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A Wealth Management &
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REPORT & COMMENTARY

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TO: **CLIENTS & FRIENDS**
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In the hundred or so years I have been in the investment business (well, really fifty-nine), I have developed some perspective on bull markets, bear markets, market volatility, risk, opportunity, wealth-creation, wealth-destruction – in fact, a book's worth of "feel" for these and countless other components of the finance enterprise. Here are, in capsule form, a few "perspectives" I believe have particular relevance to investors in these volatile times.

1. The ownership of equities (publicly traded common stocks, real estate, private businesses) is the most sensible way for most people to hold wealth. I have maintained this belief through every market cycle since 1963, and it has served me as it has served most investors well (though the devil is always in the details).

Why should this be so? There is something in the way Nature, or the Gods, or Fate have structured the world that makes it possible for us to assess risk and reward with a reasonable (not a perfect) degree of comfort. (I prefer that word to "certainty"; "comfort" is more mushy, less precise, and in keeping with the nature of probabilistic outcomes.) If you conduct your (financial) affairs in accordance with certain well established guidelines, it is probable (not certain) you will enjoy satisfactory outcomes. In my view, these outcomes would approach certainty if it weren't for the possibility that one or more endogenous risks (poor health, inadequate education, inopportune career choices, major uninsured liability claims, the accumulation of excessive consumer debt, divorce settlements, bad market timing decisions, and so on) and the possibility that one or more exogenous risks (war, drought, global climate change, long-lived economic depressions, pandemics and so on) could derail even the most well-thought-out investment plan.

2. On any given day in the history of civilization, there have been at least a thousand "good reasons" not to invest in equities. (See the examples in the paragraph below.) How do I resolve the apparent contradiction between this observation and my statement that equities are the best form in which to hold wealth? Start with an important distinction: there is investment and there is speculation. The two are often confused. If I buy Good Company X in the hope that someone will pay me more tomorrow than I paid today, then I am speculating. If I buy Good Company X because I am convinced (rightly or wrongly) that this is a company having continued promise of long-term growth and correspondingly long-term ***sustainable*** appreciation in its stock price, then I am investing.

Note that if I buy Good Company X with an investment motivation but concentrate my investment in this one (or even a few) companies, then I may really still be speculating. Recall Murphy's Law: if something can go wrong, it will go wrong. Append Weil's corollary: Murphy was an optimist. So …own equities (and for purposes of this discussion, common stocks, directly or in mutual funds), but own them sufficiently diversified so that the performance failures of some are hedged by the performance successes of others.

The reference to a "Good Company" highlights another possible difference between investment and speculation. On any given day, there are any number of "bad companies" on offer (by which I mean companies either not inherently profitable or "profitable" because somewhere in their operations they are short-changing necessary expenditures to overstate earnings). An investment commitment to a "bad company" is a speculation ***unless*** made after a reasoned analysis suggesting a turnaround opportunity.

And there is this additional consideration. Unless you are very rich, it is unrealistic to suppose that you can achieve the degree of diversification necessary if you restrict your investments to individual securities only. Diversification means diversification by company, by industry, by geography and by asset class (of which there are many). As a practical matter, this means that a typical "Good Company" portfolio will hold individual securities, mutual funds (selected because they represent good managers as well as desirable asset classes), and/or ETFs (selected because they too represent desirable asset classes).

3. We know that market-timing doesn't work very well (unless you have the skill of Will Rogers, who made known his secret of success in investing: "Sell before the market goes down and buy before the market goes up"). So what do you do when you conclude that the market is "too high," are committed to equities, and are tempted to time the market?

Well, first, remember that you could be wrong. There were many investors or advisors who concluded two or three or four or more years ago that the market was "too high" and went to cash. They either stayed on the sidelines or (more likely), ruing their "mistake," bought back later at materially higher prices. Even if market timing looks right in the short-term, it is often the case that what is sold today moves to new highs after correction and recovery. Also, in after-tax accounts, the tax impact on the sale could materially reduce the benefit.

And there is another often fatal weakness in timing as a strategy. Most people are all smiles when enjoying increases in the values of what they own. But will they be all smiles when presented with another "favorable pricing environment" (a market at or near its low)? Chances are they will not. The decision to sell high is not psychologically fraught. The decision to buy low is. Any timing advantage which inures to successful sale timing is hedged by the reluctance most people experience when the "right" time to "buy low" arises. It is much more comforting to stay in cash "until there are signs of a real recovery," which often means until price levels approach, or are likely above, those which were obtained before the fall.

We won't even talk about the risk that while you are sitting on all that cash you talk yourself into a world cruise or a new Maserati, or an investment in Uncle Benny's can't-miss dry-cleaning business. There is nothing wrong with any of these expenditures – unless they come at the expense of your long-term economic independence.

As an investor seeking to "do the right thing," you could take comfort in the experience of buy-and-hold investors (not speculators, not dot.com or crypto fanatics, not momentum players, not owners of "story" stocks priced for success in 2035) when you consider the consequences of buy-and-hold before, during, and following the Great Recession of 2008. I'm doing a bit of rounding here, but in October 2007, our benchmark ACWI, hit its all time high (at that time) around 427. It bottomed in March 2009 around 172. It reached 427 again around June of 2014. Its all time high in November 2021 was about 758, fluctuating downward to a price of about 596 as of June 30, 2022. If you had bought one (hypothetical) share of ACWI for $427 at the market

top in 2007 and gone to sleep until June 30, 2022, you would have awoken to an investment value of $596. This is the equivalent of an annual compound yield of about 3.1%. (The yield would have been over 5.8% with reinvested dividends.) And this investment was made at the high before the Great Recession, was held during a period of significant market fluctuations, and then priced during/after the Great 2022 correction.

Yes, past performance is no guarantee of future returns. But the reason I generally favor a buy-and-hold strategy for myself and our clients (always assuming quality merchandise, adequate diversification, and an investment not a speculative motivation) is because it has worked well in the past, through all kinds of markets and all kinds of economic conditions ***and*** I understand the reasons it has worked.

Buy-and-hold as an overall investment strategy does not mean buy-and-keep-everything-forever, although asking up front "is this a company I want to own forever?" is not a bad test of investment merit. It also does not mean you would never sell a good company for reasons having to do with price (even reasons that might look suspiciously like market timing). If, for example, a good company you own becomes a popular speculative favorite and the price runs up beyond reason, then it may well be the case that taking a profit is warranted. But this is a decision made on the fundamentals of a particular company and not because of a speculative success. Generally, the job of the portfolio manager (you or whoever is acting for you) is to mind your store, buying for your portfolio as and when new investment opportunities arise and selling from the portfolio as and when the quality of a particular investment degrades (or when a speculative fever has pushed the price to a level disconnected from any real world valuation).

4. This will not make you any happier about market declines, but I would like to remind you that there is generally a degree of artificiality about market highs, lows and price fluctuations. No matter how tempting it is to believe your net worth is higher today than it was yesterday because your portfolio is worth more today than it was yesterday (or vice versa), it just ain't so. Accountants will tell you the most accurate way to value equity assets is at cost and then (often grudgingly, because accountants hate values that keep shifting) marking to market yearly – and always with a tax reserve. ("Mark to market" means resetting the value of an asset on your books – and in your head – so that the asset will be valued "accurately" for that one moment in time.)

Carrying at cost for the first year or two (or five), marking to market yearly thereafter, setting up a tax reserve as a debit to net worth – all this may be a little much for the typical investor; but these do highlight two realities that most investors ignore. ***First***, price fluctuations may appear to be significant "facts," but far more important is the trend line over time around which prices fluctuate. The trend line tells you whether your asset values are going in the right or wrong direction – not daily, monthly or even yearly, but over your long-term hold. It is a reminder that, for the investor with a properly structured portfolio, patience is a rewarding virtue. ***Second***, despite what Modern Portfolio Theory would have you believe, there are times when stock prices reflect an undue degree of investor mania and times when they reflect an undue degree of investor depression. To put it crudely, there are times when you are "worth" more than you should be or less than you should be. If history is any guide, these pricing "distortions" will work themselves out in due course and you will be "priced right."

5. Stock markets are, when viewed from the proverbial 30,000 feet, more or less self-regulating. This means that when companies are priced in a way that is inconsistent with economic conditions obtaining (or ***expected*** to obtain or ***subsequently discovered*** to obtain) in the U.S. and/or other key economies, there will be price corrections, bullish or bearish as the case may be.

In these times, with so many unresolved economic, political, and climate issues weighing on the stock market, you may be inclined to believe what they say; that sooner or later the stock market will "break your heart." If true (and there is anecdotal evidence to suggest it's true enough), this is what comes from looking for love in all the wrong places – or giving your heart to one for whom breaking hearts is a matter of total indifference.

But loving what the market is doing to you during periods of exuberance (rational or otherwise) is no more sensible than hating what the market is doing to you during periods of doom and gloom.

In summary (oversimplified):

- The ownership of quality equities is the most sensible way for most people to hold wealth.
- Stock markets are self-regulating, which means that ***normally*** company values and company prices are in rough equilibrium; and there will be corrections when values and prices are out of whack.
- Investing is investing; speculating is speculating. The two are not the same although often confused. Investing means the ownership of quality assets, bought at reasonable prices, adequately diversified, properly supervised. For purposes of wealth development and wealth maintenance, probabilities of success are on the side of investing.
- Market timing is an instance of speculation.
- You are not your assets (which is a good thing because if you changed your character as often as equity assets do their values you would be a perpetual nervous wreck).

Chris Weil