On Course Financial Planning
Facing the Future with Optimism and Courage
October 2024
Vectors

geo@oncoursefp.com
425-861-9997

Quit Tinkering With Your Portfolio

Good financial planning starts with the assumption that the future is uncertain, future rates of return are unpredictable and that diversification is an essential component of any prudent investment strategy. If you stop and think about it, most conversations you have had with financial advisors or stockbrokers assumed just the opposite. You've been led to believe that the advisor, or his firm, has a clear understanding of what lies ahead for stocks and the economy or that they can recommend funds whose managers are so enlightened. Such conversations are inevitably product and market focused, not client focused.

Good financial planning takes time. Gathering and analyzing client data, discussing financial goals, and developing a plan to attain them should not be rushed. An analysis of risk tolerance, insurance coverage, income, expenses, and employee benefits should precede any portfolio allocation recommendations. The role of your invested dollars is to achieve your financial goals so they should not be allocated until we know more about you. A good financial plan containing a comprehensible investment strategy is the best defense against our natural tendency to make shortsighted, emotional investment decisions.

Upon completion of the financial planning process, your portfolio becomes the servant of your financial plan. You can control your portfolio's inputs but not its performance, which will be determined primarily by its asset allocation. I am often asked, "How often will you look at my portfolio?" Some clients are bewildered when I answer, "As infrequently as possible." Perhaps it would sound more reassuring if I answered, "As often as I look at my own." My portfolio consists solely of exchange traded index funds (if nothing else, I eat my own cooking) and is designed to meet my financial goals at an acceptable level of expected volatility. Consequently, I never tinker with it and ponder its allocation only during its annual rebalancing. Unless there are major changes in your personal circumstances, an annual portfolio review and rebalance should be sufficient. For the next 12 months you can concentrate on the more important and enjoyable things in life. It has been my experience that most clients find the peace of mind that comes from a "set it and forget it" strategy well worth the effort necessary to create a personal financial plan. The financial media's never-ending babble gives many investors the erroneous impression that their portfolio requires constant tinkering. By tinkering I mean changing your asset allocation based on what is happening in the market or someone's dubious prediction about what is about to happen.

Permitting a broker or financial advisor to tinker with your portfolio might be the worst idea you have had in a long time. Unfortunately, most investors work with advisors whose compensation is commission based. Commissioned advisors must find reasons to tinker with client portfolios to earn a living, making a market focused investment strategy the likely outcome. The first piece of advice I received when beginning my journey as a financial advisor was from a friend who had been an independent broker for many years. "If I were starting again today, I would not use commissioned compensation. I would use a fee-only compensation model." "Okay, let me write that down." was my reply. It was the best advice that I received as I began my journey as a financial advisor.

To many investors this type of plan focused, buy-hold-and-rebalance strategy seems too simple, too good to be true. (It is simple, but it is not simplistic -- there is a difference.) Wall Street's representatives and their willing accomplices in the financial media hope you will never see the light. After all, if you have sworn off portfolio tinkering you do not need the financial media. All those ads for investment products are designed to get you into a portfolio tinkering mode, even though numerous studies have shown that more frequent trading leads to lower returns. Too often the big winners in the "outsmart the market" game are, in John Bogle's words, the croupiers in the Wall Street Casino.

Most financially secure retirees will admit that they rarely looked at their portfolios during their accumulation years. They just funded their accounts year after year and one day discovered that they had more than enough to retire. Look no further than a recent report from Fidelity, which shows the number of 401(k) millionaires on its platform has reached 500,000 for the first time. The typical Fidelity 401(k) millionaire stayed disciplined, investing every month through their salary deferrals, regardless of market conditions. Whether markets were rising or falling, they stayed the course. Over time, their patience and discipline compounded into substantial wealth. Investing is more a marathon than a sprint, and short-term volatility is not a reason to take your eyes off the prize.

You need a personal financial plan; one having a comprehensible investment strategy based on your personal goals, not what the market did yesterday or what someone thinks it will do tomorrow. Take a pass on the barrage of new products offered by the Wall Street Promise Machine. Use low-cost index funds to create a diversified portfolio. By doing so, you will give less money to Wall Street's asset eating dragon; you will have more dollars working on your behalf and maximize your chances of reaching your financial goals.

In The News

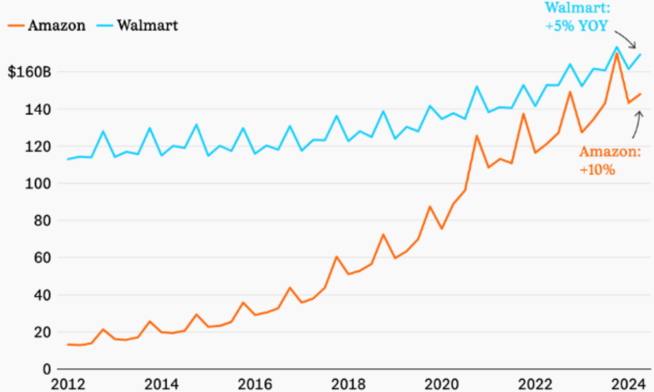
I have often said that crypto is a global, digital pump and dump scheme. Last month it was reported that the Securities and Exchange Commission (SEC) has obtained an emergency asset freeze against Jonathan and Tanner Adam, along with their associated entities, GCZ Global LLC and Triten Financial Group LLC. The brothers are accused of orchestrating a $60 million Ponzi scheme that defrauded more than 80 investors across the United States between January 2023 and June 2024. The SEC claims that the Adams brothers lured investors with promises of up to 13.5% ***monthly*** returns, falsely asserting that Jonathan had developed a "bot" to capitalize on arbitrage opportunities within the crypto market. Investors were told their money would be pooled into a lending fund which would finance "flash loans" for crypto trades. The SEC alleges that the lending pool never existed. Instead, the brothers used investor money to pay returns to earlier investors and to fund personal expenses. Tanner is accused of using investor funds to cover payments on a $30 million condominium in Miami, while Jonathan allegedly spent $480,000 on luxury vehicles. The complaint further reveals that Jonathan Adam misrepresented his background to gain investor trust, omitting the unpleasant fact that he had previously been convicted of securities fraud. Raising $60 million from crypto fanatics in 18 months by promising monthly returns of up to 13.5%. What could go wrong?

Financial journalism has turned into little more than 24/7 fear mongering. It considers consensus forecasts as holy writ, rather than a collection of random guesses about the future. Sadly, there will always be economic, political or market events proclaimed by the financial media's talking heads to be potential destroyers of everything that we hold dear. Why are economic and market forecasts so prone to error? It's because both are influenced by the emotions and irrationality of investors and the randomness of events. Studying history might help forecasting accuracy but, unfortunately for forecasters, things that have never happened happen all the time. Human nature is the one constant across all market and economic cycles, and human nature will never be predictable.

As Yogi Berra has famously said, *"It's tough to make predictions, especially about the future."* This self-evident fact seems to have been forgotten by the so-called experts, such as fund managers, media commentators and academics, who are no better at predictions than anyone else. Basing your investment strategy on forecasts is a recipe for disappointment. Now for this month's lesson in "Why You Should Ignore All Forecasts." The S&P 500 ended 2023 at 4,770. On Sept. 30th it closed at an all-time high - 5,762, a year-to-date 22.1% gain, including dividends. Year to date through September 30th, there have been 43 all-time highs in the index. There have been 27 days with a gain of 1% or more and 14 days with a decline of 1% or more. Did any of the big-name Wall Street forecasters queried by Bloomberg last December see this good news on the horizon? Of the 21 economists who responded, eight predicted a loss for the S&P 500 in 2024, led by JP Morgan's forecast for a 12% decline in the index. The highest forecast came from Yardeni Research – a 12% gain for the year. The average year-end 2024 price target from the experts was 4,861 – just 2% above the 2023 year-end value. At the end of the third quarter, the index was 362 points above the highest year-end price target from those Wall Street experts, and 20% above their average price target. I am amazed by the ease with which past erroneous forecasts are so easily updated and explained away by "experts" who cannot stop telling us what the future holds. Ignore the temptation to invest with someone who pretends to know the future and get comfortable with uncertainty. I agree with Yogi - no one knows what will happen in this year's final three months, but I like what I see so far.

Iran held Washington Post reporter Jason Rezaian for 544 days in 2014-16. When he was freed, the IRS expected him to pay $200,000 in back taxes with interest and late penalties, despite knowing he was unjustly detained overseas. IRS agents said they did not have the legal authority to remove the charges. The three freed Americans held hostage in Russia and released in August are now facing IRS fines and fees assessed while they were in captivity. According to the Wall Street Journal, *"When it comes to issuing penalties, the IRS doesn't discern unlawfully detained citizens from those unscrupulous individuals avoiding taxes, as there's no pause or postpone option available while wrongfully detained…the failure to file penalty is 5% of the unpaid taxes for each month or part of a month that a tax return is late."*

Last month's big economic news was the Federal Reserve's decision to begin lowering interest rates. That was seen as good news for stocks but let us not forget that one person's expense is another person's income. Although borrowers are happy with lower interest rates, savers, who are interest income recipients, do not see lower rates as good news at all.



In a free market economy, if something can be done better, faster, and cheaper, it will eventually be done better, faster, and cheaper. And consumers will flock to the company that provides the goods and services that they desire better, faster, and cheaper. Now, from a show of hands out there, how many of you enjoy being able to order something from Amazon while sitting in your living room drinking coffee and have it delivered for free to your doorstep tomorrow before noon? This chart compares the gross sales of Walmart and Amazon since 2012. It seems apparent that more of us are taking advantage of better, faster, and cheaper. Count me in.

October is Cybersecurity Awareness Month. Recently, I have received several "Hi, how are you?" text messages from strangers. Being from Brooklyn, "What's it to you?" followed by Delete is my usual response. These texts are sent by scammers, hoping you will answer and take the bait. According to the FTC, scammers will apologize and then engage you in friendly banter to keep the conversation going, hoping to gain your trust. Once they have your trust, they will offer advice on investing in cryptocurrency or some other investment…for a fee. But it is a scam. I have also received grandparent scam calls from people pretending to be my grandchild, purportedly in jail. Money is needed immediately. If you get this type of call, just ask the caller to tell you his mother's name and then hang up before he does.

If Only

12 Asset Classes (Indexes) 1999-2023	25-Year % Annualized Return
Large US Stock	7.56
Midcap US Stock	9.69
Small Cap Value US Stock	9.65
Developed Non-US Stock	4.43
Emerging Stock	7.88
REIT	8.39
Natural Resources	7.10
Commodities	5.94
US Bonds	3.85
TIPS	4.79
Non-US Bonds	2.59
Cash	1.77

Performance figures above are based on the following indexes: S&P 500, S&P Mid Cap 400, S&P Small Cap 600, MSCI EAFE, MSCI EM, S&P Global REIT, S&P North American Natural Resources Sector, Deutsche Bank Liquid Commodity Index Excess Return, Bloomberg U.S. Aggregate Bond, Bloomberg U.S. TIPS, Bloomberg Global Treasury ex U.S., U.S. 90-day Treasury Bill.

"If only" is a common refrain of investors lamenting that they were not invested in a recent outperforming asset class. This chart is from a report by Craig L. Israelsen, PhD, of the Woodbury School of Business at Utah Valley University. It shows the annualized annual return from 1999 through 2023 of 12 different asset class indexes that make up his simple 12T Portfolio. The 12T portfolio allocates 8.3% into each of 12 index funds that track these asset classes. If the 12T portfolio was rebalanced each January it would have netted a 25-year 7.0% annualized return - higher than the return of six of the asset classes and not too bad for a remarkably simple allocation strategy.

Another strategy would be to put 100% of the portfolio every January into the asset class that had the best performance in the prior year. This performance chasing, "momentum" strategy would have yielded an annualized return of 2.8% - welcome to reversion to the mean.

What if each January you placed 100% of the portfolio into the worst performing asset class of the previous year, hoping to benefit from reversion to the mean? That strategy produced a 25-year annualized return of 4.5%.

Of course, the best results would come from having perfect foreknowledge and placing 100% of your portfolio each January into the upcoming year's best performing asset class. This would have yielded a 29.9% annualized return. However, absent divine revelation - and neither you nor anyone you have met, or will meet, has such insight - picking the upcoming year's winning asset class for 25 consecutive years is impossible. It would be like trying to pick the Super Bowl winning team at the beginning of every NFL season for 25 consecutive years. Good luck with that. Besides, it is foolish to commit your entire portfolio to any single asset class. Boring, broad-based diversification of your portfolio using index funds is not only something anyone can do, but it has historically generated returns that have been adequate to meet most investors' long-term financial goals. The best strategy for most people is to contribute as much as you can on a regular basis to a well-diversified portfolio of index funds and stick with it for several decades. In investing, as in all aspects of life, perfection is impossible, and foreknowledge does not exist. In investing, boring is good and slow and steady wins the race.

Disclaimer - The information in this newsletter is educational in nature and should not be considered as personal investment, tax, or legal advice. Each reader must determine how its content should be applied to their investment portfolio. This newsletter is not a solicitation to sell investment advisory services where such an offer would not be legal. Investing in stocks and mutual funds involves risk and the potential loss of principal. Historical data has been obtained from sources believed to be reliable. Past performance is not an indication of future returns. The calculations or other information in this newsletter regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are shown for illustrative purposes only. Unless otherwise noted, rates of return reflect historical annual compounded total returns including the reinvestment of dividends but do not include taxes, fees, or operating expenses. If included, these additional costs would materially reduce the results. Index performance is provided as a benchmark and is not illustrative of any particular investment. It is not possible to invest directly in an index. All expressions of opinion are subject to change. OCFP accepts no responsibility for losses arising from the use of the information contained herein.