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February 2019 Investment Commentary

As of the end of February, U.S. stocks have recovered from most of the declines experienced last fall, with the S&P 500 about 5% below the all-time-high point reached last August. Now that stocks have made a strong recovery, it's important to review some key takeaways and lessons learned from last fall's bear market[1].

If last fall's market correction felt bad to you, there's good reason for it: the market decline reached 20% from peak to bottom, earning it the designation of "Bear Market". Over the past 71 years since 1947, only nine years have experienced worse declines. How did you react to last fall's bear market? Did you panic to the point where you wanted to sell your stocks? If so, you may want to contact our Group to discuss adjusting your asset allocation to a more conservative weighting. While doing so will lower your long-term return, it's important to consider that at some point we will experience a market correction worse than the one we experienced last fall. If such a large correction would push you to the point of wanting to sell your stocks, then you would be selling stocks at depressed prices. Better to know thyself and sell today at high prices than panic and sell at low prices at some point in the future. While our Group knows on the basis of logic and data that the higher the proportion of stocks an investor owns, the higher the long-term return they will achieve, we also know that emotions have a crucial role in an investor's ability to stick with an investment process, as well as their overall well-being and quality of life[2].

The ability and willingness to stick with your investments through the tough times depends not just upon your emotions, but also upon your confidence in your investment process. The investment process our Group practices was pioneered by Warren Buffett's mentor Ben Graham during the early 20th century. It treats stocks as long-term ownership positions in businesses, rather than certificates to trade on daily or quarterly emotional whim. It also involves only buying businesses that can be purchased for fair value or less. Many of history's most successful investors have followed this investment approach over the past one hundred years. Furthermore, all of the companies our Group invests in have a demonstrated track record of successfully managing through a continuous stream of unprecedented crises. Our Group has the utmost confidence in our investment process, and would never consider selling an investment as a result of temporary market pessimism, regardless of how bad that pessimism becomes. For investors who lack the confidence to stick with an investment process through the hard times, it's critical for you to align yourself with financial advisors who do possess that confidence. Many financial advisors have little more confidence in their investment skills than their clients do, which leads them to panic and sell when markets decline, just as their clients would. This sort of behavior is likely to have a detrimental impact on an investor's retirement plan and financial wellbeing. For example, a recent study by DALBAR showed that the average investor in a blend of stock and bond mutual funds earned a 1.9% annual return for the thirty years ending 12/31/2016. This poor result compares to an annual return of 8.3% for investors who simply bought and held over that time period (as calculated from the S&P 500 and Barclays Aggregate). The study attributed the dismal result achieved by investors to poor behavior, mainly buying during good times (when stocks are high) and selling during the tough times (when stocks are low). What's truly unfortunate about this behavior is that a lot of it is driven by financial advisors themselves. These advisors either have discretion over client assets and make these decisions without consulting their clients, or they recommend these poor decisions to their clients and convince them they're the right thing to do. Every correction in the history of U.S. stocks has been temporary, and the same will be true of future corrections. Panicking and selling as a result of a stock correction certain to be temporary never has and never will make sense, with the exception of certain emergency financial situations (which advisors and their clients should have mostly planned for)[3][4].

A final important takeaway from last fall's bear market consists of avoiding the most popular investments. While riding the coattails of investments that go up solely on the basis of momentum can feel great for a while, history has shown that it almost never ends well over the long-term. Over the past few years, investors flocked to highflying tech companies such as Amazon.com and Netflix, which in many cases had lots of growth potential but not necessarily profit and cash flow potential. During the bear market last fall, those companies led the market declines, as investors turned defensive and moved into companies with sound, proven profits and cash flows. A crucial point is that the U.S. economy remained strong during last fall's stock market decline. What do you think will happen to overvalued growth companies when our economy actually experiences a recession? Last fall was just a preview of the damage such growth companies will experience. When an actual recession hits, the carnage from owning the most popular investments will be far worse[1].

History is full of other examples where the most popular investments led to steep investment losses. Warren Buffett gives the example of overenthusiasm for auto and airline companies in the past. These companies were the Amazon and Netflix of their era – the hot new technology companies that promised to transform the world. They had rapidly growing revenue. And they did transform the world. The problem is they ended up not making profits over the long-term. Buffett cites overenthusiasm for auto and airline companies as a main reason why the Dow Jones index was flat from 1964 to 1981. Investors in the index saw no share price appreciation over a 17-year period. Similarly, the S&P 500 was flat from 2000 to 2013 as a result of overenthusiasm for technology companies. Over that thirteen year period, passive investors in the S&P 500 index saw no share price appreciation. How many investors have a retirement plan that allows for no return over thirteen to seventeen years[5]?

Best Regards,

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<u>Sources:</u>

(1) S&P Down Jones Indices LLC
(2) JP Morgan
(3) The Einstein of Money
(4) DALBAR
(5) Fortune