investor” by Benjamin Graham.

Last but not least, feel free to reach out to me if you have additional questions or comments that can help improve this guide.

Once again, I wish you all the best in your journey ahead!

Best Wishes,
Dexter Koh, M.B.A., CFP®, SAMP