Charting Your Financial Course: The Significance of a Personal Investment Policy Statement

Imagine embarking on a cross-country road trip without a map or a destination in mind. You might meander aimlessly, take wrong turns, and ultimately find yourself far from where you intended to be. In the world of personal finance, failing to chart a clear path for your investments can lead to a similarly uncertain and potentially rocky journey. This is where a Personal Investment Policy Statement (PIPS) comes into play – your roadmap to financial success.

A PIPS is your personalized financial GPS, providing you with a clear route to your goals, helping you navigate the unpredictable twists and turns of the market, and ensuring you arrive at your desired financial destination. In this post, we'll explore what a PIPS is, why it's crucial for financial stability, and how to create your own.

The purpose of such a policy is to govern the management of existing and future investments, liquidity, and capital deployment based on your goals, values, and risk profile.

Think of it as a blueprint that makes later decision-making effortless because you have done all the hard work upfront building the the policy to provide you direction.

So, let's fasten our seat belts and prepare to embark on a journey of financial planning, wealth accumulation, and wealth preservation with a trusty PIPS as our guide.

We will start with a high-level template that you yourself can build out and leverage in creating your own PIPS and then I'll share the GYFG policy statement.

Personal Investment Policy Statement Template

This template can serve as a foundation for your own Personal Investment Policy Statement, but you may consider also working closely with financial professionals to customize it to your specific financial situation and objectives. Your PIPS should be a dynamic document that evolves with your changing financial circumstances and market conditions.

I. Introduction

Name of Investor(s):
Date:

II. Investment Objectives

Clearly state your financial goals and objectives, such as wealth preservation, income generation, retirement planning, education funding, or philanthropy.

III. Risk Tolerance

Define your risk tolerance, specifying your comfort level with market volatility and potential losses.

IV. Asset Allocation

Describe the target asset allocation, including the percentage of your portfolio allocated to different asset classes (e.g., equities, fixed income, real estate, alternatives).

V. Investment Strategy

Provide an overview of your investment strategy, including diversification, active or passive management, and any specific investment principles or preferences.

VI. Liquidity Needs

Specify your liquidity requirements, such as maintaining a cash reserve for emergencies or planned expenses.

VII. Philanthropic Goals

Outline any philanthropic goals and allocations for charitable giving.

VIII. Family Considerations

Address family-related goals and responsibilities, such as education funding, protecting your family’s financial future, or legacy planning.

IX. Constraints

Identify any constraints, such as tax considerations, debt preferences, or regulatory compliance.

X. Contingency Plans

Define how the portfolio should adapt to major life events (e.g., retirement, health issues) or unforeseen circumstances.

XI. Performance Benchmarks

Set performance benchmarks to evaluate the success of your investments.

XII. Review and Monitoring

Specify how often you will review and adjust your portfolio and the policy itself (e.g., annually).

XIII. Professional Advisors

List the financial professionals and advisors involved in managing your portfolio.

XIV. Legal and Regulatory Considerations

Ensure that your investments and estate plan comply with relevant laws and regulations.

XV. Signature

Include a section for your signature and date to formalize the PIPS.

This is just a template with different items you may want to include in your own PIPS, but it doesn’t have to be as formal as this. The template is just meant to be a *framework for thinking through items of importance and consideration.*

Next, I'd like to share some additional context as to why I am only now creating my own policy statement – right or wrong.

Additional Context

I've been aware of the concept of a PIPS but hadn't seen the need to create one until now. You may be asking yourself if you need one. YES, you do! I wish I'd created one earlier than now, but you know what they say: "The best time to plant a tree was twenty years ago, and the second best time is today."
I didn't have one earlier because, in the early days of our personal finance adventures, I didn't think it was necessary due to how simple our financial lives were (complexity seemed to happen overnight…in reality, it took about a decade). I was maxing out my 401K, paying down the mortgage rapidly, and building the war chest (liquid cash) that I affectionately referred to as my 'opportunity fund.' Of course, I dabbled in a few investments beyond my 401K, but my primary focus was on achieving a debt-free life and assembling a safety net that eventually gave me the confidence to dive into entrepreneurship.

These days, our financial lives have become more complex and more illiquid than I'm now comfortable with. Until now, I had looked at the lack of liquidity as a feature, not a bug. And a large part of our net worth was created through a private business that left us no choice but to be illiquid.

It provided forced discipline not to interrupt compounding unnecessarily. I assumed that it would come with a premium in terms of expected return, which, for the most part, has proven to be true.

I'm now motivated to make things simple in the event I'm met with an early demise. The last thing I want to do is add the stress of unwinding the complexity I have created during an already challenging time for my family (fingers crossed that event doesn't happen).

In planning for my family's financial security and long-term well-being, here are some things I've considered:

Asset Allocation

Diversification: Spread investments across various asset classes to reduce risk. This could include a mix of stocks, bonds, real estate, and alternative investments.

Income Focus: Given the desire for financial security and income generation, allocate a significant portion of the portfolio to income-producing assets such as dividend-paying stocks, high-quality bonds, and cash-flowing real estate investments.

Growth Potential: To ensure the portfolio grows over time, maintain exposure to growth assets.

Steps to Protect My Family

Estate Planning: I've worked with legal professionals to establish a comprehensive estate plan that includes wills, trusts, and beneficiary designations to ensure a smooth transfer of assets to my family.

Life Insurance: I've added permanent life insurance to provide a tax-free income during our later years but also to protect my family and their lifestyle.

Opportunity Funds for the Kids: Set up Roth and after-tax brokerage accounts for each of the kids. These funds are not only seeding their retirement but will also be there to fund their education, provide a downpayment on their first house, provide capital to start a business, etc.

Emergency Fund: Maintain an emergency fund to cover unexpected expenses and ensure my family's financial stability.

Regular Reviews: Continually review and update the financial plan as circumstances change, including annual reviews of the investment portfolio (at a minimum).

It's been essential for me to work closely with a team of financial advisors, estate planning attorneys, and tax professionals to create a personalized financial plan that accounts for my family's specific needs, risk tolerance, and long-term goals. This plan I share below will evolve with changes in the family's financial situation and objectives to ensure they are set for the rest of their lives while seeing them use and enjoy the money during my and Mrs. GYFG's lifetime.

The GYFG Family PIPS

The purpose of this policy is to govern the management of existing and future investments, liquidity, and capital deployment based on our goals, values, and risk profile.

Before creating this policy, our net worth has skewed heavily toward illiquid assets. This was both intentional and by necessity since a large part of our net worth was locked up in the value of our business and due to our focus on remaining debt-free by having no mortgage or other debts of material value. It also provided a forced discipline not to interrupt compounding unnecessarily. It provided the blinders needed to focus on hitting our $10M net worth goal. There is no daily re-pricing of illiquid investments like you get with the stock market. Out of sight, out of mind.

Although most of our net worth was/is tied up in illiquid assets, we have maintained at least 20% in liquid assets (defined as easily converted to cash in 12 months or less). Before the significant rise in interest rates (and inflation) and putting a PAL in place, that liquidity was primarily held in cash without concern for the coercive effects of inflation or opportunity cost.

This served the purpose of risk mitigation while building the business and not stressing about the need to make money to pay our monthly bills. Today, we have a net worth of ~$11.4M, which exceeds our original goal of $10M. We not only exceeded our original goal, but we achieved it in seven years vs. the twenty years we had allotted for it.

We are plenty liquid at 20% with an 8-figure net worth, but now the focus is on simplifying our financial lives. To simplify, we will deploy new capital in liquid assets **ONLY** and re-deploy returned capital similarly.

As of 10/25/2023, our liquid net worth is ~28%, and the goal is to increase that to 50%+ by the end of 2026. This will be accomplished through both new investments (to dilute the illiquid concentration) while also re-deploying cash from illiquid investments as liquidity events present themselves. Until that metric is achieved, the standard policy will be no new private/illiquid investments, with the only exception being opportunities in which we are directly involved (not just an LP), which have a very high probability of success and distributable cash flow.

To punctuate the size and scale of achieving this balance, I provide two scenarios to provide a range and magnitude of what is essentially a rebalancing:

> **Scenario 1** – If our current net worth stays precisely where it is at $11.4M and we make no new investment, we would need to shift ~$2.5M from illiquid to liquid investment. This scenario also implies we spend all we earn and save none of our income – highly unlikely, but stick with me. It would likely take a minimum of five years to accomplish this rebalancing.
>
> **Scenario 2 –** If, on the other end of the spectrum, we accomplished the rebalance purely through new investment alone, we would need to deploy ~$5M in new capital. This, too, would also require at least five years.

That said, I expect it will come from a mix of both scenarios and take about five years to accomplish.

Based on the above, all new investments will be made into the following four asset classes:

1. **Stocks –** A minimum of 75% index funds, with an initial target allocation of 15% of total net worth (currently 6%).
2. **Bonds –** A minimum of 75% notes and bonds from the federal government as they are the most liquid; otherwise, from the corporate debt of the Fortune 100, with a target allocation of 20% (currently 12%).
3. **Options** – Primarily selling cash-secured puts and covered calls. These activities will be used to either lower the cost basis of existing positions or to enter new positions a a lower cost basis then the current market price.
4. **Permanent Life Insurance Policy** – max $200,000 per year. Funding for the policy will be completed sometime between 2029 and 2032, depending on the Modified Endowment Contract testing. The target allocation for this is less than 10% (currently 2%).

Note: the above only adds up to 20% (vs. the 28% liquid mentioned above), and the 8% delta comprises CDs, BTC, and a large cash payment coming in less than 60 days.

Preferred Characteristics:

1. Liquidity in 12 months or less.
2. Minimal to no personal debt is required to maintain the position. It's okay to obtain short-term leverage (i.e., pledged asset line) due to the timing of cash flows and the seizing of an opportunity. If debt is used and required to maintain the position, a minimum of 1,000 bps is required above and beyond the cost of capital (i.e., if the cost to borrow is 6.5%, the expected return must be 16.5% or greater, with a high probability of success).
3. Tax efficient
4. Cash distributions in the form of dividends or interest

Note: these are just preferred not mandatory characteristics, except for #1 until we reach our 50% liquid target.

Planned Portfolio Changes:

- Reducing BTC position to ≤ 2 BTC – will free up ~$200,000. This is already included in the current 28% liquid noted above. **(By 12/31/2023)**
- Converting $500,000 of business equity into cash related to current business equity position. **(By 1/15/2024 – already contractual)**
- $250,000 maturing CD will fund year 2 of the permanent life policy, and the remaining $50K goes to the brokerage account. It is also already included in the current 28% liquid noted above. **(By 7/31/2024)**
- Closing out Life Settlement Contracts as they "mature" – will free up $110,000+. **(ETA is TBD)**
- Withdraw the remaining funds from PeerStreet as they become available – will free up ~$20K. **(ETA is TBD – going through chapter 11 right now)**
- Liquidity event in 2026 or sooner to cash out $2.5M+ for gaining liquidity of business equity. **(ETA is TBD – depends on market conditions)**

Goals:

In order of priority: (a) wealth preservation, (b) income generation, and (c) capital appreciation.

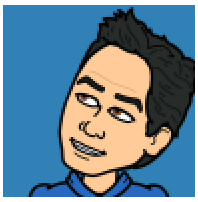
1. **Don’t lose money!**
2. Generate $600,000 in annual passive income.
3. 5-10% annual returns overall.
4. Tax minimization.
5. Simple management.
6. Gifting $17,000 to $34,000 to each kid annually for 18 years.
7. Time autonomy.
8. Luxury travel.
9. Ultimate optionality.
10. **To live life by design!**

There, you have the first GYFG investor policy statement. You’ll notice I provided a template but went utterly off-script in writing my own. I encourage you to do the same and use the template to ensure you consider all the important elements.

I expect this to be a policy I refer to regularly, but also that it will evolve with our changing needs and priorities.

Do you have a policy statement in place? What else would or do you include?

– Gen Y Finance Guy



Gen Y Finance Guy

Hey, I'm Dom - the man behind the cartoon. You'll notice that I sign off as "Gen Y Finance Guy" on all my posts, due to the fact that I write this blog anonymously (at least for now). I like to think of myself as the *Chief Freedom Officer* here of my little corner of the internet. In the real world, I'm a 30-something former C-Suite executive turned entrepreneur turned capital allocator. I am trying to humanize finance by sharing my own journey to Financial Freedom. I believe in total *honesty* and *transparency*. That is why before I ever started blogging, I decided that I would share all of my own financial stats. I do this not to brag, but instead to inspire motivate, and also to hold myself accountable. My goal is to be a beacon of hope, motivation, and inspiration for *you*, the reader, by living life by example and sharing it **all** here on the blog. My sincere hope is that you will be able to learn from me - both from my successes and my failures! Read More