This page was exported from - Pinney and Scofield
Export date: Fri Oct 30 12:36:52 2020 / +0000 GMT

Quarterly Newsletter - April 2015

April 15, 2015

Dear Client,

It can sometimes look as if the world is going straight to heck. Russia is behaving badly. China is re-arming ? to what end no-one really knows. The Middle East seems to be at the start of a total religious war ? Sunni vs Shia. Greece may well default and leave the Euro. And German deflationary preference and the German persistent trade surplus, now the largest in the world, is putting a choke hold on European recovery.

These political and economic facts have created a pessimistic outlook internationally. This is reflected in interest rates. Interest rates in Europe are now the lowest in recorded history. The bank rate for the ECB is negative, and has been negative since last September. Long-term German government and corporate debt is also selling at negative rates. This is utterly bizarre. It means that millions of people are so worried about Europe's future that they prefer the certainty of a small loss by owning bonds rather than running what they take to be a large risk in equities or property.

Pessimism like this does not normally pay off. By far and away the best time to buy U.S. equities was at the 1932 bottom, when it looked like capitalism had failed and either communism or fascism might triumph worldwide. The best time to buy, in other words, was when it felt the worst to do so. And we all have a direct experience of this ourselves. We have all been through an historic market crash. We all remember what it felt like in March 2009. The market had lost more than 50%. Congress seemed paralyzed. It was just entirely unclear whether the U.S. banking system would survive. That was the time to buy which, by sticking to our discipline, we did. Since March 2009, the U.S. stock market has more than doubled. The difficult decision ? to stay invested and even to buy more, that decision has paid off in spades.

Less so, however, internationally. The recovery from the crash has been stronger here than abroad. The consequence has been both less good international equity performance and also a stronger dollar. Since the 2009 market bottom non-U.S. equity markets, when measured in dollars, have not done nearly as well as U.S. markets. This can be clearly seen in the index data in your one year portfolio performance report. And our response to this has been to rebalance ? to trim the better performing U.S. positions and buy the less well performing international.

We are doing now the same as we did from the beginning to the end of the crash ? that is from October 2007 through March 2009. We are trimming the good performers and buying the poor performers. As the crash unfolded bonds performed best while stocks went down. We responded by trimming bonds and buying stocks. And within stocks we bought the worst performers, the REITs, value stocks and small stocks. That felt bad and was hard to do emotionally, but it has worked out. Now we are doing the same ? trimming the stronger U.S. assets and buying international.

Will our present rebalancing pay off? We do not know. Buying poorly performing asset classes is always difficult. But international diversification certainly has been helpful in the past. International returns data for most of the asset classes we use begins in 1970. Measuring from 1970 through 2013, a diversified portfolio, a portfolio that owned large and small capitalization equites, growth and value equities, both in the U.S. and internationally, had a better investment experience than a non-diversified portfolio. A diversified portfolio had a higher compound annual rate of return per unit of volatility than did a non-diversified portfolio. The various asset classes delivered roughly similar rates of return abroad as in the U.S., but at different times. The diversified portfolio was thus less volatile which means the return was delivered with less risk.

Return per unit of volatility is actually not all that important for the accumulation stage of investing ? so long as the portfolio owner has enough gumption to withstand the downs as well as enjoy the ups. However, return per unit of volatility is vitally important when a steady monthly or quarterly amount is being taken from the portfolio ? such as a retirement income. A portfolio that can deliver the same or similar returns with lower volatility can support a consistently higher draw rate than the more volatile portfolio. In our last letter we spoke of the fact that a diversified portfolio could deliver a 5% inflation adjusted income draw through the

turbulent markets since 2000. The same was true if one extends the analysis back to 1970. The increased income draw rate made possible by diversification is very clear.

This all stands to reason. Long-term returns are basically a function of purchase price. The lower the purchase price of any investment asset the higher the potential returns. The trick is to catch that lower price. Market timers try to do so by prediction, by somehow knowing what will do well when. They move the whole portfolio around. We don't do it like that. Our method is more modest, but more reliable. We don't need to know or predict anything. We just own all the markets, and then when one asset class or location does a lot better than another we sell some of the market that has done better and buy some of the market that has done worse. This does not require insight ? only discipline and patience.

With this letter we are enclosing a chart. It shows, for each year since 1990, the relative performance ranking of many of the asset classes we use. Please note how volatile the chart is. The white line traces the relative performance of bonds. In some years bonds did the best and in others the worst. It is simply not the case that the best performer for a given year reliably reappears in the next period. And this is true for all the other asset classes as well. This chart is a picture of unpredictability ? of volatility. And it is exactly this volatility of asset class performance that makes diversification and rebalancing such an attractive and at the same time difficult investment discipline.

It is that time of year to address two legally required administrative matters. First, as required by law, we are enclosing with this report our Privacy Policy statement. And second, our SEC disclosure document, known as Form ADV, has been updated as of March 31, 2015. It is available at all times upon request. It is also permanently available on our website under the Company Documents tab.

And finally, as always, should your financial circumstances change, or if you have any question about us, our method or services, please do not hesitate to call or write.

Jim John Richard & Ryan