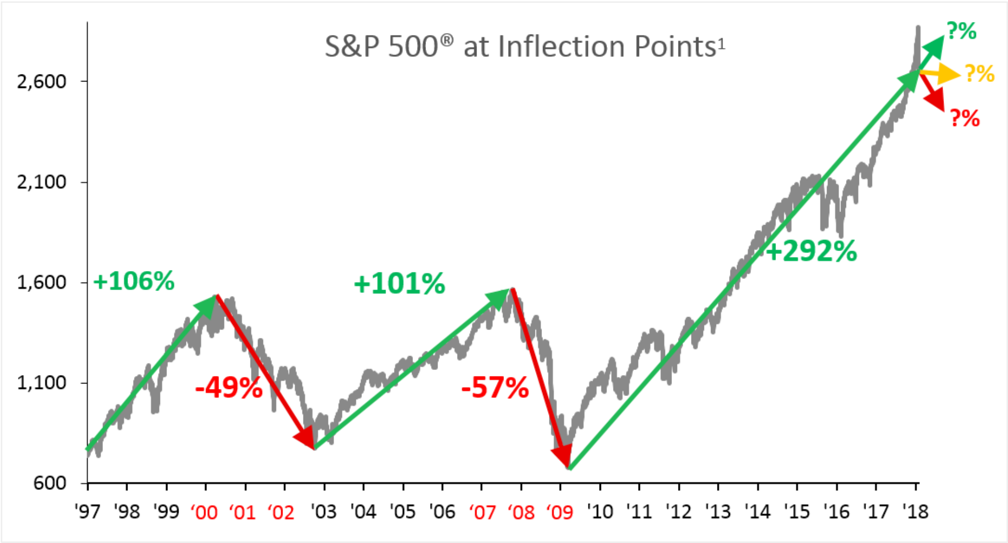
Beaumont
CAPITAL MANAGEMENT

"FOMO" or "Oh, No!": Balancing Risk and Capital Gains

By David Haviland, Managing Partner and Portfolio Manager

Can you be honest with yourself? Seriously...completely honest? OK, then please answer this question:

When was the last time you reviewed your portfolios and rebalanced them back to the asset allocation outlined in your financial plan? As the chart below illustrates, we have been enjoying a nine-year bull market, currently the second longest in history, which may continue to run for a long time. Or not. No one, including us, has any idea what the next week, month or year will bring. Looking at the chart, what does your gut tell you will happen next?



If you've been invested in, for example, a 60%/40% (equity/fixed income) portfolio, and it has grown to 80%/20%, then congratulate yourself on your growth! However, if your plan, risk tolerance and the achievement of your goals is based on 60/40 portfolio, what would compel you to keep your current allocation? Now, would you rather capture some of these gains, take some equity off the table and maintain your desired 60%/40% portfolio allocation, or let the markets rebalance it for you? Interesting perspective, right? What if the markets correct so much your 60%/40% becomes a 40%/60%?

We all know the markets are cyclical, that they will have a major correction or bear market eventually, and that this bull is getting old. So, your options are to take some of your risk off the table while the markets are going up (keeping your gains intact), or to take no action and give the markets an opportunity to destroy your gains when they go down. Inevitably the markets will go down, and statistically speaking it will be relatively soon.

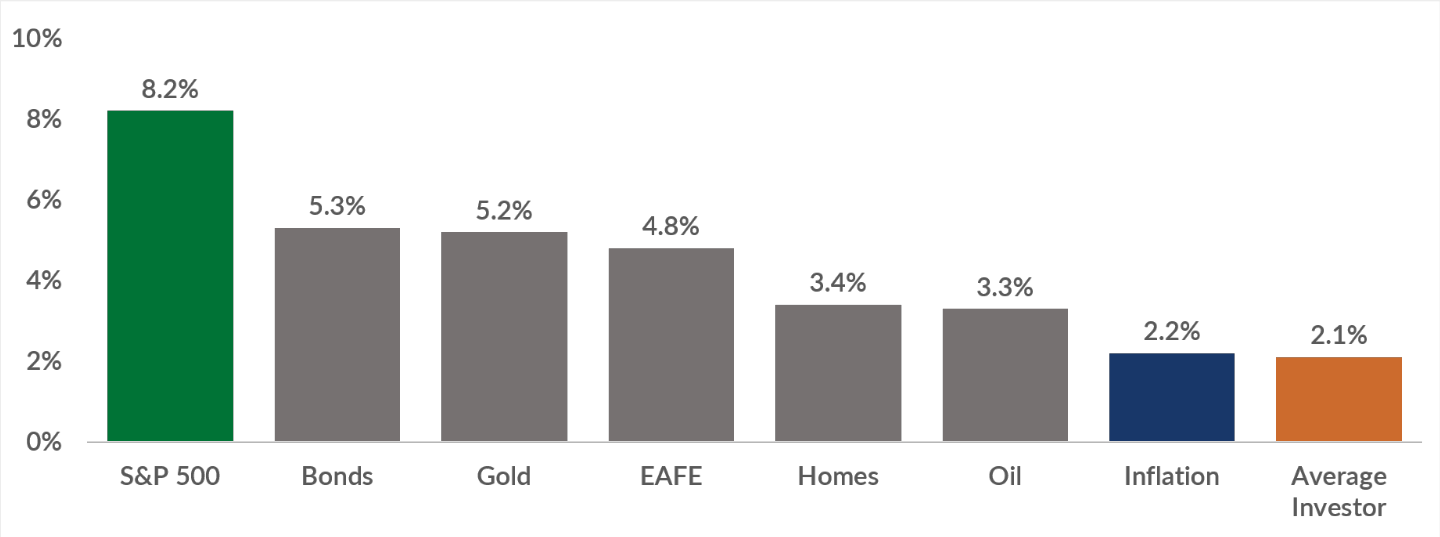
With this in mind, what is stopping you from taking action? Is it capital gains taxes? Oh, please! Paying more tax is a wonderful problem to have. As a portfolio manager, I have a different perspective: investors pay me to create capital gains. You want to pay capital gains taxes, as it means your account has risen in value and you have realized these gains! And, you have to look at it relative to the alternative—would you rather pay 15% long-term and up to 40% short-term (Federal rates) tax on realized gains... or wait until the next bear market has destroyed those gains altogether? Would you rather sell and keep 60%-85% of your gains (after tax) or keep 100% of nothing?

So aside from taxes, what else would stop you from being financially prudent? FOMO, or the "Fear of Missing Out" on additional gains? Others call this greed. In the investment business, bulls make money, bears make money and pigs get slaughtered. Keep your emotions in check and act while the time to act is in your favor. Now that you are nine years closer to retirement, how much risk do you want to take? What does your financial plan say? Whose retirement and financial well-being depend on wise, timely decisions? Make one!

A few more questions:

Can your manager adapt, or is s/he subject to one of two evils: the very same emotions as you (active) or the inability to sell (passive)? Yes, inability to sell! Check your holdings; if they are in an index-following strategy then they will go up *and* they will go down with the index. Even most active managers have significant limitations on their ability to sell. [Click here to read more on investment managers only doing half the job.] If you invest in index-following strategies, then losses, when the index declines, are guaranteed…unless of course you have the crystal ball that tells you when to sell at the top. I'm not being flip but rather brutally honest. As the DALBAR study below so pointedly shows, the average investor has earned a quarter of what the S&P 500® Index has over time due to emotionally based, ill-timed decisions. What makes you any different?

20-Year Annualized Returns by Asset Class[2]



Since most managers are unable to sell when markets begin to fail, the sell decision falls on you. Re-enter poorly timed, emotionally-based decisions. But what if there was another way? What if there was a method of investing, based on rules developed over time, which was designed to make the buy AND sell decisions for you? Would this kind of investment system have a place in a balanced financial plan? We certainly think so—it's called tactical management.

If you want a manager that only buys…good luck to you. Buy and hold works in theory, but I have yet to meet a client in my 31 years of wealth management who can withstand a 2000-2002 or a 2007-2009 bear market without panic selling at some point, usually near the low.

If you want a manager that makes both the buy and the sell decisions for you, as we march through time and in virtually all market conditions, then explore tactical management. Plan to succeed and plan to avoid failure. But for now…rebalance!

For more insights like these, visit BCM's blog at blog.investbcm.com

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Sources and Disclosures:

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The views and opinions expressed throughout this piece are those of our Portfolio Manager as of March 2018. The opinions and outlooks may change over time with changing market conditions or other relevant variables.

[1]Bloomberg. Data as of 2/14/18. The returns shown in the chart are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. The Standard & Poor's (S&P) 500® Index is an unmanaged index that tracks the performance of 500 widely held, large-capitalization U.S. stocks. Indices are not managed and do not incur fees or expenses. "S&P 500®" is a registered trademark of Standard & Poor's, Inc., a division of S&P Global Inc.

[2]DALBAR, Inc. "Quantitative Analysis of Investor Behavior, 2016", www.dalbar.com

Past performance is no guarantee of future results and an investment cannot be made directly in an index. As with all investments, there are associated inherent risks, including loss of principal. Diversification does not ensure a profit or guarantee against a loss.

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