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Looking Back 15 Years

On Course Financial Planning celebrates its fifteenth birthday this month. The past fifteen years have been challenging, rewarding and stressful enough to keep me fully engaged. I've been proud to work in a fiduciary capacity with my clients to help them get and stay on course to achieve their long-term financial goals. The strategy in our collaborative adventure has been to maintain a long-term focus, ignore short-term market gyrations, shun any temptation to time the market, keep an appropriate percentage of assets permanently invested in stocks and maintain an optimistic view of the future. Along the way I've learned a lot about investors and those who offer them advice --

The main reason why people need a goals based financial plan is that they don't know how much money they'll need to retire at the time and in the lifestyle of their choosing. The amount of information available to investors is too vast to absorb and evaluate. The financial media's short-term; market focused reporting is of little or no benefit to retirement planning. Investors don't know where to begin and those who pay too much attention to the financial news can become fearful of investing in stocks - "What if (fill in apocalypse du jour here) happens?" There is no single portfolio allocation that is right for everybody and no investment strategy will work 100% of the time. Your portfolio allocation should be based on your age, risk tolerance, job security, investment time horizon, family circumstances, health, values and long-term financial goals. Accounting for all these variables requires comprehensive financial planning.

Unfortunately for the fearful investor, risk and uncertainty will never go away because there are more things that might happen than will happen. By avoiding stock market risk, investors suffer opportunity risk – missing out on the potential long-term gains that stocks have yielded. Investors seeking to earn a return on their capital that exceeds the rate of inflation must be willing to accept short-term losses for the opportunity to earn gains over the long-term. Planning, or lack thereof, your behavior and emotional responses to the headlines will have a greater impact on your retirement lifestyle than anything that happens today on Wall Street.

I am an advocate of Leonardo da Vinci's dictum, "simplicity is the ultimate sophistication". Any important investment concept can and should be explained to clients in a clear and concise manner. I've devoted much of my writing trying to simplify investing without being simplistic. Simplicity is the product of mastery while simplistic solutions and strategies often ignore important details. I've never regretted sticking to these simple concepts -- portfolios should be widely diversified, hold transparent, understandable, liquid assets in an allocation determined by your financial plan.

The most significant change in the financial advisory business over the past fifteen years has been the rise of the independent fiduciary financial advisor; one who promises to always act in a client's best interest. The traditional product oriented, commissioned sales model is slowly becoming obsolete. Sadly, the financial advisory industry continues to do a poor job of educating and imposing standards on individuals whom they employ as brokers and financial advisors. As long as the client relationship is product and commission based, people seeking financial advice will remain rightly concerned about receiving conflicted advice.

It is not coincidental that the rise of the independent financial advisor, who isn't obligated to recommend specific investment products to clients, has coincided with the increasing popularity of index funds over these past fifteen years. When index funds first became available in the 1970s, the response from Wall Street was derision. *"It's un-American to settle for average!"* Today, the folly of that response is obvious to anyone who's been paying attention. According to S&P, 89% of actively managed domestic stock mutual funds failed to beat their benchmark index over the past 15 years. The market-equaling returns provided by low cost, tax efficient index funds have been enough for most investors to meet their financial goals. As a bonus, they have exceeded the returns achieved by most active investors. Advisors who promote index investing are battling against the multi-billion-dollar marketing budgets of the big-name Wall Street firms. Each year they create more intricate, illiquid, expensive financial products that clients don't understand. It is rarely mentioned that these complex investments have more failure points, making them more fragile than simpler, transparent investments.

Over the past fifteen years I have learned to disregard all forecasts. Investors share a disturbing trait – uncertainty makes us anxious. The apparent randomness of world events is frightening; we yearn for someone to make sense of it all. We know that the world's complexity makes prediction a fool's errand, yet it's hard to ignore the pontifications of well-known investors when they pretend to see what lies ahead. The record of most forecasters, in terms of predictions and performance is underwhelming, at best. Forecasters work in a dark room where only those who overestimate their insight dare to venture. There will always be someone who becomes famous for making a noteworthy prediction that came true. Soon thereafter, they'll likely enter the slough of flawed predictions, to the dismay and impoverishment of their acolytes.

Financial markets are dominated by institutional investors who earn a fortune speculating with other people's money. Their upside potential is unlimited, yet they assume almost no personal financial risk. Some gain prominence by producing superb short-term results but there is no way of knowing if these results came from exceptional skill, or a dose of exceptional luck. Eventually their success will end because market beating performance is the by-product of taking on more risk -- which contains the seeds of future underperformance.

Market timing strategies didn't work in 2004 and they still don't work today. Market timing is the modern-day equivalent of alchemy; the pursuit of an illusion. Yet, like mole trails in my lawn, they seem to reappear on a regular basis because if you could develop a successful market timing strategy, you'd get very rich very quickly. But market timers need to be right twice – getting out of stocks before the decline and back in before the recovery. Unfortunately, absent Divine revelation, the day a decline starts and the day the rebound begins can only be known after the fact. During the financial crisis, billions of dollars fled stocks and remained on the sidelines during the big rebound that occurred in the last half of 2009 - turning temporary price declines into permanent losses. Few claims of successful market timing strategies are validated by third-party independent analysis. John Bogle, founder and former CEO of the Vanguard Group, made this observation that all investors should heed --*"After nearly 50 years in this business, I do not know of anybody who has done it (market timing) successfully and consistently. I don't even know anybody who knows anybody who has done it successfully and consistently."*

Probably my most disheartening observation of the past fifteen years is that many financial advisors possess low self-esteem. What else can explain why so many advisors fear that they won't attract new clients if they don't explicitly or implicitly offer market beating performance as part of their value proposition. No advisor can control your portfolio's performance -- it will be the returns that the capital markets yield in proportion to its asset allocation minus the fees that you pay. Few financial advisors are forthright enough to admit this fact. None can identify funds that will outperform or securities that are being mispriced by the market (all other investors). Benjamin Franklin hit the nail on the head when he said, "*One man may be more cunning than another, but not more cunning than everyone else."* Advisors who offer a market beating value proposition are on a stress and anxiety merry-go-round that they can't escape. They hope that clients won't ask why yesteryear's recommendations have been replaced by today's great new ideas. Their value proposition attracts performance maniacs -- the worst clients imaginable. They have no loyalty and will switch advisors if promised a higher return -- adding client replacement to the to-do list of these continually stressed advisors. In my experience, most clients don't ask for this performance bonus. They are looking for a trustworthy financial professional who can provide perspective, advice and the peace of mind that comes from having a comprehensive, goals based financial plan.

Economics is not a science; it's a collection of differing opinions. In science, cause and effect yield repeatable outcomes, so the scientist can say, *"If A, then B."* Show two economists the same data and they'll often come to different conclusions. The difference between science and economics is the involvement of fallible, emotional human beings. Each day's stock market activity consists of millions of nonscientific, individual transactions between fallible people; most of whom can't separate their money from their emotions. Some economists see the glass as half-empty and others see the glass as half-full. The historical record, including the last fifteen years, reveals that the half-full crowd has been correct more often than the half-empty crowd. This is because our economy is not a house of cards. It is the product of centuries of free-market capitalism. Unlike a house of cards its stability increases as it gets larger and more citizens enjoy the prosperity that it offers. Unique among our global economic rivals, America has a growing population which is expected to increase from 325 million in 2018 to 400 million by 2040. A larger population means greater consumer demand for goods and services – everything from toothpaste to houses - more economic activity, more jobs and greater national wealth.

People who say that investing in stocks is gambling don't understand investing or gambling. Gamblers deal with risk, but investors deal with uncertainty. The two words are not synonymous. Betting on a roll of the dice has a known probability of winning. Investors will always be at the mercy of the unpredictable and unexpected because there are so many variables that influence asset prices. The gambler may lose all his money but an investor with a globally diversified allocation to equities cannot (short of the end of the world) lose all his money. Since no one knows which asset classes will be the best performers in the years ahead, diversification across many asset classes is the best defense against ongoing uncertainty.

History is the story of how people reacted to unexpected events. But there are few fields of human endeavor in which history counts for so little as in investing. Each year, the amount of past data increases but it doesn't enhance our ability to forecast future market returns. We can calculate the historical performance of any portfolio but what it will yield from today forward cannot be predicted. Be skeptical of any analysis that uses past data to predict the future. When it comes to investing, the rearview mirror is always clear, and the front windshield is always obscured.

Just like our ancestors, we are gullible, greedy and tempted by the opportunity to acquire quick riches. Too often, we become impatient and try to receive short-term gains by trading long-term assets. Since human nature doesn't change, each generation of investors repeats the mistakes of prior generations. That's why bubbles, panics and crashes have been with us for 500 years. There is nothing new under the sun and the financial markets will continue to remind each new generation of investors that foolishness carries a high price.

Unfortunately, there is no truth filter for financial books. Too many authors appeal to investors' fear or greed (whichever is in vogue at the moment). These authors and their publishers aren't interested in educating you; they're interested in selling books with easy to follow stories that will be remembered long after you've forgotten the details. My local used-book store contains books about how to profit from runaway inflation, or deflation, how to make millions through market timing and, even today, how to get rich flipping real estate. Caveat emptor.

Speculation is the desire for quick profit and a rejection of the virtues of thrift, deferred gratification and hard work. It has attained respectability, sitting comfortably at the table with legitimate investing. I've come to hate speculation and pity speculators. How do I define speculation? Any strategy attempting to outperform the market is speculation, since all these strategies are based on someone's prediction about the future. The reason the investment media is overflowing with forecasters is that there are so many speculators seeking guidance.

When you first begin investing, your portfolio won't yield big dollar gains with typical market returns. Throughout the years, the most important action you can take is funding your portfolio on a regular basis; especially during times of market volatility. Your savings will exceed your investment gains for many years. Eventually, your investment returns will exceed your annual contributions and your portfolio growth will start surprising you.

It is a long-standing tradition among financial advisory firms to provide periodic reports detailing the performance of client portfolios on a percentage basis. But percentage-based reports can be misleading because a percentage number is not a fixed measurement of value. For example, a 10% return on a $10,000 portfolio does not produce the same monetary gain as a 10% return on a $100,000 portfolio. Percentages don't reveal whether you are on track to achieving your long-term financial goals. The only useful function of percentage-based performance reports is to compare the performance of actively managed funds in your portfolio to their benchmark index – an unnecessary activity for passive index investors. I prefer to use a performance reporting format that emphasizes the dollar change in investable assets over the past year. The endgame is dollar accumulation. I don't care if your net worth increased because of portfolio performance, additional contributions on your part, an inheritance or if you got lucky in the lottery. Progress on the journey to achieve your financial goals is best measured by focusing on net worth accumulation, not rate of return.

Risk is always proportional to expected return, which is not the same as saying that taking extra risk leads to greater return -- a distinction that you ignore at your peril. No investor is guaranteed a higher return simply because they take more risk. If riskier assets could be counted on to produce higher returns, they wouldn't be high risk investments and would yield the same return as Treasury securities.

New retirees who roll over their former employer's 401k plan to their IRA are in a vulnerable position. For the first time, these assets are under their full control. Few have the knowledge to manage these assets on their own. This makes them easy marks for unscrupulous financial advisors who promote unsuitable products and investment strategies.

Setting an arbitrary retirement age of 65 makes little sense to me, especially when considering the longer life expectancies today. Your life doesn't suddenly change on your 65th birthday, so why put this imaginary finish line on your calendar? Everyone needs a reason to get up each morning and perpetual leisure won't satisfy most people.

The cost of good financial advice is a fraction of the money that will be lost without it; it's worth more than its weight in gold. Bad financial advice is worth less than its weight in sand. This is probably the simplest, most valuable truth that I've written in the past fifteen years.