Planning Perspectives 2Q 2020

Integrity in Investing
How I Learned to Stop Stressing and Trust the Market

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PROFESSIONAL FINANCIAL
Purposeful Wealth Management

"The investor's chief problem—and even his worst enemy—is likely to be himself."
– **Benjamin Graham**

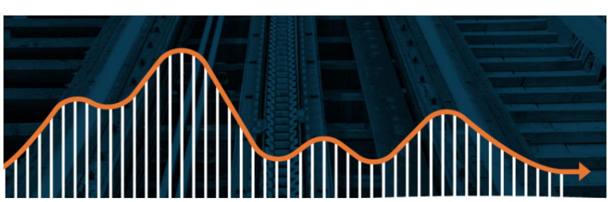
This is part of a series exploring integrity in professional wealth planning

Key takeaways:

- Unpredictable events create conditions of uncertainty leading to crisis
- High market volatility is exactly what we would expect in crisis situations
- High volatility implies high risk implying high current expected returns
- Decisions for investing should be evaluated on their quality, not the outcome

I don't know about you, but the financial market's response to the Coronavirus event and the often raucous commentary about it from internet news has bombarded my sensibilities. It trickles in minute by minute, day after day. In my job, I can't escape it for long. Weeks of semi-isolation here in my office and at home due to state mandates has made me a captivated audience. But when I turn it off, I recall from many years ago visiting Disneyland my very first jumbo-sized roller coaster ride.

The 'coaster was early in the day. After boarding, it clanked ominously as it scaled the air. The first dip was only about half of the distance we had climbed up. That wasn't so bad. Then our car climbed even higher, and we crested a second time. I looked waaaaay down and realized that the park had been invaded by tiny ant-like creatures. I had just enough time to consider the implications and sensed a sudden surge of fear just as our car crested and dropped straight dooooown. The truly devilish part was, I saw no bottom. And then up again. And down again. My wife screamed all the ride until the car jerked to a sudden halt at the platform. (I suffered residual auditory damage.) After a quick look back, I noted no vacant seats as riders got off.



In hindsight, I know there had to be a bottom with each drop, and that we'd survive the fall.

No medics roamed about picking up bodies. So why was I scared? Why was logic so difficult in free-fall, and why was I unable to remind myself that Disney had no record of serious rider injury reports?

No, I couldn't be logical. As soon as the roller coaster crested at the top of its tracks and I looked down, the lizard-like part of the back of my brain hijacked my thinking processes. It screamed, against all logic, that my wife and I were about to die, sending a surge of adrenalin and signals of dread instantaneously into my system so strongly and so thoroughly that it was momentarily difficult to step out of the halted coaster and walk steadily off the platform.

Crisis, Volatility and Opportunity

At some point over the last quarter, at times you may have felt like being on a roller-coaster going through free-fall. Some investors ride with their eyes open, others keep them closed. Perhaps when the Dow dropped 3000 and it seemed like 1929 was upon you, you wanted to scream. Not at someone. Just scream. Some scream silently, others can't contain themselves.

Unpredictable events create conditions of uncertainty. We collectively struggle to handle all the uncertainty of what this unknown virus means to our lives and that of our families. Too much uncertainty with media talk about disasters from previous unknown viruses in a light-speed internet age inspired a panic aided and abetted by politicians with their own agendas that swiftly devolved into what became a full-blown market crisis moving at terrifying speed. While the volatility has slowed, markets remain in uncharted territory struggling to figure out the implications of future cash flows from business due to shutting down much of the global economy. The discount rate at which the future cash flows of each public company are collectively estimated and incorporated into prices being set moment by moment by trades on exchanges.

I don't know whether the worst of the virus or government mandates is behind us, and when high market volatility will stop or when politicians will stop inventing new reasons to spend. But in a few years, I suggest we will be looking at graph something like *Exhibit 1* where we see the effect on global markets of past crises like the Oil Embargo, Dotcom Crash or the Financial Crisis. Once we get off this super roller-coaster of the Crisis of the Day, if you have been


MARKETS

Dow drops nearly 3,000 points, as coronavirus collapse continues; worst day since '87

Stock market live Tuesday: Dow soars 2,100 points, biggest jump in 80 years, stimulus close

OPEC's pact with Russia falls apart, sending oil into tailspin

Stock market live Thursday: Among best weeks in history, Dow and S&P 500 jump 12%, thank the Fed

securely harnessed and locked into your seat when you took your ride as an investor, *if you wisely chose which roller coaster ride that would take through this inevitable crisis—and the next one*—you could be looking back years from now instead with nostalgia, rather than regret, despite whatever screaming you may have done along those dips and curves. You won't remember any of that—*but you could recall the excitement* of the great financial experience you had as a result of choosing to take that ride with us.

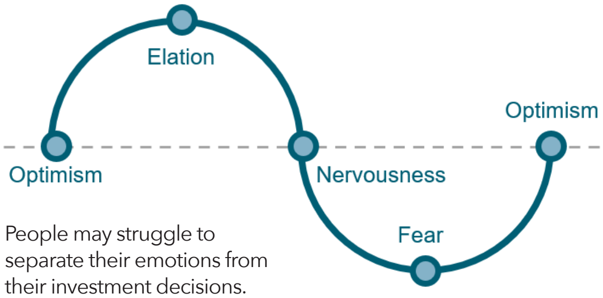
The Irrational Investor Rider

Much of the last eleven years were a remarkably smooth and profitable ride for those invested in U.S. large stocks, especially large growth stocks. For someone concentrated in S&P 500 stocks after enduring the early 2009 drop, and simply stayed invested, the cumulative return from early 2009 to the end of 2019 was 350%. The historically low volatility of 2015-2019 was unrealistic to expect those for getting into S&P 500 indexes as it kept climbing. Yet I regularly met prospective clients nearing retirement with upwards of 80% or more of their now-inflated portfolios of U.S. large cap stocks or ETF equivalents—and yet completely unaware the same U.S. stock market had close to zero return for the decade prior to 2010. Late comers had got onto a high-speed

Exhibit 1: Growth of a dollar–markets have rewarded discipline
MSCI World Index (net dividends), 1970-2019

In US dollars. MSCI data© MSCI 2020, all rights reserved. Indices are not available for direct invesstment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results.

Exhibit 2: The Investors Emotional Roller Coaster



Following a reactive cycle of excessive optimism and fear may lead to poor decisions at the worst times.

roller coaster without their seatbelts, much less a parachute for a sudden jump to get off.

Alas, the market is a cruel task master who teaches expensive lessons. From Morningstar fund flows for the 2020 first quarter and from bond price data recording bizarre drops, primal screams were audible from investors who previously rode only those Fantasyland coasters.

Investors know, in the cortical section of their brains, that they agreed to take a roller coaster ride. Logically you know, although a virus might kill you, a market drop won't. But we forget that the lizard core of our brains that takes control of our minds and drowns out all reason if a 'coaster ride becomes wild enough. All your education and experience is neutralized by a little lump of tissue with only an "on" switch that, when triggered, involuntarily activates a powerful hormonal stimulus which screams a message into your brain to jump out of your seat to save your life. Without a belt or harness, you follow the crush of others committing financial *hari kari.*

When group think causes crowds to scream when markets severely drop, fear is maximized until markets bottom. *Exhibit 2* illustrates how a market rally could be the next bull market or just a sucker's rally before another drop. As the lizard's scream gradually quiets, those investors who jumped off gradually get back on, and begin buying back at higher prices than they sold—until either another decline and the lizard screams again—also a sure sign of a bull market: powered by the media, the madness of crowds takes over as a new panic begins—the envious fear *maybe they'll get in too late.* It's an unending Sisyphean cycle upward and downward over and over.

Success for strategic wealth planning is your conviction in an investing philosophy based on financial science employing a systematic process using structured strategies to disentangle emotions from financial decisions. But a specific time frame must be established for your goals and circumstances to measure and evaluate outcomes. Assuming through you engaged Professional Financial an informed methodology that minimizes the vagaries, idiosyncrasies and high costs of traditional management as much as possible and are focused tax-efficiently on dimensionally-targeted sources of return, and continue to save or spend within your parameters,[1] *what remains is to keep you from emotionally changing the rules we fixed for measuring and evaluating results.* This problem is typically due to financial pornography from excessive media exposure or chance encounters at parties whose investment results are so radically unique that it creates returns envy. What should be at least a ten-year evaluation time frame for **decades** of planning, gets condensed to a sequence of **days**.

My Greatest Investing Lesson

In 1999 *Money* magazine declared Sir John Templeton "arguably the greatest global stock picker of the century." Templeton pioneered the global approach to investing back in 1954 with his once renowned Templeton Growth Fund, that opened investment opportunities for Americans outside the familiar U.S. $10,000 invested back at the founding of his fund was worth $8.4 *million* when Templeton died in 2008 at the age of 95. Sir John believed his success, based on his "enthusiasm for progress," was his willingness to think independently, not chasing the crowd, and watching for what he called "points of maximum pessimism" in different markets and times.

As a young CFP in practice years before Dimensional Fund Advisors was available to fiduciary advisors, I often recommended Templeton's Growth Fund for clients, including for my own mother. A persistent problem back in those early years was keeping clients focused on long-term outcomes. In late 1987 the University of Rochester dedicated the Simon Business School when I was a lowly first-year MBA student. At that event I approached and chatted with Sir John before he was whisked away. He was tall, stately and approachable. Unlike other attendees, I knew something about his personal background. I used those five precious minutes to ask Sir John for details concerning his early, but daring, stock investing scheme many years before as a young man in another unprecedented time. It was his first important investing success, eventually leading to founding his famous Growth Fund. That chance meeting, as I recalled what he shared time and again as I

completed learning advanced ideas and theory in finance from leading professors, impacted both my thinking about markets and my future investing for clients.

After an unprecedented Great Depression following the "roaring Twenties," an unprecedented takeover of Europe by Axis powers, and after an unprecedented Japanese attack leading to war with the U.S., American financial markets collapsed once again. The total return of the U.S. stock market from September 1929 to the end of December 1941 was minus 45 percent. Eleven million American men would go to war. My father joined the Navy in the late 1930s, fought in the Pacific theater and survived (surely good for me) sinkings in two different battles of ships that he served on. Templeton had grown up in similar modest circumstances in Kentucky but became a Rhodes scholar where he took economics at Oxford, and then onto law school. He was a young man practicing law at the time of what was then, his innovative investment strategy.

While details are forgotten by most, World War II was the deadliest military conflict in history. It was a fight for unconditional surrender in an ultimate death struggle for world control. An estimated total of 70 to 85 million people would perish beginning in 1939, which was about 3 percent of the world population in 1940. The U.S. population was 132 million. Over 400,000 American soldiers and sailors would not return home. December 1941 was a most desperate hour. 11 million healthy young men leaving factories and farms to fight in a war would create a supply shock for the U.S. economy, much like our extended mandatory business closings today, driving the U.S into a serious recession.

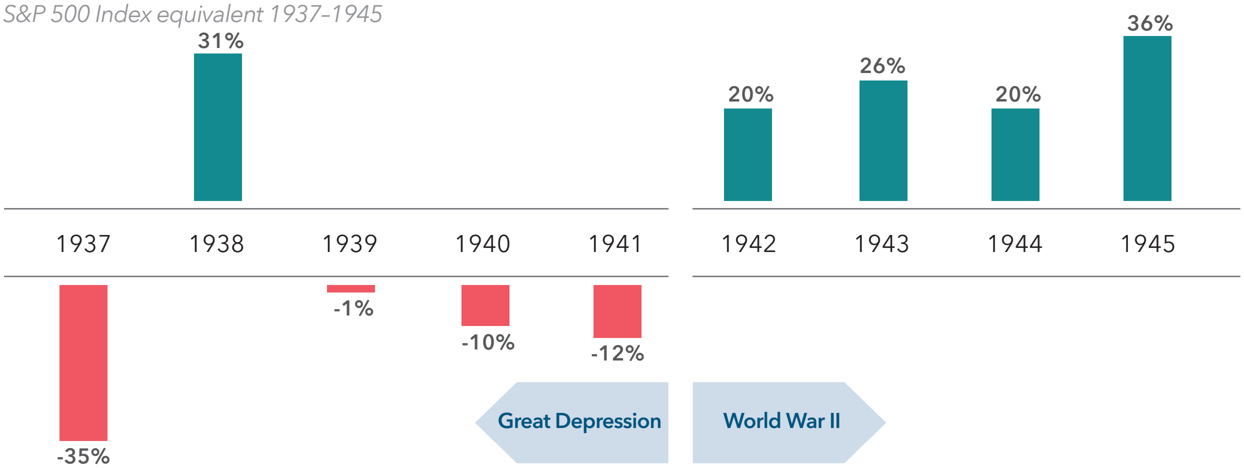
Finding Opportunity in Crisis

In the days after America's declaration of war on Japan and Germany, Sir John shared that he decided to visit his stockbroker, not for his advice, but to give him specific instructions: *buy $100 of shares of every company selling for $1 or less on the New York Stock Exchange.* After the trade confirmations came back, Templeton had to call his broker back. He insisted that the broker *buy shares in all companies in bankruptcy for $1 or less, too.* He ended up purchasing shares for 104 companies. 37 were in bankruptcy. Templeton focused on riskier, not safer company shares. Templeton had invested about $10,000 that he had saved, borrowed and begged from family, friends and associates. That amounts to $140,000 in today's dollars when money was hard to get.

Sir John explained his reasoning for doing for what was a great gamble: he foresaw that in a world war, everything that was in surplus then would become scarce and thus

Exhibit 3: US Stock Market Before and During World War II

S&P 500 Index equivalent 1937–1945



Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Index returns not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. Actual returns may be lower.

highly profitable. An American government focused on winning would buy everything that companies could produce. Therefore, either (1) America would win and so victory and democracy would bring the world into a new future, ending the Great Depression, or (2) America would lose. In that bad outcome, hyper-inflation would eventually ensue as the Axis took over, and his debt (if not his life) would become worthless. Templeton, as student of economics, would have known of the German hyperinflation following its loss of The Great War, setting the stage for an even greater war.

Exhibit 3 shows U.S. stock market returns immediately before and after America's war began. It's context for Templeton's investment, and offers insight into economic conditions of the time. The S&P 500 index did not exist as an investible index until the 1970s. Trading individual stocks was expensive in those days, reducing potential returns. Templeton would have seen a 35 percent market drop in 1937, partial recovery in 1938 and then three more losing years. The cumulative return was minus 7.5 percent annualized. It is difficult to imagine many investors staying in the seats of that roller coaster for five years even with dividend income. Considering that total returns of the U.S. stock market were cumulatively negative since 1930, that type of losing "long run" for stocks would be much too long for most investors worried about the future.

Contrary to popular belief that returns in stocks are related to growth, and with bad news of lots of American deaths coming from war zones month after month, the U.S. stock index returned an astonishing 25.4% annualized for 1941 through 1945! Templeton, with his economic education and his firm belief in capitalism, realized that companies would find a way to make money in whatever state of the world is. Capitalism is resilient. Companies seek profit opportunities wherever they exist. Instead of cars for the public, manufacturers made tanks for the Army. Instead of toys, others made bullets. Today, instead of making alcohol, firms are making hand sanitizers. Investors willing

to put their capital at risk are rewarded. Capitalism is innovative: the solution for losing 11 million young men was to put 11 million young women to work in jobs that up to that time it was believed (most likely by men) that only men were capable of doing.[2]

The "market" is the combined value of all public companies. The S&P 500 index is a subset of a much larger group of public companies in the U.S. that comprise a "market." The U.S. market is, in turn, a subset of publicly traded companies in many countries around the entire world. The value of these companies isn't static and fixed, and changes every minute of every day. Prices of their shares are impacted by their expected profits not just for the current year but for their expected profits year-after-year. Buyers and sellers interact constantly, setting prices in real time. Volatility in the price of a company's shares likely reflect a consensus between buyers and sellers that recent events, such as shutting down huge sectors of the American economy by government mandate and thereby putting tens of millions involuntarily out of work and unable to earn (and spend) money, as well as the ripple effect of thousands of other interacting factors, negatively impact future profitability of firms. How negatively (or positively) is incorporated into share prices.

Templeton's Decision Process

No one could know in advance the War's outcome. So much would be driven by chance, although the productive capacity of the Allies far exceeded that of the Axis powers. If the Axis powers won, then Templeton's stocks would have become worthless or expropriated. That would not have meant young Templeton made a mistake; the quality of a decision—how sensible or informed—is based on information known at the time, not the outcome. In the war's early days, those highly volatile shares likely declined more than once, likely severely. Templeton's success depending not only on buying shares but holding onto them for the entire time he planned, even though stock prices often changed unpredictably and violently with war news

So how did Templeton's strategy turn out? By war's end, 4 stocks were worthless, but 37 had been in bankruptcy when purchased. The rest of the portfolio more than made up for those losers. Templeton's original $10,000 investment multiplied to about $80,000 by the time the war ended after four years—over $1 million in 2020 dollars. He would have been 33 years old at the time.

From those early days, Templeton gained a "maximum optimism" that his methods would reward him—over the long term. Small companies struggle more than large companies, and so prices are more volatile. But Templeton understood that the prices he paid for those shares incorporate expectations about future profits due to the war. He sold out of all those shares just before a brief market downturn in 1946. What principles did Templeton intuitively understand and apply that decades of modern theory and research of financial science have confirmed?

Diversification: Rather than betting on a small number of stocks he had "researched" for their "potential," as was common practice of speculators, Templeton anticipated modern indexing and minimized anti-selection biases by having a randomized but disciplined stock selection method. He used the "law of large numbers" to allow for a number of those shares becoming worthless.

Size Tilt: He intuited that smaller stocks, although having much higher price volatility, would provide "a higher expected return" than big company stocks to compensate for that higher risk. Their much lower price offered him informal leverage without actual loans against his shares.

Cost of Capital: We know now that a company's cost of capital is the investors return. Like Benjamin Graham believed, Templeton intuited that the less you pay for a stock relative to its book value, the less likely you would lose money. This is suggested by his insistence on buying shares of bankrupt companies, although that likely worked well due to the conditions of a war.

No Market Timing: Templeton was disciplined. He bought the shares with no intention to sell regardless of price volatility until the time he was planning to sell—at the end of the war, whenever that would be. When the War ended, he cashed out just as he had planned and paid off all his loans and taxes. He understood the high risk involved and did not speculate on the "right" time to sell. We can see from *Exhibit 4* that in 1946, the stock market would collapse suddenly once again, and taking an entire decade to return to where it once had been at the end of 1945.

How Templeton Stayed Disciplined

While all those concepts and methods were critical to Templeton's success those many years ago, I failed to understand that his investing success critically depended on being able to manage his own behavior. He'd mentioned how he did it, but did not emphasize its importance. Only after ten years of planning for clients did I appreciate the great wisdom of one thing he intentionally did.

I realized it after an experience with my own mother. I had

Exhibit 4: A History of Market Ups and Downs

S&P 500 Index total returns in USD, January 1926 – December 2019

Using a 20% threshold for downturns

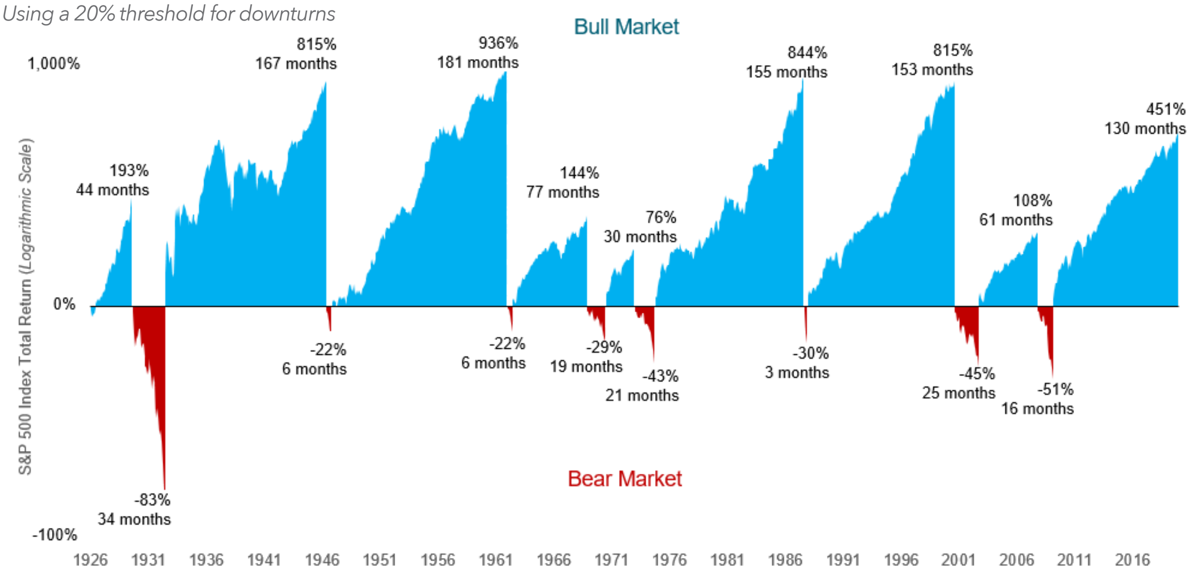


Chart end date is 12/31/2019, the last trough to peak return of 451% represents the return through December 2019.

Bear markets are defined as downturns of 20% of greater from new index highs. Bull markets are subsequent rises following the bear market trough through the next new market high. The chart shows bear markets and bull markets, the number of months they lasted and the associated cumulative performance for each market period. Results for different time periods could differ from the results shown.

Past performance is no guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Source: S&P data@ 2020 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Mom invest a modest amount in the Templeton Global Growth Fund. Most of her money was in bank CDs. She did well over the years, but the value went up and down. Every year at our review, Mom would worry about it. She grew up poor in the Depression and was afraid of stocks in any form. Mom definitely preferred her CDs, and every year recalled back in the early '80s when she got a 12 percent return rather than the 3 percent or 4 percent she got from shopping around banks. Mom maybe earned a 12 percent return with me, but she was not really happy. Finally, fearing a market drop toward the end of the 1990s, and tired of the negativity, I returned her money at a profit. To have her die with a severe price decline in the middle of a market crisis was not acceptable.

The next year when I visited, she raved about the "great investment" my half-brother put her into. She remarked about it each time I visited after that but would not tell me what it was. In 1998 Mom had a stroke that incapacitated her until she passed away five years later. Dad brought me to take over family finances and we spent two days collecting all those CDs from different banks. But what I most wanted to learn was what that "great investment" my brother had put that mutual fund into: I was shocked to discover it was a simple Vanguard money market fund.

My half-brother *was* always risk adverse, so that was no big surprise. But that my mother *believed* that it was such a "great" investment and was *so happy about it* was the big surprise. As I thought about my discovery, I eventually recalled once again my long-ago conversation with Sir John, and thought how he could tolerate all that leveraged investment risk for so many years: *He had taken the certificates themselves and put them into a safe deposit box until the war ended. Then, he didn't look at them again or pay attention to their value until it was the time he planned to sell.*

Templeton must have known himself well enough to realize that his emotions could impact his investing behavior. The frequency someone uses to review their accounts subconsciously undermines their time frame for evaluation. His time frame had to be at least five years—not five months, five weeks, or even five days. Today we get the latest media news every five minutes. Until that experience with my mother, I did not see why Investment Policies were a key framework for successful client evaluations, and a key to keeping critical planning and investing goals on track.

I realized for the first time that her problem was largely my fault. I looked back and saw the same problem with so many clients. And even though since then we've developed a reporting system and process to reduce that behavior, when clients hear too much media news they forget, and begin to check their account more often, and gradually lose their confidence. All that volatility becomes too much to handle. The best approach is to simply review it once a year, and when it is reviewed, review it as part of a complete portfolio, and not as individual components.

Each month my mother would look at those mutual fund statements just like she looked at her bank statements. Worse, she did it individually, and not as part of a total portfolio. So she judged results relative to the performance of her fixed interest CDs based on their term over the past month. No wonder she became miserable: about 63% of months it was up, and about 37% it was down. Behavioral research tells us that investors feel pain of loss twice as acutely as they feel pleasure of gain. Emotionally, the lesser bad cancelled out the greater good. Even with our annual review, gains would be 75% and losses 25% of the time with an all-equity fund.

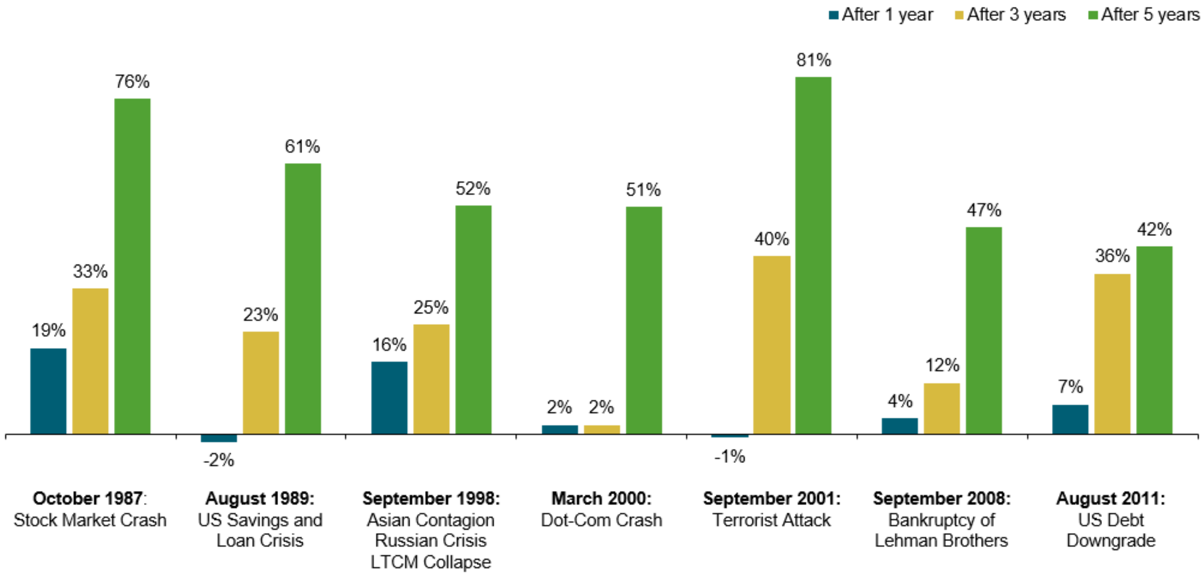
After that we formally developed and installed the first version of our automated reporting system, happily coinciding with my transition to structured strategies with Dimensional Fund Advisors. Together with a Schwab custodial platform, not only was it much easier to keep clients focused on the whole portfolio and pay less attention to the individual allocations, but planning conversations with clients were constructively reframed in a meaningful way. Combining Sir John's insight in an advanced reporting system and structured portfolios gradually transformed my practice, and my ability to provide *what clients perceived* as a successful financial experience.

How to Stop Stressing

Market volatility has returned, and it's here with a vengeance, at least until markets can reprice these new uncertainties. Fixating on unusually high volatility that you are suddenly aware of due to all the media news, unconsciously reframes your planning perspective and evaluation framework from ten or twenty years to a must shorter time frame. However unprecedented these times may be, they are unlikely to negatively impact your long-term investing outcomes if you stay in your seat, keep looking out at least five years and keep riding until car fully stops. *Exhibit 5* looks at seven major events of the past 33 years for globally balanced portfolios that echo

Exhibit 5: The Market's Response to Crisis

Performance of a Balanced Strategy: 60% Stocks, 40% Bonds Cumulative Total Return



Represents cumulative total returns of a balanced strategy inyested on the first day of the following calendar month of the eyenl noled. Balanced Strategy: 12% S&P 500 Index, 12% Dimensional US large Cap Value Index, 6% Dow Jones US Select REIT Index, 6% Dimensional International Value Index, 6% Dimensional US Small Cap Index, 6% Dimensional US Small Cap Value Index, 3% Dimensional International Small Cap Index, 3% Dimensional International Small Cap Value Index, 2.4% Dimensional Emerging Markets Small Index, 1.8% Dimensional Emerging Markets Value Index, 1.8% Dimensional Emerging Markets Index, 10% Bloomberg Ban:lays Treasury Bond Index 1-5 Years, 10% FTSE World Government Bond Index 1-5 Years (hedged), 10% FTSE World Government Bond Index 1-3 Years (hedged), 10% ICE BofA 1-Year US Treasury Note Index. Assumes monthly rebalancing. For illustrative purposes only. S&P and Dow Jones data ©2019 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. ICE BofA index data ©20l9 ICE Data Indices, LLC. FTSE fixed income indices©2019 FTSE Fixed Income LLC. Al rights reserved. Bloomberg Barclays data provided by Bloomberg. Dimensional indices use CRSP and Compustat data.

In US dollars. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Not to be construed as investment advice. Returns of model portfolios are based on back-tested model allocation mixes designed with the benefit of hindsight and do not represent actual investment performance.

a dimensionally-targeted approach. Five years later (and often in three), we see little negative impact on long-term goals if we consider only the investments. While the results of Dow Jones or S&P 500 index that are dramatized each night are scary at times, your portfolio is balanced. It's not all "in the [equity] market." Then do what Sir John did, and shut your eyes.

We don't say that jobless claims are at record levels or that economic output is not in a big hole. But economic disruption is not uniform. If you have a job (or social Security and/or pension), adequate cash reserves, substantial fixed income allocation and lines of credit or HECM—and of course, assuming you don't get sick or die—despite the recent declines, much of which has already recovered, the crisis should have little practical impact on you. If you stop saving as you planned or make unplanned withdrawals, that would be a separate planning conversation.

Learning to Trust the Market

Constant bombardment with data and relentless streaming headlines can evoke strong emotional responses due to overexposure to the internet will cause you to lose your peace of mind and lose perspective about what truly matters in life. Templeton resolved that problem by moving himself and his office to the beautiful Bahamas, far away from the babble of New York City. He felt that he could not only relax but see opportunities ahead with greater clarity.

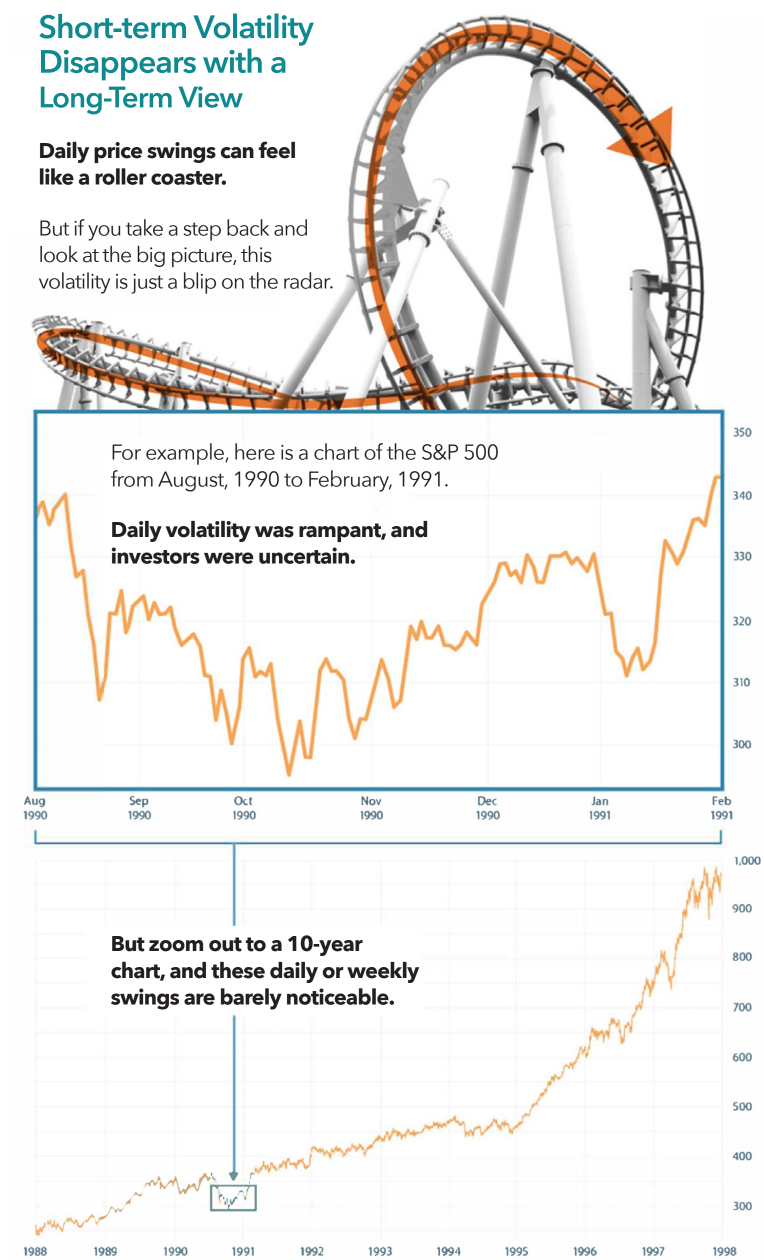
Templeton, known for his generosity and philanthropy, joked about "helping people" at critical times: When people are desperately trying to sell, help them and buy. *When people are enthusiastically trying to buy, help them and sell.* Bear markets such as we have now are the best of times for disciplined investors with long view and informed strategies: the worse it gets, the better are your expected returns as your portfolio is rebalanced. Back in early 2009 as financial markets were collapsing for their second time and clients called in fear daily, I received an inheritance from my father who had passed away only months earlier after a long illness. It was mostly fixed income. Channeling Sir John, I had a Templeton moment: that time of crisis was the best opportunity to invest of my life. I put it all into a new non-U.S. tax-advantaged equity strategy that had lost 42% from inception. Nine years later, it had returned over 300 percent. Some are not impressed, but it surely outperformed my half-brother's Vanguard money market fund. Even during this crisis, I was buying for myself and for clients down through its lowest day.

After many years I find that living here in Pittsford with an office view of trees provides an advantageous perspective. The pressures of conventional businesses in major metro areas would have prevented development of our professional wealth management process with multidimensional investment management strategies. Anecdotally, a series of plaques from old *Wealth Manager* magazines during the Financial Crisis years traces our national ranking of firms like ours from 313 in 2008 (2007 year-end data) to 200 in 2011 (2010 year-end data). While we grew 25% with about the same number of client households, many firms must have shrunk. As Warren Buffett remarked, you don't know who's swimming naked until the tide goes out.

Tuning out the MacGuffins

The Coronavirus event has unleashed unprecedented Federal, state and international executive actions to shut down businesses and ordinary daily life. We are now in a major recession. Based on better models with more recent data, this event, although serious like the Hong Kong flu, might not qualify as a "pandemic." But no conversation considering the costs and benefits of far-reaching governmental mandates seems to have been tolerated by media or elites. Prolonged shutdowns as heroic measures to hopefully save a handful of lives ignores the agony in human cost of millions of lost jobs and paychecks, ruined businesses, and the psychological toll on the majority of Americans not affected. New models suggest costs outweigh benefits by at least 4 to 1.[3] This "crisis" seems manufactured and intended to destabilize a healthy American economy. A monetary crisis due to exploding U.S. government spending and debt will play itself come November elections in highly unpredictable ways. And all the while, markets will keep incorporating economic prospects of all this information into stock prices.

The Coronavirus appears to have become a politicized MacGuffin. What's a "MacGuffin"? In movies, a MacGuffin is an object or event necessary to the plot and motivation of the characters, but unimportant of itself. MacGuffins were a favorite plot device of Alfred Hitchcock (who invented the name) to distract the audience from the important action going on, or more

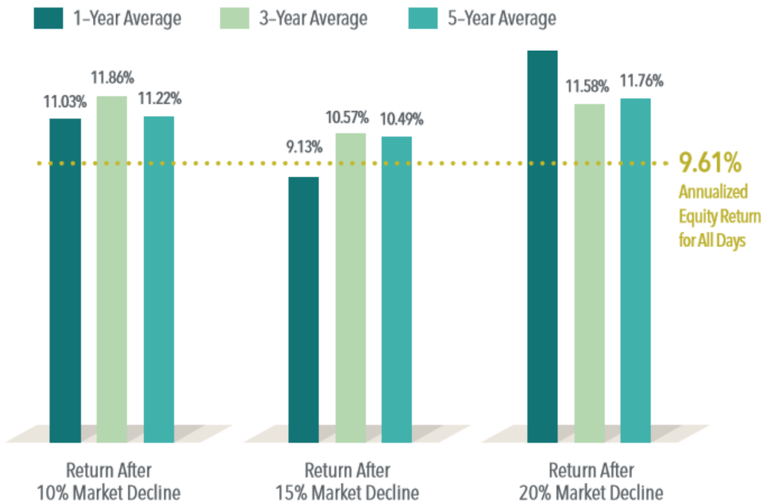


Source: *stockchart.com, accessed Jan. 19, 2019.*

recently like George Lucas used them as plot devices with an importance of its own, setting into motion a whole chains of events (think of Star Wars' R2D2 with Death Star specifications inside).

Governors justify their actions by appeals to "science." But from my little place far away from the madness of crowds, many such appeals appear transparently political or ideological. The World Health Organization case-fatality estimated rate of 3.4% has been discredited, and the original high-side estimates from the Imperial College London were reduced almost 95%. The models employed used data biased by survivorship. Dr. John Ioannidis, a statistical expert, performed a statistical sampling near

Exhibit 6: U.S. Equity Returns After Sharp Downturns
July 1926-December 2019



Past performance is no guarantee of future results. Investing risks include loss of principal and fluctuating value. There is no guarantee an investment strategy will be successful. Short-term performance results should be considered in connection with longer-term performance results. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

Periods in which cumulative return from peak is -10%, -15%, or -20% or lower and where a recovery of 10%, 15%, or 20% from trough has not yet occurred are considered downturns. For the 10% threshold, there are 3,442 observations for 1-year look-ahead, 3,396 observations for 3-year look-ahead, and 3,345 observations for 5-year look-ahead. For the 15% threshold, there are 3,175 observations for 1-year look-ahead, 3,167 observations for 3-year look-ahead, and 3,166 observations for 5-year look-ahead. For the 20% threshold, there are 2,561 observations for 1-year look-ahead, 2,560 observations for 3-year look-ahead, and 2,560 observations for 5-year look-ahead. 1-year, 3-year, and 5-year periods are overlapping periods. The bar chart shows the average returns for the 1-, 3-, and 5-year period following market declines. Data provided by Fama/French, available at mba.tuck.dartmouth. edu/pages/faculty/ken.french/data_library.html. Eugene Fama and Ken French are members of the Board of Directors of the general partner of, and provide consulting services to, Dimensional Fund Advisors LP.

San Francisco and estimates a truer infection fatality rate with an outer bounds of 0.05 to 1%—comparable to the seasonal flu.[4] This corresponds to actual death rates on those petri dishes floating in the ocean, the Diamond Princess and the USS Theodore Roosevelt. The fast recovery of the markets is likely due in part to incorporating this new information.

Conclusion: What Will Your Ride Be Like?

Price contagion from the Coronavirus precipitated a market panic worldwide. The "madness of crowds" as well as hedge fund algorithms fed the market monster. "Stocks End Worst Quarter in 12 Years" announced a *Wall Street Journal* headline of April 1. It was not an April Fool's joke. But excessive market volatility is ebbing. Those on this wild roller coaster ride should keep in their seats until the ride slows to a more normal speed.

Sudden market downturns such as the recent roller coaster you've been riding can be unsettling. Sticking with the wealth planning strategy we've designed for you is most likely to best capture the recovery and to achieve your long-term planning goals. Don't have a crisis of confidence now. You've realized the risk; you might as well stick around for the return you expect.

A broad market index tracking data since 1926 in the U.S. shows that stocks have generally delivered strong returns over one-year, three-year, and five-year periods following steep downturns. The average equity return for all days is 9.6% annualized.

- Just one year from a decline of 10% or 20%, returns were higher than the long-term average of 9.6%. And the return after a 15% decline was within half a percentage point of the average.
- Looking three and five years past declines of 10%, 15%, and 20%, also shows annualized returns averaged higher than the long-term average. For 20%, the average five-year return is 11.8%. Of course, portfolios with fixed income allocations will have a lower expected return.

Returns from 1945 to 2020 show that the average monthly return of U.S. equities is 65 bps (0.65%). At a market high, expected return is -220 bps *per month* (negative). At the low its 320 bps *per month* (positive). Clients who rebalanced on the ride down should keep that in mind.

You know, looking back on that day with my wife—that Disney roller coaster was a great ride. There will be roller coasters in your life, too. You must decide which ones to ride. Make sure they are ones that won't go off the rails or get you thrown off. Sometimes we brag about our bravery and talk about those rides where we screamed at the time. But we want to do it again.

We have many clients who stayed in their seats in times like in 2008-9. Sometimes, when we get together, we talk and laugh about those rides from years ago. And they want to do it again. And for me, I think each time of Sir John Templeton who taught me how to trust the market.

Endnotes

1 Assuming you avoid premature death, disability or divorce, of which two can be insured to offset financial loss.

2 Full disclosure: My mother helped assemble airplanes in California during WWII, earning more than she ever did in her life. She could afford to pay someone to take care of my older half-brother who was of pre-school age. I only came along a lot later. Strangely, I happen to be an uncle to cousins in Texas who are older than I am.

3 PandemicCosts.com, see U.S. daily cumulative costs of the COVID-19 pandemic, updated daily. As of April 23, 2020 that figure is $7,798 per household or $947 billion in aggregate. This does not include nearly $3 trillion in U.S. government spending in addition to a $1 trillion deficit already expected for 2020.

4 Allysia Finley, "The Bearer of Good Coronavirus News," *Wall Street Journal* (April 25-26, 2020). Andrew Bogan, "New Data Suggest the Coronavirus Isn't as Deadly as We Thought," *Wall Street Journal* (April 17, 2020). See also, Editorial Board, "Corona Models of Uncertainty," *Wall Street Journal* (March 30, 2020).

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Paul founded Professional Financial Strategies, Inc. as one of the first fiduciary advisory firms in 1993 that now specializes in retirement and wealth planning for affluent and aspiring families. Paul is a personal chief financial officer who acts in the best interest of clients. He brings together a distinctive management process and a network of specialists for making informed decisions for scientifically-structured investing, secure income, mitigating taxes, protecting assets, and preserving wealth for family and causes for making an enduring impact.

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