

July 2018

*Instead of a mid-year review, we believe a set of mid-year thoughts would be more useful. These thoughts are based on July Paradigms going back to 2008 plus current events.*

Harry Markowitz is a major figure in the development of modern portfolio theory. His research showed that diversification can, up to a point, increase returns for a given level of risk. He still believes the single best investment advice is to diversify. His second piece of advice is to remember that the future will not mirror the past. Those two thoughts would be wise ones to take from this Paradigm.

### Past Themes Tying Back to Harry

We are not going to make you relive the past 10 July Paradigms, but several themes from them are worth noting here.

Diversified portfolios endure. Over the past 10 years, you have experienced the Great Recession (unemployment above 10%), multiple country-specific debt problems (Greece), swings in the mood toward the growth or slow-down of China (early 2016 stock market sell-off). Throughout all of this, diversified portfolios endured.

Maintaining a proper perspective has added value. Your goals are carefully thought out. Not letting near term events throw you off kilter is important, while understanding that the future will not mirror the past. Therefore, we do believe in regular meetings and disciplined execution.

Reviewing actual returns has proven useful. Six months is a very short period of time in what could be a 30 to 40-year investment horizon. However, consistently placing returns into a framework of your long-term strategy and goals has helped investors maintain the proper perspective in a world where the present and future do not mirror the past.

Non-portfolio return factors that you control contribute to your success. We emphasize your spending habits, but the security of your data, regular meetings, and realistic expectations also fall in here.

Inflection points are exceedingly hard to **both** predict and to base sound investment decisions on. In reviewing prior July Paradigms, we noted in 2008 that Chip Case (one of the namesakes of the S&P/Case-Shiller Home Price Indi-

ces) started to think that home prices may be near a bottom. In 2012 we noted that talk of a “bond bubble” was evident. Market enthusiasm, not our enthusiasm, for gold and emerging market stocks has ebbed and flowed in the past 10 years.

The point of these examples is to get investors to think about their ability to call and act on inflection points, plus the need to do this at all in order to achieve their long-term goals. Some were successful in real estate, commodities, or distressed debt. However, we suspect that if an investor made too many decisions regarding inflections points, the net effect of being right and wrong was not material and most likely negative in dollar terms. Finally, by attempting the above, you can lose sight of your goals.

### Current Themes Tying Back to Harry

The future will not be like the past, but diversified portfolios will endure. You don't have to diversify into all assets, but broad diversification is a cornerstone for your long-term success. You most likely need to take some level of risk in stocks and real estate while accepting the benefits of bonds.

Reviewing actual returns will prove useful. The 2017 tax reform will impact stock returns through 2019 because earnings' growth will be well above long-term trends. As the Federal Reserve continues to raise short term rates, understanding bond returns and the role of bonds in your portfolio is important.

Inflection points will continue to be difficult to predict and to act upon in a material manner. The current trade disputes potentially turning into trade wars, plus the belief by some that 2020 could be a rough period (tax impacts wear off and interest rates are higher) are two good examples. Another example is copper. The price is down 17% year to date. Do you really believe you can **successfully** 1) call the bottom in copper prices, 2) find an appropriate investment, and 3) be willing to invest a material amount of money? You have to do all three correctly or you are likely better off doing nothing.

*Looking forward, you control the approach to your portfolio. Remain diversified, accept that the future will not mirror the past, and focus on the many factors you control. We can help.*