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INVESTMENT ADVISORY GROUP

Lessons (Re-) Learned

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At the Master's golf tournament, long-time TV announcer Jim Nantz describes the championship as "*A tradition unlike any other*." For investors, 2022 has been a year unlike any other. With both stocks and bonds declining in each of the first three quarters – for the first time ever – it's also one that most investors would prefer to forget. But just like politicians don't like to let a good crisis go to waste, we should never let a bear market pass without reflecting on the important lessons learned, or in some cases, re-learned. Like the aches endured to build muscle, the pain of 2022 should make us stronger investors and financial planners. We think this year has provided all of us with a bounty of valuable lessons:

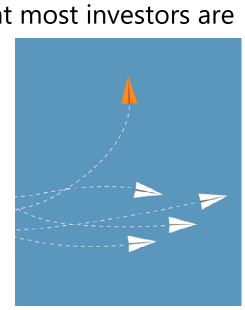
- **Past Performance is No Guarantee of Future Results** – We list this first because it's the most important. This ubiquitous disclosure that can be found at the bottom of every piece of financial services marketing is not just a CYA – It's a strategic and tactical rule. And it's very important to both portfolio design AND financial planning. Just because something has happened before, even if it's been going on for a long time, doesn't mean it will continue (e.g. – U.S. stocks performing great). And just because something has NOT happened, doesn't mean it can't (e.g. – Core Bonds declining over 10%).

- **Don't Fall in Love with your Investments** – Prior to this year, Large U.S. Growth stocks had risen with such consistency over the past 10+ years that it seemed like their annual ascent had become a law of nature. They had gained 19.8% annualized for the ten years ended 12/31/21! Yet, unemotional investors knew that their valuations were 60% higher than their 20-year average. This year, they are some of the biggest losers and were down 31% through September 30.

- **Be Flexible, Tactical, and Keep an Open Mind** – Investors today have never had more options. Unfortunately, taking advantage of these opportunities can be difficult as many of them are complicated, or may have such differentiated performance patterns that they can be hard to hold for the long-term. For example, for the seven-year period 2014-2021, Managed Futures (an Alternative strategy) provided a very frustrating experience. Yet this year, while stocks and bonds have suffered, they are one of the few strategies to post strong, positive returns. It's important to have a large toolkit, and to know when a particular tool might be useful.

- **If it's too good to be true, it is** – If you haven't heard, several big players in the Cryptocurrency space have crashed and burned in the past few months. One of them, FTX, had an affiliated hedge fund, the marketing documents for which offered "*High Returns with No Risk*." They promised 15% returns, guaranteed, with "*no downside*". I'm not kidding. Their marketing document actually said that. They attracted Billions. They went bankrupt.

- **It's OK to be Different** – With core assets like stocks and bonds both down sharply this year, many Alternative Investments have provided shelter during this year's storm. We believe that most investors are much too focused on the U.S. stock market, especially large companies, when there are literally trillions of dollars of other investment categories available – both public and private.



- **Beware Shiny New Things** – This year it has been Crypto and NFTs. Last year it was SPACs. Not too long ago, Energy MLP's couldn't miss. Before that it was fix-and-flip real estate, which followed the Tech Bubble. There's always something. And after those who get burned at the stove retire, another set of naïve speculators take their place.

- **Have a Margin of Safety in your Investing Strategy** – In other words, ask yourself, "*What if I'm wrong?*" Also ask yourself, "*What's the worst that I think can happen?*" And then plan for it being a little worse. This requires diversification, risk management, discipline, and proper position sizing. Even if you're convinced something will go up, or down, you should remain diversified and humble, and size your "bet" responsibly. Nobody knows for sure.

- **Have a Margin of Safety with your Financial Plan –** With stocks and bonds both down this year, and inflation at a 40-year high, a strong argument could be made that the beginning of this year was the worst time to retire in many decades – perhaps since 1929. Without a margin of safety in your plan, a lifetime of saving and planning could be under severe stress in just 9-10 months. Consider that with many conservative portfolios down 15-20%, and inflation over 8%, someone who saved and planned for decades and who retired on January 1st could have watched their life savings lose 20-25% of its purchasing power in only nine months! Some ways to build a margin of safety into a retirement plan are to:

  1) Keep 1-2 years of living expenses in a cash "reserve" so you are not forced to sell during a downturn,

  2) Work part-time during retirement,

  3) Have a robust portfolio designed to keep up with inflation while seeking to avoid significant declines during the retirement withdrawal phase - especially important during the beginning of retirement, and

  4) Plan for your savings and investments to meet 100% of your retirement needs and view Social Security as "extra".

- "**Abnormally good or abnormally bad conditions do not last forever**" – This is a classic quote from famous investor Benjamin Graham. If you recall the end of 2021, most stock markets gained 15-30% during 2021, and house prices were rising at double digit rates across much of the country. Everyone felt euphoric. Then 2022 came and it's been one of the most challenging investment years on record. We like to remind clients to not get too excited when things are going great, or too down when they're not. Looking forward, if history is any guide, this too will pass, and this investing winter will turn to spring.

Benjamin Graham also famously said that "*Those who do not remember the past are condemned to repeat it*." That's been evident in 2022 as many of this year's lessons were also taught during the bear markets of the 1970's, the Tech Bubble of 2000, and the Great Financial Crisis of 2008. Whether this list is new to you or not, the difficulty of this year should serve as a valuable lesson or reminder of the importance of building resilient portfolios and robust financial plans.