April 2016
Market Comments

The Final Score is the only one that matters

The NY Giants finished last season with a disappointing record of 6 wins and 10 losses. If each of their games had ended at the 2 minute warning they would have had 10 wins and 5 losses and one tie.

At the end of the first quarter 2016, both the S&P500 and the DJIA were in positive territory after being down more than 10% in February.[1]

These facts make us think about how and when we should measure investment results. Interim results can be instructive, but market swings between measurement periods can also cause behaviors that detract from performance. We will have ups and downs along the way, but the Final Score for investing is having sufficient assets to satisfy your financial goals.

As a Giants fan, life would be much better to take an early lead, maintain it throughout the game, then finish with a win. Likewise, we would prefer if our investments gained value every day so that each monthly statement showed ever increasing account balances. The reality of football and investing make these "low stress" scenarios impossible. Markets move up and down making short periods of time unpredictable. Over the longer run, as we have written in past letters, history tells us that equity markets will give us superior returns.

During the first quarter the US economy maintained its slow growth. 2015 full year GDP grew at 2.4% while the employment situation continued to improve[2]. Unemployment is low at 5% with encouraging signs of more people coming back into the labor force (an indicator of a strengthening economy[3]) Early estimates for first quarter growth are coming in low, but for now the US seems to be on a moderate slow uptrend[4]. In December the FED raised their target funds rate by 25 basis points in a signal that they feel the economy is on solid footing. After the first increase in 7 years, pundits were expecting multiple rate increases in 2016. Seeing capital market turmoil in the first few weeks of the year the FED decided to take a more cautious approach to additional rate increases. Economies outside the US are still weak with recessions in Russia and Brazil continuing longer than many expected. Weak oil prices are taking their toll on many emerging economies. China continues to report reasonably good 7% growth but the boom days of fast growth and big construction spending seem to be waning[5] (The US presidential election cycle has been dominating US media and even getting good coverage outside of our country. It's too early to predict the impact that any of the candidates may have on our economy but we will be watchful as the election progresses.

The S&P 500 Index (total return) finished the 1st quarter up 1.35% after the worst ever start to a year[6] This emotional roller coaster hit a low in mid February. On February 11, the S&P 500 closed at 1,829[7]… down 11% for the year; crude oil was $26/bbl…the lowest price in 12 years; and economists warned of the impending recession[8]. Then in the latter half of the quarter with

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continued good employment reports, comforting talk from Janet Yellen and a potential OPEC/Russian oil production agreement, the financial markets returned to a state of normalcy. If you did not hear a news report or read a paper for 3 months, the financial markets on March 31 were not much different than they were on January 1. But all of our emotions were frayed in the middle of February and the human tendency to sell into the panic was perfectly normal. These are the times where we need to take a longer term view and hold our course.

With an objective of meeting our long-term financial goals, we need to achieve the best returns available to us as investors. We find the best approach is to be Balanced and Steady:

- Balanced - creating an asset allocation fit for our stage of life and our financial goals
- Steady - resisting our emotional reaction to be overly enthusiastic when markets are up and overly fearful when markets are down

Both of these fundamental tenets of investing relate to the purpose of our money. For most of us, we are saving and investing to meet our life goals. Having the right asset allocation based on when you will be using your investments is critical. If we have 10 or more years before we need to draw on our investments, we can tolerate more market volatility and keep a higher percentage of equity in our portfolio. As we get closer to the point of drawing down our investments, we would have a portfolio with less equity. Because of the long term outperformance of equity over other asset classes, we will always recommend some equity allocation in all portfolios.

We are investors and not traders. We strive to keep a steady focus on long term results. The most important measurement is the overall return. Interim results, much like the score at the 2-minute warning of a football game, are instructive as a guide but not the most important measure.

One of our favorite quotes from Warren Buffett is “be fearful when others are greedy, be greedy when others are fearful”. Though simple to understand, our natural instinct causes us to react inefficiently to short term information. Signs of trouble cause us to worry about losing our nest egg and drive us to take action to protect what we have. On the other hand, once our investments start to grow, we become more optimistic which gives us confidence to invest more. Investing decisions based on these emotions have been proven to deliver lower returns. A study by Dalbar “Quantitative Analysis of Investor Behavior” shows that retail investor timing of buying and selling investments causes underperformance.

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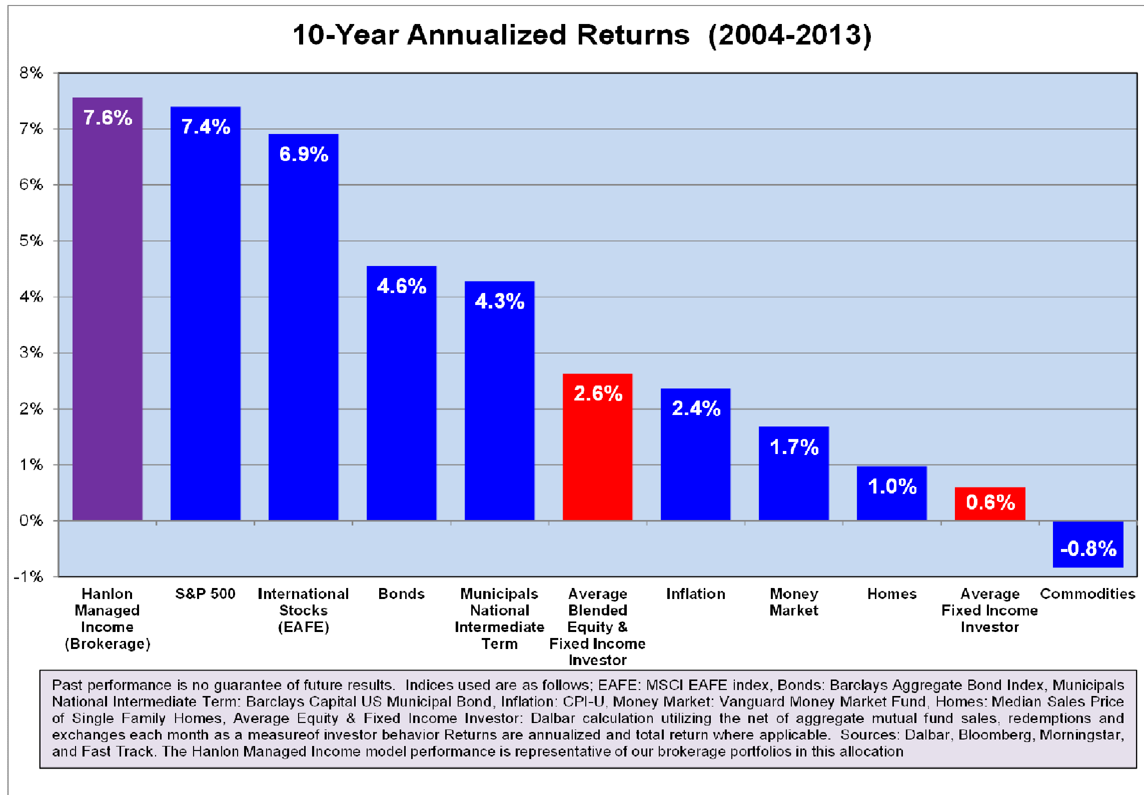

For the 10 year period from 2004-2013, the Dalbar study chart above shows that the S&P 500 was up 7.4%, bonds were up 4.6% and sadly the average investor earned only 2.6%. Analysis of the data shows that the predominant reason for investor underperformance is the timing of when investments are purchased and when they are sold.

We are dedicated to work together with you to ensure that you have a good plan, the right asset allocation and keep a steady approach to investing to avoid the pitfalls of bad timing. To achieve this goal we believe the following steps are essential:

1. Understand the purpose for your money - financial goals
2. Project new money to be invested and money to be withdrawn
3. Set an asset allocation that matches your goals and your timing
4. Monitor performance - making trading decisions to opportunistically add when values exist and trim positions when markets seem over extended

We have worked with many of our clients on the broader perspectives of financial planning and welcome anyone who has not yet had these conversations with us. Knowing the purpose of your money and when you will be needing it to meet financial goals lets us all know when the "Final Score" is important.

Russ, Ralf, Brett, Bruce and Rob

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Sources:

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2. Bureau of Labor Statistics for GDP
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5. Trading Economics http://www.tradingeconomics.com/china/gdp-growth-annual
6. Yahoo Finance, March 31, 2016
7. Yahoo Finance, S&P 500 Index (price return) March 31, 2016
8. US Energy Information Administration, Petroleum & Other Liquids, Spot Prices, February 11, 2016

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