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PORTFOLIO WATCH

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Fee FO Only®

A Performance Guarantee

One of my many gripes about the financial industry is that most advisors will agree past performance is not a guarantee, or if they're honest it's not even an indication, of future performance. But then they will spend their careers convincing people that history does indeed repeat itself, allowing everyone to retire comfortably by simply owning a balanced mix of stocks and bonds. This theory may form the basis of the majority of investment strategies, and some advisors may even believe it, but there's one thing they will all agree on…you can't *say* that you guarantee performance. It's just not done. And yet, I am guaranteeing that the performance of most stock funds is about to get much better.

Performance Has Two Ends

Every mutual fund and many portfolio managers who have been around for a while will quote Year-To-Date performance (as if there is something special about "performance since January"), and also publish performance over the last 1 year, 5 years, and 10 years. The longer the timeframe the more accurate performance is thought to be, and the more indicative of future performance. When choosing a mutual fund, it would seem to make sense to choose one that has a better 10-year record. My guarantee is that many of these 10-year track records are about to look a lot better. Why is that? Because we're getting close to the 10-year anniversary of the real estate peak and the stomach-in-your-throat, hands-in-the-air rollercoaster drop that followed in 2008. In other words, the starting end of 10-year performance is about to go a whole lot lower, and that will make performance numbers a whole lot better without investment managers having to do a thing. That's going to be pretty cool for some funds, because they will essentially be rewarded for how much money they lost during the financial crisis.

Performance Implications

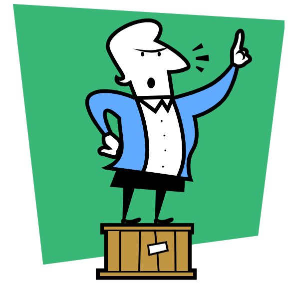
By measuring performance with a fixed duration (5 years, 10 years, etc), the performance is always affected as much by the starting point as the end point. Let's take a look into the future and see what will happen to the 10-year performance of two funds, one with a gain (MBXIX) and one with a loss (LMNOX) in 2008, as well as the S&P. The numbers below show past performance as of today, and then 2 years from now assuming the funds and the market stay exactly the same (no gain and no loss) for the next two years. The only difference is the starting point.

	10-year Avg (today)	10-year Avg (in 2019)
MBXIX	8.63%	6.07%
LMNOX	0.09%	15.06%
S&P 500	4.66%	10.69%

If you started with $10,000 in 2007 and held each of these investments for the last 10 years, the S&P 500 would have resulted in $15,765, LMNOX would have ended up with $10,092, and MBXIX would trounce both with $22,879 (and much less volatility). And yet, if those values don't move for two more years, LMNOX looks like the better investment based on its (future) 10-year number. The S&P 500, and almost all mutual funds, will be rewarded for how much they lost in 2008. It's one of those ridiculous things that is part of the financial industry, but it is something I can guarantee.

Veripax News

There is so much going on, I will be sending a separate letter to clients. It's all good stuff. More staffing, more capabilities, more regulation (I'm not wild about that last one). Veripax Financial Management is at an inflection point in terms of its growth, and it's very exciting.



Market Comments

The market hit the pause button last month as it absorbed the implications of a Trump presidency. There were a couple of big "up" days based on speculation about potentially lower taxes, but the last little boost was fairly short-lived. The Fed kept interest rates flat, President Trump still tweets every day but hasn't fired off any nuclear weapons yet, and so the market is taking a breather.

There are two competing scenarios from a stock perspective over the next few years, and I'm seeing client views on both ends of the spectrum. In one case, we could be in a scenario of lower corporate taxes and lighter regulation, resulting in another move higher for the market, especially small cap stocks and banking. In the second scenario, Trump's "America First" policy backfires into a trade war and all of the gains over the last 8 years evaporate like water in Phoenix in July. Which scenario you think is more likely probably depends on your political leanings, and I try not to let political preferences influence strategy.

I do think we will finally see a pick-up in market volatility, and that is not necessarily a bad thing. I like things that are predictable, and in a normally-functioning market, when stocks go up volatility falls and when stocks go down volatility rises. This is because "volatility" reflects the cost of options used to protect portfolios. This is the natural and logical order of things, and it got pretty messed up with all of the bail-outs, quantitative easing, and stimulus since 2009. For the last 8 years, investors have assumed that the Fed will always step in and fix things if the market drops, and so volatility (i.e. the cost of portfolio insurance) has remained extremely low. Granted, it was good for the stock market, but the only way to take advantage of it was to maintain a belief that the government would always step in and fix things. That's not normal, and I prefer normal.