

# financial INSIGHT

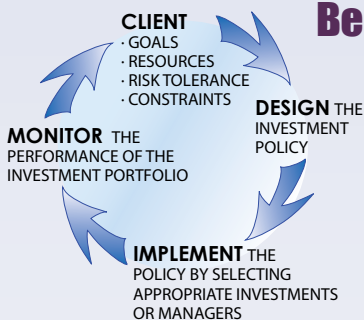
A QUARTERLY PUBLICATION FOR PREFERRED CLIENTS OF D.A. DAVIDSON & CO., DAVIDSON INVESTMENT ADVISORS AND DAVIDSON TRUST CO.

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## Chart your investment decisions

The investment policy statement (IPS) is a critical component of any investment program. While investment policy statements have for years been a required part of Employee Retirement Income Security Acts plans and many trusts, endowments and foundations, they have only recently become an accepted "best practice" for individual investors as well. This is a document investors can prepare themselves or with the assistance of a financial consultant, and can be completed in many different formats.



### Benefits

A well-thought-out, formalized IPS benefits both the client and the financial consultant. For the investor, an IPS guides and controls the investment decision-making over his or her portfolio. Objectives and constraints are considered in formulating investment decisions that optimize the benefit to the investor in achieving long-term goals.

The client/financial consultant relationship is a circular continuum. It begins with the client and returns to the client being ever mindful of the goals, resources, risk tolerance and constraints unique to the individual, family or organization.



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### WE ARE CLOSED GOOD FRIDAY

2006 is a good year to complete your tax returns well ahead of April 15. It's particularly important to pay attention to the approaching deadline if you need tax information, investment assistance or documents from your D.A. Davidson & Co. financial consultant to complete your returns.

U.S. stock exchanges observe Good Friday, which means D.A. Davidson & Co. offices will be closed that day. That's important to investors because the Good Friday holiday falls this year on April 14 — just one day before the traditional federal deadline to complete and file tax returns or make IRA contributions.

The good news in the equation is that when the tax-filing deadline is on a Saturday, the IRS gives taxpayers an extra day to complete their work. So you actually have until Monday, April 17, to file your individual tax returns or contribute to an IRA.

We hope and recommend that you do not wait that long to come see us on tax-related issues. We look forward to helping you with any investment matters, hopefully well before the deadline.

# Chart your investment decisions

## Benefits (continued)

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The process is dynamic in that it should allow for changes in the investor's circumstances as he or she moves through the crossroads in life that affect portfolio construction.

An IPS not only helps provide a focused discipline to achieving long-term financial objectives, but also helps prevent emotional short-term decisions that are incongruent with their long-term goals. Additionally, if there is a change in financial consultants, subsequent financial consultants should be able to implement a program consistent with the investor's previously stated goals and objectives.

Another clear advantage of using the IPS is that it represents a formal understanding and agreement with the investor. If questions arise over a specific investment decision, the IPS can be consulted for clarification as to the appropriateness of that action. Since an investment policy statement should specify the frequency of reviews and appropriate benchmarks to measure success, it can help identify and provide direction for issues that result from changes in a client's circumstances. It is important that the client and financial consultant agree on clearly defined and appropriate benchmarks to properly mark progress.

## IPS Components

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A formal IPS should contain two main categories: objectives and constraints. The portfolio objectives refer

to the risk and return requirements needed to meet the investor's goals. The constraints are those unique characteristics that must be considered when formulating these objectives into a comprehensive investment plan.

## Objectives

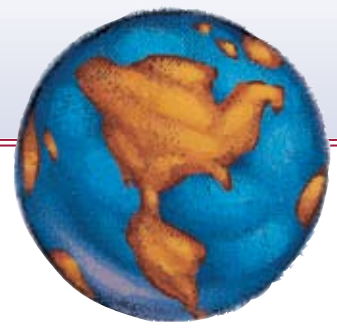
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The objective section of the IPS should clearly detail the levels of risk and return needed to meet the portfolio requirements. As these growth and income needs are evaluated, attention must be given both to desired objectives and required objectives. For example, if the investor wants minimal risk and a 100% investment in bonds, but the required risk to meet the portfolio's objectives dictates higher equity exposure, there is a direct conflict that must be resolved in the policy. It is in this section that an investor's "sleep-at-night factor" must be fully taken into consideration. It is very important to achieve a balance between both these quantitative and qualitative factors in this section of the IPS.

## Constraints

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Each investor has unique constraints or important considerations that must be incorporated into the investment process. The constraints portion of the IPS is where these specifics are outlined. At a minimum, this section should address time horizon, tax issues, liquidity needs, legal constraints and any unique circumstances the investor may have. As always, other categories can be added if needed to clarify goals.



Investment goals should be separated according to the investor's time horizon. It is not uncommon for an investor to have more than one time horizon in his or her IPS, such as pre-retirement, post-retirement and even testamentary disposition. Children and their educational needs can dictate additional time horizons. Each horizon can and should have its own unique risk and return considerations. Time horizons can also be broken down between short term (usually two years or less) and long term, if necessary.

Tax considerations, including income tax, capital gains tax and possible estate taxes should be included. Also relevant for this section are specific questions, such as those concerning tax deferral (low portfolio turnover), tax avoidance (tax-exempt securities such as municipal bonds), tax reduction (longer holding periods for preferential capital gains treatment) or estate tax minimization strategies (pre-death transfer). Different strategies for managing qualified retirement accounts, such as concentrating taxable fixed income allocation in IRA accounts, could be included here as well.

Liquidity needs should be addressed to cover expected and unexpected cash flow requirements. Specifically, the investor's liquidity reserve requirements must be clearly outlined. Typically, a cash liquidity reserve should range from three to 12 months of living expenses. Also, major purchases or upcoming liabilities can be planned for and covered in this section. Careful liquidity planning can help an investor get through adverse market conditions with minimal impact to the portfolio.

Any legal and regulatory constraints should be a part of the investor's constraints. Examples include the use of trusts (revocable and irrevocable), foundations and endowments, or jurisdictional issues such as the

use of dynasty or offshore trusts. These entities can have special rules and regulations that can affect the type of investment vehicles used or have unique income generating requirements. Fiduciary standards can also be addressed, including the Prudent Investor Rule for individual investors. This rule reflects modern portfolio theory and provides guidance to investment managers regarding the standards for managing an investment portfolio in a legally satisfactory manner. Any unique state, local or institutional regulations should be included here as well.

Finally, there should be a "catch-all" category for any constraints not specifically addressed elsewhere. Unique circumstances can be articulated in this section, including anything from addressing a stock concentration to special family circumstances or even ethical provisions, such as a preference for socially conscious investing. These types of provisions are common. Additional categories can always be added in this section as situations or goals dictate.

## Success

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We all know the goals that have the greatest likelihood of success are those clearly articulated in writing. Financial goals are no different. As with institutional investors, adopting the IPS as a best practice allows individual investors the same opportunities for blueprinting their financial success.

— *Jim Searles, CFP®*, Senior Vice President, Director of Professional Development

— *Gene Harrison, CFP®, CFA®* Director of Financial Planning

## Meet a D.A. Davidson & Co. Professional

Gene has extensive experience in financial planning, portfolio management and other areas of the investment industry. He comes to D.A. Davidson & Co. from Kanaly Trust Company, after previous work with Wells Fargo Private Asset Management; JP Morgan Private Bank, Deloitte & Touche and Transamerica Funds.

Gene holds a bachelor's degree in business, with an emphasis in finance, from Stephen F. Austin State University in Texas. He also has earned the Chartered Financial Analyst®, CERTIFIED FINANCIAL PLANNER™ and Certified Trust and Financial Advisor designations.



**Gene Harrison CFP®, CFA®**  
Director of  
Financial Planning

### First, can you describe your background for us?

I was born and raised in Houston, Texas, and just moved to Great Falls, Montana (D.A. Davidson & Co. headquarters) in February with my wife and our 4-year-old son and 2-year-old daughter. I am a CERTIFIED FINANCIAL PLANNER™ and hold the Chartered Financial Analyst® designation. I have been in the financial services industry for almost 20 years now, with 15 of those in Private Client Services. My background includes trust administration, portfolio management and fee-only financial planning.

I come here from Kanaly Trust Company in Houston, where I was a Financial Advisor and guided clients through the financial planning process. Kanaly was the pioneer in fee-only financial planning 30 years ago and the company's core business was providing objective, comprehensive financial planning, with no products to sell. The level of detail that went into that company's financial planning was impressive. This was an excellent training ground for providing true holistic financial planning and I look forward to bringing that same approach to D.A. Davidson & Co.

My family and I are very excited about being here in beautiful Montana and happy to leave the traffic, brown air and hurricanes back in Houston. Everyone here has made us feel very welcome here and we truly feel we've found a new home.

**Second, please tell us what you bring to D.A. Davidson & Co., how you will be working with our financial consultants and how that benefits our clients.**

The most important thing I bring to the table is a comprehensive, holistic approach to financial planning and the ability to coordinate the implementation of the plan. I see my role as adding value to the relationship the financial consultant has established with the client and helping them work together to formulate a financial blueprint to meet each client's goals. My only agenda is to provide objective financial planning advice to the client and help him or her implement the plan.

### What trends are you seeing in the way companies help investors plan their financial futures?

Most firms I have seen just used basic financial planning services as a way to sell more products and services. D.A. Davidson management has made it clear to me that their main goal is to do what is right for the client and do it in a way that is not oriented only around selling products. They are clearly dedicated to providing comprehensive financial planning services for their clients and are willing to commit the proper resources to get it done right. It is very exciting and refreshing to see.

### What do you foresee as the greatest challenge ahead?

Frankly, the biggest challenge I see is keeping up with the demand. The most common e-mail message I have received from my D.A. Davidson & Co. colleagues is, "Welcome aboard and when can you come see us?"