Monthly Commentary

June 19, 2013

"Good investors gather information, put that information into current and historical context, then make sound decisions."

This is the truth about index returns and why we don't want to duplicate them. Investors want to know what the index returns are, but the wisest investors use this information very carefully. We consider indexes to be a weathervane, with an accompanying wind speed. It is always good to know the direction of the prevailing winds in addition to their wind speeds. It is also important to know how those directions and wind speeds relate to your flight plan and your destination. I am a pilot and this is pilot talk, but it is very relevant pilot talk.

When a pilot takes off from the runway, they have a destination in mind. The destination may be distant or relatively close, depending on the mission. There generally are a number of weather factors associated with the flight. If it is a long distance flight those weather factors could be several hundred miles downrange. If it is a local flight those factors may be related to local weather conditions. Either way, those weather factors impact the route and the longevity of the flight. When taking off and when landing, the local winds dictate direction. During the 'body of the flight' prevailing winds will provide a benefit or a impediment to the progress of the flight. Rarely do they align perfectly with the course, and it is not necessary that they do.

A professionally managed investment portfolio will normally include several different investment vehicles on varied flight paths to mitigate changeable weather conditions. This is prudent portfolio management. It is unlikely and unreasonable to expect any, let alone all, of the components of a managed investment portfolio to behave like any single index. Rather, it is important that they collectively pull the portfolio in a direction and at a speed that is consistent with the long-reaching objective.

Flying and investing have a number of correlations. They are both optional. I know several people who have opted to never fly. Coincidentally, these people have also opted to never invest. The alternative to investing is to save money in a bank or in a mattress. These days the rates of return are almost identical. Not flying, and not investing, are not critical failures. They are just quite limiting with respects to the outcome. Savers don't care, just as people who don't fly don't miss flying. But investors do care. They realize that their destinations may be out of reach if they don't board the plane and they enjoy traveling!

When you are flying and the winds are favorable, and when you are investing and the indexes are favorable, you can generally expect to make good time. Conversely, when you are flying, or when you are investing, and the winds/ indexes are not favorable, you can expect your progress to be impeded. By the same measure, favorable winds/indexes do not necessarily mean that they align perfectly with your individual destinations/investment objectives.

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This is the truth about index returns. Your objectives are YOUR objectives and index returns care nothing about your objectives. They are just favorable or unfavorable winds that you encounter along your journey. We discuss index returns and we provide index returns as required by industry standards as indications of prevailing winds along the journey. We do NOT present them as a measure or a yardstick to compare to your results as you continue upon your personal journey. Your investment objectives and risk tolerances should have very little to do with the very changeable winds that will occur along the way.

Edward D. Foy
Manager, SELECTOR® Money Management
www.foyfinancial.com, Ed@foyfinancial.com
(800) 456-4380

 Sources: Bloomberg, Marketwatch.com, StockCharts.com.