Monthly Commentary
February 21, 2018

What You Don't Own Can Be As Important As What You Do Own

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

When you have been investing for a long time, like my thirty-eight years as a professional, you learn how to simplify the process. The basic skills and lessons gradually become more clear. This is in sharp contrast to the early days, when the rules alone could befuddle the mind, let alone the financial market's gyrations. One of the more subtle advantages of having earned experience in a field of endeavor is that you are surprised less often by the events of the day. You have seen it before. You remember how the process transpired in the past. You recognize the sequences that preceded and followed similar events. Perhaps most importantly, you don't get too excited or discouraged, and are more capable of taking appropriate action.

Now, this does not mean that eventually the activity of financial markets appears to become clear as day. Financial markets are the brain child and the playing field for the most aggressive, most brilliant people on earth. They utilize the services of the most complex computers, computer programmers, and artificial intelligence algorithms that mankind can devise. Yet, an experienced investor learns to recognize certain patterns in the market activity that can lend clarity to seemingly hopeless confusion. They have their own protocols and algorithms that assist them in navigating towards their objectives.

One of the most profound lessons I have ever learned is that it's not as important what you own, as what you don't own. Our current Bull Market in equities is a great example, especially over the past twelve months. Equity indexes have advanced in a remarkable fashion over the past twelve months. The move has been broad, but it has NOT been all-inclusive. If you were unfortunate enough to own positions in energy and/or real estate securities over the last rolling 12 months your portfolio has NOT grown at the 17% rate of the S&P 500 Index and the Russell 3000 Index. Over that same period of time the Morningstar US Energy Sector Index fell -3.4%, the Dow Jones Utilities Average only gained +3.6%, and the Dow Jones US Real Estate Index fell by -1.8%. So why would anyone waste their time and their portfolio dollars on these sectors when there were so many wonderful choices!

If you want to be a better investor, Job One is to avoid playing with the broken toys. Identify not only what IS working, but what is NOT working. This means that you have to be paying attention to the entire toy box all of the time. Unfortunately, most people don't have the time or the resources to be this discerning. So they make decisions to either 1) choose a professional to assist them, 2) pick and choose on their own and hope they get lucky, 3) resign themselves to owning the whole toy box with its sub-par results. Obviously we have a strong opinion on the most effective solution. This is one of the most important ways that we help investors manage risk. It's worth the price of admission all by itself.

Every investor is different, and deserves their own, unique solution. While we do utilize investment models representing multiple styles, the exact solution depends on our client's exact situation. Different investment models address different investment objectives, bring consistency to the solutions, and efficiency to the execution. However, all of our investment models share the same risk management principles of avoiding what is not working. This holds true for bonds as well as for equities. It is also a natural reality of investing in diversified models that you are not going to pile all of the assets into one asset class, no matter how many home runs it is hitting at the moment. It is nice to have a home run hitter or two in the lineup, but it's even better to have runners on base consistently. For an efficient portfolio allocation, this means implementing multiple asset classes into the portfolio. It does NOT mean including a player that can't get on base for their life, in the hope that one day they will get lucky, or unlucky enough to get hit by a pitch.

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