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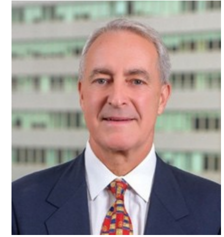
Thoughts for Investors



Albert C. Boris, III
Managing Director, Investments

Ten Investment Life Lessons I Shared With My Children

Summer Client Letter 2021

I started writing these quarterly letters in 1997. Following the birth of my son, I wrote about the downside of electronic "baby monitors." Each "squeak" from a baby brings the parents running. I compared this to investors who monitor the news and their portfolios constantly, worrying about every market "squeak."

Well here I am in 2021 and that "newborn" is 23 and his sister, is 26. Recently, my daughter thanked me for managing the stock portfolio I started for her when she was born. She has enjoyed the fruits of a 26-year head start on "compounding" her portfolio! Now she wants to learn and take a more "active" role in managing and growing her investments as her friends are doing the same.

As a naturally inquisitive and intelligent woman, she asked what I learned as an investor and portfolio manager over my nearly 40-year career that I could share with her. It's ironic that few investors ask me how I invest my own portfolio. Instead, they will seek out and subscribe to financial media and tweets often written by people who don't actually manage portfolios and whose views shift with the wind (and ratings).

Do I try to "teach" her "portfolio management"? I doubt she and her friends are interested or have the time to attend company "analyst days," or talk to company managements, analysts or industry knowledge leaders. Do I educate her on reading 10-Ks, 8-Ks, annual reports, research reports or accessing "sec.gov"? Just what kind of "research" should my daughter be doing to make smart decisions about her money? Monitoring "tweets" and chat rooms? As we have long argued, portfolio management is not a part-time job, squeezed in between career or family demands or done while on your Peloton. Nor can any portfolio be put on "auto-pilot." Should she build a "diversified" portfolio of "5-star" funds or ETFs with the help of a "robo- advisor" as her friends might be doing? As the government admonishes, "Past performance is no guarantee of future results." Why did they choose those words? What is the difference between "performance" and "results?" What, if anything, is the connection between the "past" and the "future"when it comes to investing?

I believe that to become a better educated investor, non-investment professionals should concentrate all their initial effort on developing the right "behavioral skills" for investing. The stock market can fluctuate wildly sometimes and the cause is never quite the same every time. How you behave during these periods can be critical to your investment success. Changing investments in response to events that have already occurred is, in my experience, one of the biggest mistakes investors make. So instead of teaching her portfolio management, I suggested she learn these Ten Investment Life Lessons.

1. Tom W., a client, advised, "You become rich through owning not earning." As I wrote in one of my earliest client letters, Bill Gates had just gotten a salary increase to over $900k per year.
Nice, but it is Microsoft stock (owning) not his salary (earning) that accounts for his great wealth. Likewise Jeff Bezos at Amazon and many others. Stocks allow you to become an "owner". By the way, bonds make you a loaner not an owner.

2. My father said, "Use your brain not your back. It's stronger." I will worry when mankind has exhausted the capacity of the human brain. I believe the stock market (andlife) has as much potential as the human brain has capacity…limitless, IMHO.

3. Learning to save is important and learning to invest is even more important. Don't confuse the two. Buying US Treasury bonds is saving. Owning stocks is investing.

4. To invest, you need an investment style or approach. Decide what yours will be. If you are learning to throw a ball, you must first decide whether you will be throwing right or left-handed. Or maybe you prefer the game where you kick the ball instead? Read The Money Masters by JohnTrain (available used online for ~$5). It explains the different investment approaches of nine great investors. Surprising to many is that though their "investment approaches" vary greatly, their "behavior" when investing is quite uniform. With respect to the debate between "growth" and "value" investing, we believe they are like the eaves of a roof. You need both to stay dry. Copy a Money Master or a combination based on your personality.

5. Memorize the Cardinal Rule of Investing: For every buyer there is a seller and for every seller there is a buyer and they both think they're right. The stock market is an auction market. There are no "piles" of stock like piles of goods in a grocery store. Nor are there piles of "cash" to take from when you are tired of your stocks. No stock changes hands until both buyer and seller agree on a price. You better know(or attempt to know) what the other side is thinking. When you are tempted to sell in fear, buyers will be eagerly taking advantage of that "emotion." Likewise when it seems the "sky's the limit", ask yourself why current owners would be selling such a great investment?

6. You want to look for the needle in the haystack. The needle is the useful part. There are not 500 "needles" in the S&P500, it's mostly hay.

7. Concentrate your efforts on seeking "results" not "performance." "Performance" tells you if you are "leading" whereas "results" tell you if you won.

8. The "story" of the stocks you own might have many "chapters." But the story is only finished when the stock is sold. In the meantime, volatility is not risk unless you don't know the difference.

9. Decide whether your goal is to leave heirs an apple seed or an apple tree.

10. Above all, remain patient. Patience is an investor's greatest friend and emotion their greatest enemy. As Steve M. says, "I've lost more money on the stocks I sold than the ones I bought." Good managements are always trying to improve their company. Don't sell too early. Time is critical to compounding and compounding is critical to creating wealth. "It never hurts to take a profit" is most often uttered by investors who sold too early. It is also uttered by investors who never had conviction that they owned a great stock. Remember, your downside is limited to what you invested (and for some, the government allows you to write-off part of a loss) whereas your upside can potentially be unlimited.

In conclusion, I explained to my daughter that today, as much can be controlled from your smartphone, many investors assume investments can as well. If it were that easy, why isn't the world filled with index fund multi-millionaires? Decision-making involves "emotion" and great decision-making involves emotion plus "imagination". The Ten Investment Life Lessons are built to harness emotion and imagination. These are unique human traits, difficult to learn, defy "automation" or "calculation", make possible the impossible and thus contribute greatly to wealth creation. This, we believe, is where investors should concentrate their learning.

The growth of a child also involves emotion and imagination in the form of patience, love, at times detachment and a recognition that each one is unique and matures on his/her own schedule. And with faith, in the end there is no greater reward for a parent. I couldn't be prouder of the adults my children continue to become. As they continue to master the Ten Investment Life Lessons along their own path, I believe they too will one day pass along an apple tree.

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The Boris-Kaplan Group // 1735 Market Street, Suite 1400 // Philadelphia, PA 19103 // T 215.563.2300
www.alexbrown.com/boriskaplan

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