INVESTMENT INSIGHT

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THIRD QUARTER

LEGACY WEALTH MANAGEMENT®

The insight offered in two articles I recently read are worth a review in this quarter's Investment Insight. *While the views of the authors cannot be categorized as revolutionary, their views do serve as a good reminder that sticking to the basics is often the right thing to do.*

Jason Zweig writes a column for *The Wall Street Journal* called The Intelligent Investor, where he reviews a soon-to-be published book called *Mastering the Market Cycle*, by Howard Marks. Marks is an investor of some notoriety that runs a firm called Oaktree Capital Management. Zweig states at the outset of his review that the very title of Marks' book "might inspire many readers to scour it for evidence that short-term market timing can work. They will look in vain." Again, this seems very basic, so much so that a colleague quipped, "We need a new book to tell us market timing doesn't work?" But clients frequently ask, and we often query, if the market is going to go up [or down] from here. It is human nature. The answer is that no one really knows in the short term. Zweig observes, "Marks explains in his book, markets typically move in big, multi-year cycles . . . [s]o investors who react to what they perceive as short-term signals are likely, most of the time, to be basing their moves on little more than noise."

The second article that caught my attention was from Tae Kim and Leslie Picker on CNBC.com. This article focused on several famous and very wealthy investors who hit it big in the financial crisis and how they have fared since. The opening line of the article is, "It's difficult to stay on top." Hedge fund manager David Einhorn declared ahead of the Lehman Brothers failure that the bank was in serious trouble and was a danger to the financial system. His hedge fund made investments that bet the value of Lehman would fall significantly (he sold the stock short) and made lots of money. Yet through the end of August 2018, his fund is down 25% year to date while the broader U.S. stock market is up roughly 10%. John Paulson bet against subprime mortgages between 2007 and 2009 and made an estimated $20 billion on his trades, earning himself investment fame and a paycheck of roughly $4 billion over the same time period. Since then his fund has underperformed the broader market significantly. According to the article, Bloomberg reported that "the assets of Paulson's firm fell to $9 billion earlier this year from $38 billion in 2011." These gentlemen are obviously smart individuals who made some terrific investments during their careers. Yet even though they manage billions of dollars, have endless tools and research at their fingertips, and have brilliant connections with business and economic leaders only a phone call away, they don't get it right all the time.

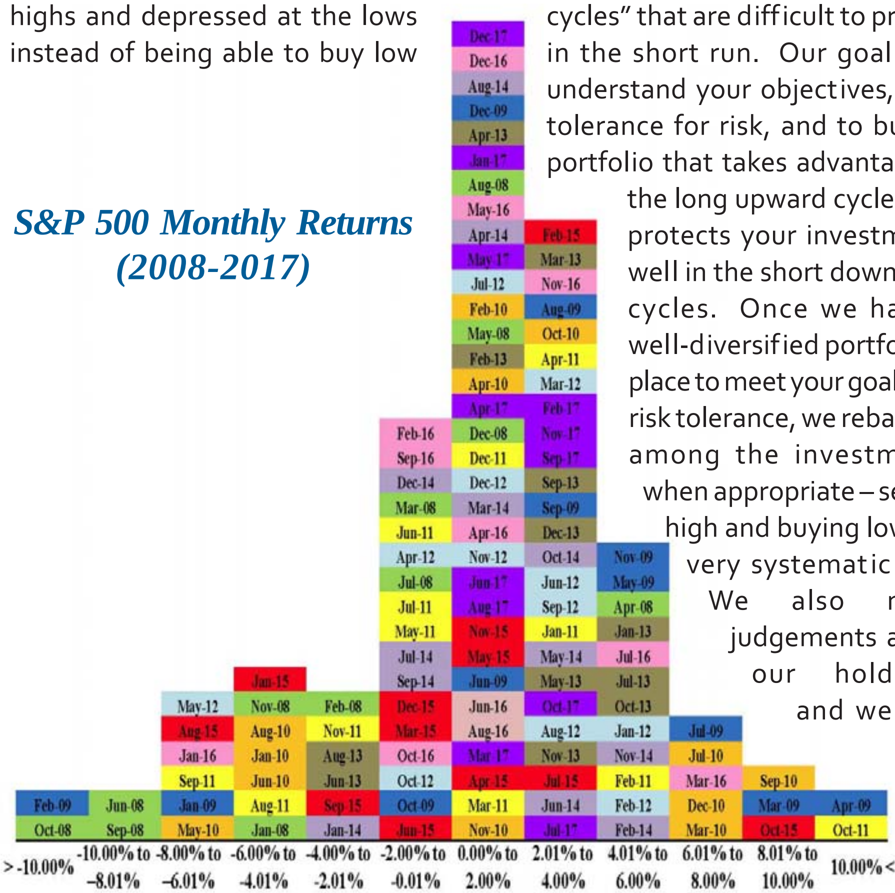
Market returns are also often very "choppy" *(my word)* in the short term, reinforcing the difficulty of getting short-term timing right. The following chart shows the monthly returns of the S&P 500 index, a popular investment index that tracks large companies in the U.S. The months of a single year are all the same color; for example, the twelve months representing 2015 are all colored red. The S&P 500 index returned between 0-2% in April, May and November of 2015, rose between 2-4% in February and July, and even went up between 8-10% in October, but also saw declines in January, March, June, August, September and December ranging from slightly negative to down 6-8%. Such returns may make for a colorful chart, but not for a sound short-term investing strategy.

According to Zweig, Marks states, "Everything about our human makeup conspires to make us do the wrong thing. Most people get excited at the highs and depressed at the lows instead of being able to buy low and sell high." When we are not excited by the highs or depressed by the lows, we tend to worry in the middle! Mr. Einhorn and Mr. Paulson are in the hedge fund business, meaning they get paid to worry and to "hedge" against those worries. Their worries made them rich men in the financial crisis but have cost them a tremendous amount of money and clients in the time since the crisis. The fact is, there are very few predictable opportunities where such worries will pay off. The stock markets go up roughly 70% of the time, and as we see from the chart below, they do so in unpredictable ways that make betting against that long-term upward trend difficult at best.

Your investment committee at Legacy believes, like Marks, that "markets typically move in big, multi-year cycles" that are difficult to predict in the short run. Our goal is to understand your objectives, your tolerance for risk, and to build a portfolio that takes advantage of the long upward cycles and protects your investments well in the short downward cycles. Once we have a well-diversified portfolio in place to meet your goals and risk tolerance, we rebalance among the investments when appropriate – selling high and buying low in a very systematic way. We also make judgements about our holdings, and we may trade one for another to reduce risk (sell high) or take advantage of an opportunity (buy low). This year, for example, we sold a high-yield (junk) fixed income fund and an emerging market fixed income fund for clients who held them and purchased a high-quality, short-term fixed income fund in their place. We initially purchased the high yield and emerging market funds several years ago, were pleased with the results they provided, and felt it was time to realize our profits and reduce the risk in the safe fixed income portion of our portfolios. We also recently reduced our international equity investments in favor of more investments inside the United States.

Marks comments that "he likes [his] book's subtitle – *Getting the Odds on Your Side* – better than its title." The research, the data, and the professionals all show us that no one can successfully predict and time the markets, so we work hard to make small changes in the portfolio to keep the odds on your side so that you can achieve your financial goals.

S&P 500 Monthly Returns (2008-2017)



This Third Quarter
Investment Insight
has been written by Legacy's
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Sources
Chart: FactSet
Zweig, Jason. *You Can Time The Market, Just Not All The Time.* The Wall Street Journal, 14 Sept 2018
Kim, Tae & Picker, Leslie. (2018 Sept 17). *Most of the 'big shorts' who thrived during the financial crisis, have faltered since 2008.* Retrieved from CNBC.com