A PORTFOLIO TO WEATHER ALL SEASONS

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The purpose of this commentary is to discuss how we build the foundation for your investment portfolio, and how we make our ongoing investment decisions thereafter.

First, let's briefly discuss a commonly accepted approach. Many investors, both novice and professional, make investment decisions based on their near-term outlook for the stock market or on their own personal views regarding the future health of the economy. In other words, they will invest today based upon their prediction for *yet-to-be-seen (i.e. future)* results - results that may *or may not* come to fruition. Hmmmm…?

As such, it seems these folks not only believe they can somehow forecast *upcoming* results; they are willing to bet their financial success on their supernatural ability to see into the future. Given the unpredictability of the markets and the economy, at least in the short term, does this sound like a prudent foundation for designing an investment portfolio – one that will be relied upon to achieve you and your family's future financial wellbeing? Say it with me this time – hmmmm…?

As we all know, no one has a crystal ball. As such, no one, and I do mean NO ONE, has been able to accurately AND consistently predict short term future investment or economic outcomes (let alone geopolitical events). Given this fact, I believe investors today fall into one of two camps: (1) those that don't know, but know they don't know; and (2) those that don't know, but don't yet know that they don't know. Of these two groups, which do you think is more dangerous?

Perhaps you're still holding on to the notion that we can indeed see into the future and that we should therefore simply position your investments accordingly. Maybe you'd like a real life, practical example of the futility of this commonly held approach to investing; this widely followed investment 'strategy' (which also almost sounds like 'tragedy'. You'll see the significance of this in a minute or two). The following are just a couple of real life examples of the propensity among investors to base their decisions on a near-term, commonly-held outlook. And by the way, the participants involved, I have no doubt, actually thought they were investing. Meanwhile, they were really doing nothing more than speculating or gambling with their hard-earned savings. They just didn't know it yet (they were still in camp #2)! But I digress…

Do you rememberY2K? As a financial advisor at the time, I distinctly recall the prevailing investor sentiment going into the year 1999. As a result of the Y2K computer 'bug', dire results for stocks were predicted by all but a few. Companies, and investors all around the world, stood to suffer severely when the clock struck midnight on January 1, 2000. Some predicted that planes would fall out of the sky. Others feared that ATM machines would freeze up entirely; right when we would need our cash the most what with the inevitable Armageddon that was sure to follow (of course, those with physical gold bars would trump those with cash anyway. Ugh!). Rather than buying stocks, it was wilderness survival boot camps that were in high demand. NBC even made a TV movie about the impending disaster. Given the dire forecast, a number of my clients (at the time…) were adamant that we drastically reduce their equity exposure. The message I was hearing; "*Gimme my cash and let me hunker down!*"

So, how did the stock market perform in a year where such catastrophic results seemed to be a foregone conclusion? Equities did indeed experience a huge move leading up to the impending doom of Y2K - a 30% move UP, not down (during calendar year 1999 the Canadian stock market, as per the S&P/TSX Index, *advanced* by 29.72%, with the tech sector leading the way). So in hindsight - while everyone was screaming "run for the hills" stocks were actually advancing, and rapidly so, NOT plummeting as so many had predicted. (As an aside, the next time Canadian stocks saw a 30% return in a single calendar year was 2009 - again coinciding with a period of extreme pessimism on the heels of the global financial crisis. Once again, attempting to predict short term outcomes, and investing accordingly, proved counterintuitive). As Warren Buffett has said "*It won't be the economy that will do in investors; it will be investors themselves.*"

A second example supporting the futility of market forecasts, the mood among investors shortly after Y2K could only be described as one of outright euphoria. On the heels of the stellar market returns in 1999 and the prevailing tech boom, investor predictions turned wildly optimistic (after all, ATMs and computers didn't explode at midnight at the turn of the century). The survivalists from those wilderness boot camps graduated to do-it-yourself investing. Regardless of the experience of 1999 and Y2K, many *still* didn't know what they didn't know. Much to the contrary, the new consensus was that anyone can make money in stocks – just buy anything with a .com at the end of it, sit back, and let the money roll in. In early 2000 market pundits like Jim Cramer, now of CNBC's "Mad Money" (shouldn't that name itself be a red flag!?) proclaimed that internet-related companies "*are the only one's worth owning right now*" (he also proposed shorting, in other words - betting against, Warren Buffett's holding company Berkshire Hathaway. No need to go into detail as to how that would have turned out).

As we all know, the tech bubble promptly went bust, and once again investor sentiment proved incorrect. As for Jim Cramer's highly touted internet-related stock picks (made at the peak of the tech bubble); by the end of 2002 a $10,000 investment spread equally among them would have lost 94%, leaving his followers with a grand total of $597 (perhaps that's where the name "Mad Money" originated?). As for the consensus view that anything tech related was the *only* way to invest, after a drop of close to 80% from early 2000 to late 2002, it took close to 15 years for the technology sector to climb back to those previous highs (as per the tech stock laden NASDAQ Composite Index). As far as predictions go, the euphoria around .com stocks during the tech bubble had to have been one of the worst for investors. What those in camp #2 thought was an investment "strategy" became more of an investment "tragedy".

I should point out that the above is not meant to be an indictment of Jim Cramer or his knowledge of the stock market. His optimism for tech stocks was shared by most market pundits, and Warren Buffett was often referred to as a 'dinosaur' and was deemed 'out of touch' with the rapidly expanding tech sector. However, the next time you read or hear (on BNN… dread) anyone's market outlook or economic forecast, I challenge you to go back just one year to look at what that same prognosticator was saying then. I think you may be surprised as to how inaccurate most of those forecasts turned out to be. Which begs the question: why pay too much attention to their *current* forecast?

In the hope of putting the final nail in the coffin on this, here is another quote from Warren Buffett, the world's greatest investor, regarding the fallacy of stock market predictions: "*We have long felt that the only value of stock forecasters is to make fortune-tellers look good.*" For anyone who is not yet convinced, please keep in mind that this is coming from inarguably the World's Greatest Investor!

Getting back to how I manage your portfolios, I have never heard Buffett make a short- term prediction on interest rates, the price of gold, or where the stock market will be at year end. When describing his latest multi-billion dollar acquisition, I have yet to hear him proclaim that he's buying based on his six-month outlook for commodity prices, or on what he believes global GDP will be by year end. Clearly the World's Greatest Investor knows the futility of investing in such a fashion. Given this, I most certainly will not bet your financial success on an uncanny ability to do what Warren Buffett cannot.

Having said all of the above, please allow me to make one thing very clear. This does not mean that we should ignore the economic climate, current events, geopolitical risks, or the valuation metrics of the broad stock market. Let me plainly state that nothing could be further from the truth. It is indeed at least part of my job as a portfolio manager to remain abreast of all of the above (so that you don't have to, please turn off BNN!). As you know, I'm always happy to discuss my outlook and thoughts on these matters with you at any time. However, here is the important and very fundamental difference: while those views will and should *influence* how your portfolio is managed, they will never form its foundation.

Rather, for our part as "partners" in your financial success – let me also clearly state that we are *investors*, not speculators. Speculating is gambling. We are *investing* in your financial future – not gambling with it. Building the foundation of any portfolio based on your, my, or anyone else's near-term outlook for the future, i.e. a pure speculation on what may or may not come to be, is gambling, pure and simple. We are not in the gambling business!

Here is some more good news. As the success of Warren Buffett has proven, we don't need to be able to predict the future in order to achieve substantial long term investment success. Rather than positioning your investments based on the entirely unknowable (like where oil prices will be next month?), we can and will succeed by managing your portfolio based on what IS knowable. These are factors like your age and the number of years to your retirement or your current income needs if you are already retired. Other factors include the size of your portfolio today in relation to where we'll want it to be at a given target date (i.e. at your retirement or when a child enters university). Or the approximate rate of return needed to reach your long-term goals. This is what our investment decisions today should and will always be based upon; not a fleeting guess as to what might happen at the next Fed meeting.

To summarize, through an investment plan that is professionally managed and allocated based on these far more knowable factors, you end up with a portfolio that is designed to weather all seasons. Your long term investment strategy or your retirement income plan, for retirees is designed to achieve your own unique financial goals and objectives, and does not change any more often than do the aforementioned goals and objectives (which typically don't 'fluctuate' from one quarter to the next). By properly and prudently allocating your investment assets, with no undue exposure to the stock market, but with as much exposure as your plan can stomach, we can rest, confident in the fact that your future financial viability does not rest on our ability to somehow know the unknowable.

The result is a portfolio to weather all seasons; an approach to investing that will survive regardless of what outcome prevails in the near-future (so long as you stick with it).

On that note, I thank you for doing just that.