

My investment philosophy; ten ideas about money and the future.

These ten ideas are not gospel. That's because depending on how old you are or how close you are to retirement; the message gets cloudier. But if you want a reasonable summary of how I think about investing money, these are useful thoughts to keep in mind. We can argue right now about the political divide in this country and how it will affect your financial future. It does, however, represent an existential risk for all of us. How you deal with that risk, and understand how it will influence your life, is what you have to come to terms with.

1. In the long run, real wealth comes to the owner, not the lender. The Ibbotson chart of which we (financial planners) are so fond, shows 80-year average annual returns of about 10.7% and 12.6% for the stocks of large and small companies respectively. Long-term corporate bonds in the same period paid an average of about 5.6%; long-term government bonds returned 5.1%.

Either these numbers are random, or it looks like you get paid about twice as much to be an owner as to be a loaner. But wait: These are merely the nominal returns. Adjusted for 3% average inflation over that period, the equity investor earns more like four or five times what a debt investor does in real terms.

Now, you know there's gotta be another variable in here somewhere. An efficient market doesn't pay equity investors four or five times the real return of bonds because owners are better human beings.

So, why do equities return so much more than bonds? The academic answer is more risk. But the answer is not that they are "riskier" but that they are more volatile. And risk and volatility are two totally different animals. For now, just focus on the apparently incontrovertible fact that, in the race for real worth, bonds are a non-starter.

2. The great risk of the 20th century was losing your money. The great risk of the 21st century will be outliving your money. You may be retired nearly as long as you have worked; in retirement, you'll still have to deal with as many as three decades of rising living costs. Twenty years ago, a first-class postage

stamp cost 13¢; today it (and everything else) costs almost 4 times as much. In the same 20 years, the cash dividend of the S&P 500 quadrupled, (while the index itself octupled), and bond yields actually went down.

The point is that whether you believe in the Ibbotson return relationships or not, you still need to be an owner. If you've got any kind of life expectancy, and/or heirs you really care about, bonds are irrational. Don't look at yield; look at total return.

And above all, don't mistake certainty ("I'm guaranteed to get my \$100,000 back in twenty years") with safety ("Twenty years from now my increased dividends will let me buy everything I do today, even though everything will cost two or three times what it does now.")

3. All you have to do to be a great investor is to be able to watch huge percentages of your capital disappear every so often and have faith that the disappearance is temporary. Here is what you need to know: every advance is permanent and every decline is temporary. The DOW was about 170 at the end of WWII; on October 3, 2018, it was 26,828.39. Did it get there in a straight line? No, life never moves in a straight line which is what makes life interesting.

During the last century, the DOW took ten hits of 20% or more; the average was 28.4%, and the market went down for a year or so. Here is the key; you could not know intellectually how, when or why any of those declines would end. You could, however, maintain perfect faith that they would end. And that turned out to be all you needed to do just hold on. Long term equity investment success is, therefore, as has been said so many times before, not the triumph of knowledge over ignorance, but the victory of faith over fear.

4. No panic, no sell; no sell, no lose. If markets are only capable of creating temporary declines, permanent loss can only be created by people – losing faith, succumbing to fear, and selling. That's a remarkable realization, and it enables people to see that volatility isn't, in and of itself, risk. Warren Buffet's net worth went down \$342,000,000 on October 19, 1987 – and yet he didn't lose anything. Why? He didn't sell, of course. Markets don't kill people. People kill themselves.

The same people (well, the same kind of people, anyhow) who sold the

Mexican Bolsa during the peso crisis in the fall of 1994 after it went from 3,000 to 1,500, and then watched it go to 4,500 in three years, are now selling Thailand and Brazil. Mark my words, they'll someday sell the US at exactly the same point in our euphoria/panic cycle. Unless they have an advisor, whose faith is so strong it vanquishes their fear.

5. You cannot time markets. The only way you can be absolutely sure of participating in every day of the permanent advance is to be willing, even eager, to participate in every day of the temporary declines. That is the deal.

6. If the volatility was not there, the investment returns would not be there either. There is no such thing as good markets and bad markets. There is just one supremely efficient market, in which return, and volatility are two sides of the same coin. If the volatility of stocks died down, over time, to match the volatility of bonds, the premium return of equities would disappear, God forbid. The size, scope, and frequency of the temporary declines are responsible for the shape of the permanent advance. That is also the deal.

7. A portfolio matched to the great goals of life is an investment. A portfolio driven by a market outlook is a speculation. If your goals have not changed (which is a way of saying: if your life and the lives of the people you love have not changed) and if your portfolio is appropriate to your goals, why change it?

Changing your portfolio because of market conditions is virtually synonymous with abandoning your goals. ("Yes, I am still 56 and my bride is 51 and our kids/heirs are still young adults, so over the next two generations, our investment time horizon is about two-thirds of a century...but I gotta sell Thailand and Brazil... which in my heirs' lifetime will probably be as fully developed as Europe is today... because those markets are getting killed this month!")

Do not speculate. In other words, do not let your portfolios be driven by a market outlook. Keep your head out of today. Keep asking yourself, "Where will these markets be in 20 years?" Look back 20 years and see how far we have come. Maintain a life-driven, goal-oriented, long-term (indeed, if appropriate, a multigenerational) perspective.

8. Focus on the big picture. The central reality of our time is not the downward revaluation of currencies and markets of some emerging countries

that got ahead of themselves. It is the global capitalist revolution in these and indeed all the countries of the world. It is the conversion of the world energies to free-market capitalism. It is the explosive growth of property rights and the concomitant eclipse of big government. It is the twenty-first century paradigm: globalization!

Whatever battles have yet to be fought, this war is over. The good guys won. This is the great getting'-up morning of universal economic freedom and development. And there is a lot more to come. Just think India and China.

9. Focus on the other big picture. Technological progress, coming at a speed and on a scale hitherto unimaginable. And all of it coming from the private sector – which means we can own it!

Think of the great technological breakthroughs of 50-70 years ago; jet propulsion, radar, atomic energy, lasers – virtually all products of government research and development. Things are not like that anymore. So much innovation today comes from small, entrepreneurial, capital hungry companies that we (or, more properly, our portfolio managers) can invest in. And I say again: there is a lot more to come.

10. Try to remember how relatively elegant today's problems are. Seventy-five years ago, we did not know if capitalism had a future. Sixty-five years ago, we did not know if democracy could survive. Fifty plus years ago, the Cold War froze the world over and in the Cuban missile crisis, we probably got as close to the suicide of the species as we will ever get. The next year, an American president was assassinated.

Fifty years ago, a presidential candidate and our greatest civil rights leader were shot to death within weeks of each other. Forty years ago, OPEC and Watergate. Thirty plus years ago, stagflation, the Ayatollah, and Oil Shock II. Eighteen years ago, almost everyone believed the world would end when computers would crash on January 1, 2000. Today we have a massive national debt that somehow has to be fixed. And, of course, the events of 9/11 have indeed changed the way we live.

But as we move forward, and apply our collective energy to solving our problems, we understand that crises do occur from time to time and yet we

somehow prosper.

Yes, there will be new crises. A phrase that comes to mind is that you never step in the same river again; water moves on and takes with it all the footprints we leave behind. In so many ways, the issues of today are wonderfully elegant compared to those of yesteryear. And that the investment opportunities created by the problems of today are truly historic.