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Facing the Future with Optimism and Courage
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So Far, So Good

The deadpan comic Steven Wright tells the following joke -- "I'm planning to live forever. So far, so good." It's a silly joke but it contains a kernel of truth that applies to the journey of achieving your long-term financial goals.

Studies in behavioral finance reveal that human nature makes us poor investors because our emotions are more powerful than our intellect. When we become fearful, we treat temporary declines in our portfolio as if they were permanent losses. We tend to see the future as an extension of the present and every day the media provides a litany of bad news. Thus, many investors have decided to play defense, changing their financial priority from winning to not losing. Instead of taking advantage of lower stock prices, investors who have fled to the "safety" of cash are interrupting the compounded capital growth necessary to achieve their financial goals. No matter what you hear from Wall Street's representatives, a portfolio designed to avoid risk must yield lower returns. Eventually, the financial media will announce that it's safe to buy stocks again -- long after they have resumed an upward momentum. Sadly, many investors will compound the error of fleeing stocks by taking too much risk going forward in an attempt to catch up with a train that has already left the station.

With dividends reinvested, the S&P 500 Index has yielded and annualized average return of about 10% for the past 95 years. The S&P 500 returned 31% in 2019, 18% in 2020, and 29% in 2021 – an annualized average return of 27%. Its 13% decline year-to-date through June 3rd has only given back a portion of those gains. While this might provide little comfort, it should come as no surprise. Periodic, and often significant, downturns are par for the course for stock investors. Wise investors understand these three investing truths –

- The economy cannot be forecasted.
- The stock market cannot be timed.
- The only way to be sure of capturing the long-term return of equities is to stay invested and withstand their unpredictable, often significant, temporary declines.

These truths are counterintuitive, and thus unknown, by your friends, neighbors, relatives, and coworkers - most of whom believe just the opposite. Charts and graphs are the stained-glass windows in the church of Wall Street, where ultimate faith is placed in the ability of computers to analyze past data to predict the future. This false religion is relentlessly promoted, even though the disclaimer that past performance is no indicator of future returns appears in every prospectus, in every mutual fund ad and on the lips of every financial advisor that Wall Street employs.

The question being asked today is, “When will the market bottom?” In other words, "When will stocks stop going down so that I can feel better?" Don't be fooled, nobody knows the answer (see investing truth #2 above). If you don't need to liquidate your portfolio in the near future, what difference does it make when the market bottoms? Someone will gain 15 minutes of fame by predicting the bottom, whenever it occurs (if it hasn’t already). Having been the recipient of a big smooch on the lips by Lady Luck, he or she will be heralded by the financial media as its newest seer. Here's the answer to the question - the stock market will go down until that unpredictable day when it reverses, and the trajectory of the subsequent advance will leave market timers in the dust – as it always has. As legendary fund manager, Peter Lynch, has said, *“The real key to making money in stocks is not to get scared out of them.”*

Obsessing over your portfolio every time the market falls is a waste of time and emotional energy. What good does it do to worry about something that’s out of your control? You can control what you do, you can control your emotions, but you cannot control how your investments will perform. Investors who are disciplined enough to ignore the headlines and continue funding their plan are likely to discover that the tried-and-true buy, hold and rebalance strategy that has served investors well in years past will continue to prove its value.

There is no investment strategy that will produce positive returns every year. Adopting a market timing strategy to avoid market declines will lead to an ongoing series of “guess when to sell/guess when to buy” decisions and turn you into a compulsive market watcher. The getting out is easy, it’s getting back in that’s hard because market turning points are unpredictable. So let’s ignore those artificial experts who claim an ability to see history before it happens.

Take the long-term view and ignore today's noise. During an annual review with your financial advisor a verdict of -- "So far, so good." is more than a good report -- it is the best report we can hope for in this life.

Warning Signs

Investor gullibility increases in every bull market. It seems that each new generation of investors falls for some kind of can't miss mania, only to experience firsthand how they always end. They become older and wiser but eventually another generation comes along and blissfully ignores the lessons of the past. Over the past three years, fear of missing out (FOMO) has led many naive, first-time investors to get caught up in the hype and herd mentality surrounding popular get rich quick investments. Unfortunately for these misguided souls, the price declines have made the stock market decline look tame in comparison. With 20/20 hindsight, it seems obvious that the valuations of NFTs, cryptocurrencies, SPACs, meme stocks and high growth tech stocks would collapse. Everyone knew, (and some made a fortune by not saying), that their prices made no sense. But just as in generations past, it was easy to believe that this time would be different, and that pricing sanity would never arrive.

Regrettably, many financial advisors were enablers of this foolishness. The big brokerage and investment firms are product manufacturers -- they make a fortune selling investments catering to investors' desire to participate in the latest investment fads. How else can you explain Fidelity Investments' decision to launch a crypto product on its 401(k) platform that will allow plan participants to invest in crypto via their company’s core investment menu. Here are some warning signs that the financial advice that you’re receiving may be more hype than substance and more likely to enhance your advisor’s bottom line than yours --

- You get the unpleasant feeling that your financial advisor is more interested in talking about investments than in creating a detailed financial plan that reflects your goals, time horizon and risk tolerance. Good financial planning is difficult work -- it requires a broad understanding of financial subjects, history, and human behavior. It is much easier to sell products disguised as financial planning, which the financial services industry does through its vast network of pretend planners.
- You have never been given an Investment Policy Statement that describes in plain English exactly what your financial advisor is doing with your money. At a minimum, it should contain a list of assets under management, your portfolio allocation, a net worth summary, an explanation of the strategy being used to manage your assets and a clear description of the portfolio rebalancing schedule.
- Your investment portfolio is being allocated following the predictions of some in-house analyst, a well-known artificial expert or God forbid, your investment advisor’s opinion about what markets will do in the near term.
- Every year your advisor has a new and exciting investment idea that requires a reallocation of your portfolio. The most common account churning justification is a plausible sounding story based on current events that concludes that “it’s different this time".
- You're being pitched an investment that promises returns that are higher than what similar investments are yielding.
- Each year, your advisor seems to be promoting investments that are more complicated than the ones he couldn't stop talking about last year. Complexity hides risk and if you don't understand how an investment works you won't understand how you might lose money.
- Your investment advisor seems to have a great deal of certainty about many uncertain things. This is a long-standing Wall Street tradition -- always certain, often wrong.

In some perverse way, incomprehensibility has become an attractive feature of many investments. I believe that simplicity is the ultimate sophistication and that clients are best served when they understand what they own and why they own it. I realize why complexity might appeal to an advisor -- it minimizes questions. But I believe that most investors have little or no need for complex investments that are easier to sell than explain.

Securities In an Insecure World

As we have seen again this year, investors are unnerved by uncertainty. Recently I reread the transcript of a lecture given by a well-known money manager dealing with investing in an insecure world. Here are some excerpts -

On inflation -- *“We have had a small inflation in recent years accompanied by a very large increase in stock market prices. The continuation of some degree of inflation is certainly probable in the future and that is the chief reason why most intelligent investors now recognize that some common stocks must be included in their portfolio.”*

On speculating -- He noted that the distinction between investing and speculating has almost vanished --
“A fact which has caused a great deal of trouble in the past and will cause a great deal of trouble in the future.”

On stock picking --*"It seems to be a ruling tenant of Wall Street that if you practice the proper kind of selectivity in investments you don't have to worry about what the stock market does as a whole…all you need to do is pick the good stocks."*

But he warned -- *"There is no indication that the investor can do better than the market averages by making his own selections or by taking expert advice. The support for this pessimistic statement is found in the record of the investment (mutual) funds, which represent a combination of about the best financial brains in the country, a tremendous expenditure of money, time and carefully directed effort. The record shows that the funds have had great difficulty as a whole in equaling the performance of the Dow Jones Industrial Average or the S&P 500 Index."*

"If they (investors) can get results equal to the averages in an easy way, why shouldn't they try to get substantially higher returns by careful and competently advised (stock) selection?..if the investment funds as a whole can't beat the averages, even pretty clever investors as a whole can't do it either."

Investors own individual stocks because they believe that the market has undervalued them. This is nothing more than a hunch. In the case of financial advisers and brokers, it can only be described as hubris --

"Take the case where an individual stock is favored by one of my own fraternity of security analysts because he is optimistic about its future earnings and general prospects…its prospects are also likely to be fully reflected, and perhaps over reflected, in the market price."

On stock market volatility -- *"I don't see any change in human nature vis-à-vis the stock market which is sufficient to establish more restraint in the public behavior than it showed over so many decades in the past…It is still subject to very substantial over-valuation at times and substantial under-valuation at others."*

On market forecasts -- After mentioning that he made his last stock market prediction 49 years ago he stated --

"I must reluctantly express some skepticism about the general efficacy of economic forecasting, of stock market forecasting and of expert selection of common stocks…to the extent that an economic forecast appears dependable…its effect is likely to be already reflected in the market level. I don't think there is any good evidence that a recognized and publicly used method of stock market forecasting can be relied upon to be profitable."

He recommended investors use portfolio rebalancing and dollar cost averaging and shun market timing. He pitied investors who sell in bear markets and are out of the market when it rebounds --

"Your disappointment would have been so great because of the ensuing advance as probably to ruin you from the standpoint of intelligent investing for the rest of your life."

Finally ---*In my nearly 50 years of experience in Wall Street I've found that I know less and less about what the stock market is going to do but I know more and more about what investors ought to do…..to maintain at all times some division of funds between bonds and stocks...My suggestion is that the minimum position of a portfolio held in common stocks should be 25% and the maximum should be 75%."*

These quotes do not come from some talking head on CNBC or hot shot hedge fund manager. They come from a lecture entitled *Securities In An Insecure World* delivered by the legendary investor Benjamin Graham in November of 1963. He is considered to be the originator of "value" investing, buying the stocks of profitable, out of favor companies instead of growth stocks because - *"We were not willing to accept the prospects and promises of the future as compensation for a lack of sufficient value at hand."*

Graham concluded his lecture by stating – *"According to an old Wall Street story, when a certain broker was asked by a client to recommend issues to buy, he always asked in return, "What is your preference? Do you want to eat well or to sleep well?" I am optimistic enough to believe that by following sound policies almost any investor -- even in this insecure world -- should be able to eat well enough without having to lose any sleep."*

The advice that Graham gave to his audience in 1963 has stood the test of time. It is impossible to calculate the money lost over the past 59 years by investors who ignored his advice. Investors who followed his advice have been handsomely rewarded. A globally diversified portfolio of low-cost index funds and a financial plan flexible enough to be modified when personal circumstances warrant are your best financial resources in an insecure world.