

Book Review: Clear guide to asset allocation

Morgan Stanley exec
charts path for investors sorting out confusing times

The Little Book That Still
Saves Your Assets: What the Rich
Continue to Do to Stay Wealthy in Up and Down Markets. By David M. Darst, Wiley, 226 pp.

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done, see the end of this article.

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The Little Book That
Still Saves Your Assets, by investment guru David M. Darst, was first
published prior to the economic crash of 2008 (sans the "still" in the title).
Now it has been re-published in an updated edition to address the recent
economic downturn and to answer the question that has been on so many of our
minds:

stay rich through the crisis?

According to Darst, the key is proper asset allocation in their investment portfolios.

This is Darst's entry into Wiley's "Little Book, Big Profits" series of more than two dozen books written by credible experts containing investment advice of different stripes for the nonprofessional.

And Darst is nothing if not credible, having gained vast experience and knowledge throughout his long career. He currently serves as a Managing Director at Morgan Stanley with the title of Chief Investment Strategist of the firm's Global Wealth Management Group. He is also a long-time former senior executive at Goldman Sachs.

Jim Cramer, of CNBC's "Mad Money" fame--you know, that commentator who yells frequently--wrote the book's introduction and credits Darst with teaching him everything he knows about asset allocation. Cramer indicates that Darst literally "wrote the book" on asset allocation: The Art of Asset Allocation, which Darst first published in 2003 and is now in its second edition, remains a favorite resource among professional investors.

It also sits on Jim Cramer's desk at CNBC.

Basics of the technique

Darst describes asset allocation as the most fundamental principle of investing and "the ultimate determinant of success in the markets," without which even seasoned investment professionals could not hope to do well.

Asset allocation, which itself connotes a mix of investments, includes a range of principles: diversification, rebalancing, risk management, and reinvestment. It is the process by which we ensure that we "buy low, sell high," and introduces a disciplined and systematic approach to managing personal investment strategies.

Asset allocation helps the knowledgeable and inexperienced alike avoid common investing pitfalls, such as following the crowd, giving into hype, or panicking when the going gets tough. Through careful asset allocation, we are forced to understand our investment goals and take the calculated steps necessary to reach them.

Throughout this Little Book, Darst refers to "Uncle Frank," an amusing invention who is meant to serve as surrogate elder advisor for the reader, the someone in each of our lives who knows us well and can help us to maintain objectivity in our investment decisions.

One from Uncle Frank: "Trees don't grow to the sky, and the sky will not fall, but you can take the fruits of compounding to the bank."
(More about compounding later.)

Another: "Did you buy that stock for your plan or for your ego?"

And one more: "Keep your eye on the Big Picture, but watch your step!"

Having an Uncle Frank who functions as a friend and mentor and who knows our strengths and weaknesses, can help to guide our portfolio decisions and asset allocation strategies, helping us to achieve our financial goals. Darst attributes great significance to this role, asserting that each of the great investors credits one or two such individuals with contributing substantially to his or her success.

Achieving true diversification

Asset allocation means more than just diversification. And diversification is more than simply owning several types of assets, according to Darst.

Consider this: One or more factors may link the investments in your portfolio that could cause them all to respond negatively to a certain economic event. For instance, consumer airlines and shipping companies may seem like distinct industries that diversify your portfolio. Yet think about how each would respond to an increase in oil prices.

True diversification involves owning multiple types of asset classes that respond differently to the same economic event. That way, no matter what is happening in the global environment, part of your portfolio improves even while other parts may suffer. The key to proper portfolio diversification is negative correlation.

In the author's words

"Asset allocation prevents you from becoming dogmatically wedded to a small number of asset classes or investment approaches, which do well for a certain period of time and then languish..."

--David Darst

Darst appreciates that heavy concentration can create fortunes, but it cannot maintain them.

He cites numerous examples of clients who made tremendous amounts of money suddenly--through inheritance, the dotcom bubble of the late 1990s, the real estate bubble of the mid-2000s. Yet they failed to diversify afterward and then subsequently lost it all.

Fortunes sometimes may be generated by concentrations, says Darst, but concentrations certainly do not maintain them. Wealth is compounded, accumulated, and retained by proper asset allocation.

As bankers, we are all too familiar with the detrimental effects of concentrations. We have seen our banks experience losses due to the economic recession and the accompanying drastic decline in real estate values in many parts of the country.

How many of the 400-plus banks that were closed by FDIC between 2009 and 2012 experienced too great an amount of loan losses to survive due to heavy concentrations in real estate lending?

How many of the 12% of all operating banks in the country that are currently under severe enforcement actions can attribute their weakened state to concentrations, particularly in their loan portfolios?

And whether our banks have experienced the harmful effects of concentrations in a particular asset class or if we have only seen it happen

to our neighbors, surely we can all appreciate that in the past few years the supervisory authorities have heightened their focus on concentrations of all kinds during regulatory examinations.

Certainly, Darst does not need to convince us bankers of the importance of adequate diversification. But the book is a strong reminder.

Powerful magic in not
believing in "magic"--and seeking discipline

Many financial experts insist that there is one surefire investment path to riches. Darst warns the reader that there is no magic formula, and that proper investment portfolio management involves conscious effort and careful understanding of your motivations, your goals, and yourself.

He notes that it is now more important for individuals to take our investment strategies seriously than ever before. The days of guaranteed pension plans are gone. Most of us must now be responsible for the maintenance of our own retirement savings through IRAs and 401(k) plans.

Darst explains that proper asset allocation gives an investment portfolio the stability it requires to work the "powerful magic" of compounding interest. I recently took an MOOC (massive open online course) in finance instructed by a professor at the University of Michigan. During most of the course lectures, he repeated the following lighthearted advice to his students:

"Remember, when someone asks you a question and you want to seem smart, first you pause, and then you say, 'compounding!'"

The professor's thought echoes a similar sentiment that Darst attributes to Albert Einstein, in which the famed thinker and scientist reportedly stated that compound interest is the most powerful force in the universe. (Incidentally, a search for the source of this statement reveals that it is an oft-cited quotation of dubious origin. But whether or not Einstein actually said it, the fact remains that the effect of compounding interest is indeed powerful.)

Not a pro? Don't worry

Darst drills down into the details of each component of asset allocation while maintaining a level of accessibility for the uninitiated. He presents information clearly and concisely, with an easy style of explanation that suggests that these are lessons he has taught many, many times over his long career.

The Morgan Stanley expert presents short chapters written conversationally, and organizes information into lists, including, "6 key investment objectives", "6 reasons to invest in equity-based assets", and "10 basic questions for evaluating and selecting investment managers."

Darst assumes some basic understanding of finances and investing such that any reasonably informed, educated professional would possess. Where he does introduce specific terminology, Darst explains the concepts with a simple analogy or a clear, straightforward description.

Never did I feel that Darst was either talking over the heads of his readers or talking down to them. He also does not lose the reader with complicated math. He directs us to understand the principles at work and to use software programs, internet services, or other resources for complex calculations.

Darst also lets the reader know that it is OK not to be an expert.

He advocates knowing enough to have a solid understanding, and then selecting a worthy investment manager to guide your portfolio down the course that you determine will most likely lead to your desired result.

You don't have to be a restaurant critic for The New York Times to select a good restaurant for dinner, he says. But you should be informed enough to know if the place has been closed several times for health code violations.

Source of valuable resources

Darst also includes valuable outside resources. He lists links where investors can gather information about assets, asset classes, investment managers, and individual companies. He describes in detail numerous other investment experts who have written books of their own that he recommends for further research.

The book also includes an appendix with checklists to help readers determine their investment profiles, investment outlooks, and investment selections, as well as interview questions to use in when choosing an investment manager.

One of the valuable charts contained within the book details the most popular asset classes and reasons for owning each type. In two exhibits, Darst lists the 16 most popular asset classes and indicates which are subject to each of the 7 primary asset risks and which are advantageous according to each of the 6 primary investment objectives.

If you are an experienced financial advisor, this may not be the book for you. I would suggest instead that you read Darst's books written at the professional level. For the rest of us, though, *The Little Book That Still Saves Your Assets* presents a necessary introduction to managing personal investments that would be beneficial to anyone in the financial services industry.

Those in a customer-facing role at a bank should have at least a conversational knowledge of some basic investment principles to be able to call upon when speaking with clients. Those in a managerial capacity should appreciate gaining a better understanding of asset allocation as it relates to their bank's operations.

And everyone who invests money now or ever intends to would benefit from Darst's worthwhile introduction to the most fundamental principle of investing.

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