PORTFOLIO WATCH

August, 2016

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Fee FO Only®

Where To or How Fast?

Let's pretend I want to go to Tahoe. Actually, we don't need to pretend. I would love to go to Tahoe. Further, let's pretend I have a tee time at Edgewood in Tahoe at noon, just so we can actually pretend. So now I know where I want to be and when I need to be there. As I drive up the mountain, I'm going to monitor my progress to make sure I'm on track to make my tee time, and to monitor my progress I'm going to get regular updates on how fast my friend is driving to San Francisco. I figure if I'm going at least as fast as my friend, I must be OK. If my friend ends up rear-ending a truck full of alpacas and the freeway (and his car) is a mess, then I'm really in good shape to make my tee time. Huh? If I really thought this way you would probably want to remove all sharp objects from my reach.

Acceptable Nonsense

We can all agree (except for at least one guy I know) that what I described above is complete nonsense. Since this is a financial newsletter let's apply it to investing. Let's pretend I want to retire in 25 years at age 65. To support my marathon running hobby in retirement I'm going to need $3M in my portfolio. So from an investing standpoint I know where I want to be and when I want to be there. So far so good. To monitor my progress, like most investors, I'm going to track the movements of US large cap stocks (S&P 500), because as long as my portfolio is growing at least as fast as this subset of the market I must be doing OK. Even if the market runs into the back of a bunch of alpacas. Huh? How does that make any more sense than my driving-to-Tahoe example? "Well, because the stock market has a good long-term average return." (That was the guy who won't agree with anything.) My friend with the alpaca goo on his grill had a good average time to get to San Francisco. That has nothing to do with me

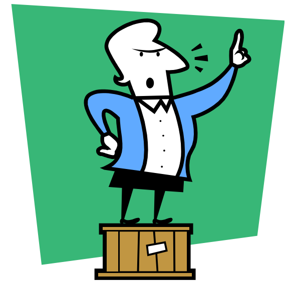
getting to Tahoe before noon, and the average return of stocks has nothing to do with hitting my retirement goal. And yet this nonsense is completely acceptable in the financial world.

Goofing Up Benchmarks and Indicators

The S&P 500 is often considered to be a benchmark for portfolio performance. Benchmarks are used for comparison purposes. If we're ahead we're winning and if we're behind we're losing. But a financial goal like retirement is not a competition. If you are on-track to meet your financial goals, who cares whether you're running ahead or behind the random movements of the market. It's not a competition and, therefore, a "benchmark" is not appropriate. What we need is an *indicator* that tells us whether we are on-track to meet our goals. An average rate of return is a good one. The required rate of return to meet your goals is specific to you and has nothing to do with what stocks or bonds are doing.

How did the industry get this all mixed up? Because most of what we think and how we behave with respect to investing is driven by the mutual fund industry. When choosing a mutual fund it makes sense to measure it against a benchmark because it pretty much *is* a competition. A portfolio, on the other hand, is put together with (hopefully) a diverse set of investments in order to minimize risk, provide more stable and predictable returns, and reach your financial goals with the best chance possible. If you want to spend your investing life in a competition, then I guess worrying about beating a benchmark is a good use of time. If you want to meet your financial goals, then pick an indicator, check on it once a year, and go have fun.

Some (More) News About Veripax



I flew to Boston last month for some meetings at Fidelity headquarters. The purpose was to kick off a 3-month, executive coaching program. Fidelity selected about 20 independent advisory firms nationwide to send through a fairly intense coaching program to help us run our business more like a business. The program will focus on things like providing more value to clients, which in turn provides more value to the business, succession planning, efficiency, organizational improvements, etc. I had to commit to active participation, meeting regularly with an individual executive coach, and being held accountable by a team of advisors made up of 4 of us on the west coast.

As I mentioned last month, Veripax is growing up. To do that well is going to require an increase in discipline, tightening up processes, and perhaps becoming a bit more formal with things like compliance. I don't want to ever lose the personal side of the business, but I think this effort will benefit everyone in the long run.

Market Comments

GDP growth came in below expectations (less than 2%), and that caused the market to waiver a little bit. Then Britain cut their interest rate, which makes the dollar stronger but didn't have much of an impact on stocks. Then the latest job numbers came in a little above expectations and stocks jumped. All of this means that the market is simply responding to news, which it's been doing for a long time. A strong month of job creation is good news, but doesn't mean that everything is hunky dory (I've been looking for a reason to use that phrase). For stocks to add another leg to the bull market we will need to see economic growth, and growth isn't looking so hot. With the market at close to all-time highs and economic growth below 2%, this is a very difficult time to invest in stocks. This is why new accounts are seeing a fairly slow entry into stocks. I'll add them, but only on dips.

I was in Portland this week (in fact, that's where I am as I write this), and the radio in the rental car happened to be tuned to The Money Show. Most people would be instantly horrified when they realized they were listening to a financial program, but I was intrigued. An investment manager from La Jolla who manages a little over $2B was being interviewed. His opinion was that there is little further upside in stocks, or at least more potential downside than upside, and the bond market is pretty much done as an investment (this is a "duh" with interest rates this low). So much for the old 60/40 portfolio. His answer? Tangible assets such as real estate, investments in businesses that can generate a steady return based on their operations, and funds that do something other than just hope that stocks go up. For selfish purposes, I think this guy is absolutely brilliant.