Thoughts for Investors

Audi Partem Alteram

ALEX. BROWN
A DIVISION OF RAYMOND JAMES®

Albert C. Boris, III
Managing Director

03/13

Beware, The S&P Has No Fear

My daughter recently got her driver's license. I believe you can learn something about investing by comparing it to the art of driving, which I will attempt to do in this newsletter.

"By three methods we may learn wisdom: first, by reflection, which is noblest; second, by imitation, which is easiest; and third, by experience, which is bitterest."

— Confucius

I still remember learning to drive. For months before my 16th birthday, my father told me all about driving and got me a copy of the driver education booklet from the Department of Transportation so I could memorize the laws. Next he told me to pay attention as he drove. Finally one sunny Sunday afternoon in July, with my driver's permit in hand, my father took me to the deserted far end of a mall parking lot and I drove around in circles. I soon learned that not all driving is done on sunny days in empty mall parking lots. Driving in real life is a lot more difficult. Like driving a car, steering your investment portfolio can be equally complicated.

Just as a car is used to getting you to your destination, savvy investment management helps you get to your financial "destination." As evidenced by the number of cars on the road, there are a lot of different destinations.

Before starting a road trip there are certain preparations you should make. Your first decision is whether to drive your own finances or be a passenger and pay for a driver (a financial professional). The next obvious consideration is where are you going? When investing, this is called setting your goals. If you choose to let someone else drive, then you need to tell them where you want to go. Though it may sound silly, some investors seem to tell their advisors, "Just drive and I will decide when we are there." In other words, they give their investment advisor insufficient instructions or keep changing the destination and then wonder why they don't get where they want to go. Whether driving or investing, you need to know your destination, have planned a "route" to get there and tell the driver.

"You have to be careful if you don't know where you are going, because you might not get there."

— Yogi Berra

In my experience, investors who don't get to their destination, i.e., don't have enough savings for retirement, can trace the problem to several factors. Some don't have a route, i.e., getting in and out of the market, some change drivers (client advisors) too often, and some either drive too fast and crash or drive too slow and never get there in time. Just as you know you cannot drive all the way to Hawaii, investors should know by now that living off the interest income from bonds today is near impossible (unless you have lots and lots of them or extremely modest expectations). On a road trip, not having directions not only means it may take you longer to get there but it will probably cost you more in fuel and driver costs. It is similar when investing. Of course, both travelers and investors should always be prepared for unexpected detours and delays, since markets will continue to fluctuate and roads will continue to be bumpy.

Drivers must also assess “conditions” such as the weather and reliability of the car. Every parent of a teenage driver can attest to the frustration of getting into a car with no gas in the tank. Like drivers, investors often simply “jump in and go.” This is not recommended for drivers or investors.

As for the act of driving itself, everyone knows you can’t drive by looking in the rearview mirror (in financial terms, this means that past returns are not indicative of future results). Yet investors do it all the time, complimenting themselves on great past investments or on the bad investments they avoided. They assume that everything in front and behind remains the same. Whether driving or investing, you must constantly pay attention to what’s in front of you. That’s why the windshield is bigger than the rearview mirror.

“God made time, but man made haste.”

— Irish Proverb

Another major concern is what I refer to as “the danger of comparison” when investing. I admit that it is human to compare and nothing will persuade investors otherwise. Sometimes investors compare their performance (or the performance of their advisors) to that of the S&P 500 index. No investor likes to underperform “the market.” How does this theory apply to driving? Some drivers get angry when passed by another car, and then it can become a dangerous “race.”

“Have you ever noticed that anybody driving slower than you is an idiot and anyone going faster than you is a maniac.”

— George Carlin

The difficulty of comparing your performance to that of the S&P 500 is that the S&P 500 has no fear of crashing and is oblivious to any time frame. You, on the other hand, may be able to afford the luxury of driving more slowly to increase your chance of arriving safely. While the S&P 500 may occasionally pass you, and you may become annoyed, it can also hit a pothole, run off the road going around a bend, or make you carsick. Also, it does not stop to let you climb out at your retirement destination; you have to jump out while it is still moving! In other words, it continues along at the same speed regardless of all circumstances, good weather or bad, straight roads or curvy ones, or when you need to get there.

We often tell our clients that just because the speedometer can register 120 mph doesn’t mean you have to drive that fast. That’s when accidents happen. We explain that if we get them to their destination safely and on time while driving only 55 mph what’s wrong with that? Sure someone is bound to pass you. Yet like investors during the bursting of the tech, housing or financial bubbles, is it better to go fast and risk ending up in a ditch? Speeding (such as leverage) may be tempting for some investors who started saving too late, but it is potentially dangerous even for “professional” drivers.

“Obstacles are those frightful things you see when you take your eyes off your goal.”

— Henry Ford

The newest driving issue is “driving while distracted,” i.e., talking on a cell phone or worse yet, texting. When investing, I believe the equivalent is being distracted by the fiscal cliff, changes to the tax law, elections, the Greek crisis, etc. All these issues are certainly important and seemingly require immediate attention and action. Yet being distracted and not focusing on the job of investing with your financial destination in mind can be lethal to one’s portfolio.

In summary, student drivers are taught the importance of paying attention and driving defensively. I believe that advice is equally important for investors regardless of their experience level. Though you may occasionally be passed, investing defensively and arriving safely is much more important than arriving first, especially if you have family in the back seat. And of course, I believe the journey is often made more enjoyable if you allow someone else to do some of the driving.

"Go Greyhound … and leave the driving to us."

— Old Greyhound bus slogan

Thoughts for Investors is a quarterly newsletter written for clients since 1997 by Albert C. Boris, III. The purpose is two-fold. First, to help explain the investment philosophy that guides the author's approach to portfolio management. Second, to remind readers of important behavioral skills that the author believes are necessary to help them become successful investors. The author welcomes comments and criticisms, especially if they can be shared for the betterment of all investors. Audi Partem Alteram refers to our team's motto which translates to, "hear the other side."

For more information contact Al.Boris@alex-brown.com or visit www.alex-brown.com/boriskaplan.

The S&P 500 is an unmanaged index of 500 widely held stocks. It is not possible to invest directly in an index.

Views expressed in this newsletter are the current opinion of the author and are subject to change without notice. Information contained in this report was received from sources believed to be reliable, but accuracy is not guaranteed. Information provided is general in nature, and is not a complete statement of all information necessary for making an investment decision, and is not a recommendation or a solicitation to buy or sell any security. Past performance is not indicative of future results. Investing always involves risk and you may incur a profit or loss. No investment strategy can guarantee success.

Raymond James & Associates, Inc., Member New York Stock Exchange/SIPC