Wealth Care LLC Monthly Commentary July 2016

Investment Thoughts

Brexit brought us some interesting market volatility, of no consequense as is the case most of the time. We had a remarkable 800+ point swing down and then right back up in six trading days.

Markets grind on this year, although at least in a marginally positive direction. There is a great deal of pessimism on stock investments, despite averages with little change over 1-2 years. At Wealth Care LLC, we remain generally invested in low cost, globally diversified funds holding stocks and fixed income. A possible catalyst in changing the markets may indeed be the Presidential election which is coming up soon.

What if You Were the World's Best Market Timer?

By Michael Batnick

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If you're like most people, you contribute to your 401(k) every two weeks and only notice the stock market when your balance falls ten or twenty percent. With the recent volatility, it might be your inclination to run and hide until the dust settles. In theory this makes sense, in reality it could be one of the most destructive actions you can take when attempting to build long-term wealth.

But what if there were a way to eliminate the lousy feeling of checking your account by simply avoiding every bear market? Well lucky for you it exists and I call it the crystal ball strategy. The premise is very simple: every time you know a 20% drawdown is coming, you sell at the peak and wait for the bear market to run its course. In the meantime, you invest in short-term treasury bills and only get back into stocks when they're at the level at which you sold; no point in trying to catch a bottom, right? Look at the declines of the Crystal Ball Strategy versus a simple buy and hold methodology.

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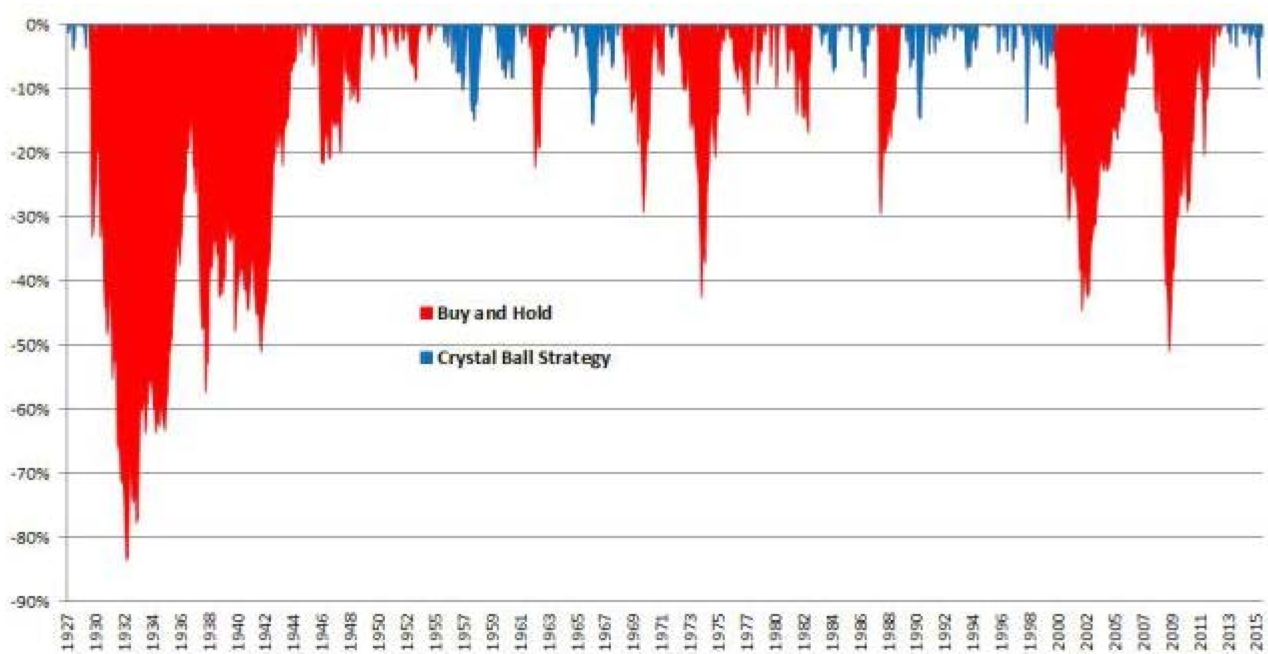

You'll notice that the Crystal Ball Strategy isn't perfect, it did experience a 16% drawdown in 1966 (my bad), however, it sure did a lot better than buy and hold, which got cut in half on multiple occasions.

By now, it should be obvious that the Crystal Ball Strategy is a farce, nobody can identify every peak before a 20% bear market. But what might shock you is that even if you were able to avoid every 20% drop, you still would have been better off buying and holding. Buy and hold ended up with $360,856 versus $130,523 for the Crystal Ball Strategy, beating it by nearly 200%. How is this possible? The Crystal Ball Strategy kept you out of stocks 62% of the time, robbing you of the ability to leverage dividends, compound interest, and time.

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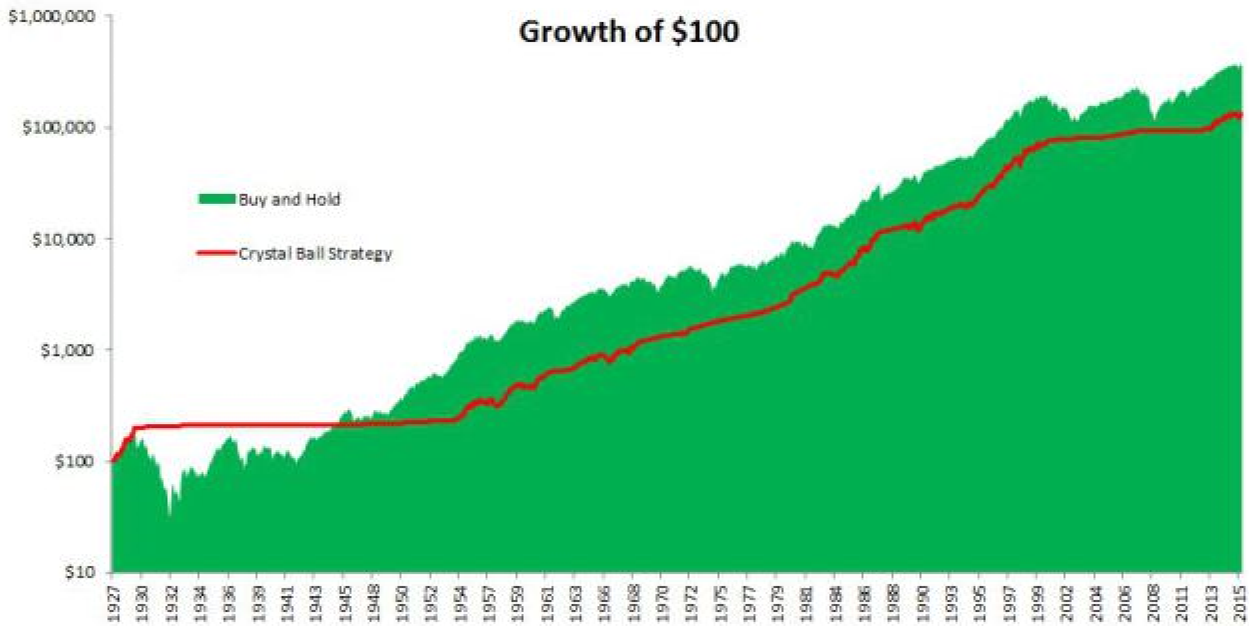

Compound interest is one of those concepts that is really hard to wrap your head around. One of the best investors of all time, Warren Buffett understands this concept extremely well. Think about this, 98% of Buffett's current net worth was accumulated after he first become a billionaire at age 56.

Another person who understands compound interest is my friend and colleague Ben Carlson. Ben wrote a post where he mentioned that the worst 30-year period for the S&P 500 was 854%. A lot of people think "wait a minute, 854 divided by 30 is 28.4% a year, that isn't possible." Well, they're right that it's not possible, but they're misunderstanding how compound interest works. An 854% gain over thirty years requires a compound growth rate not of 28.4%, but just 7.8%. The takeaway is that whenever you run out of the market, you're not receiving the incredible benefit of compound interest or the benefit of reinvesting dividends at bargain prices.

Regular people underestimate the huge advantage they have over professionals. They have nobody to report to. Most managers live and die in three-year windows. You have the ability to leverage time and compound interest. Nobody knows what future returns will be, but I can tell you for a fact that the likelihood of losses decreases with the passage of time.

So if you're tempted to sell out of your 401(k) on Tuesday, recognize that you are likely doing your future self a big disservice. Volatility is a permanent feature of the stock market.

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The Death of Coal and the Risk of a Concentrated Portfolio

We have witnessed something remarkable this year: the death and burial of an entire industry. The coal sector's descent happened remarkably fast. Peabody Energy (BTU) went from nearly $1,000 a share in 2011 to $2.07 just before it filed for bankrupcty on April 13.

Peabody is the fifth and largest US coal producer to enter bankruptcy in the last year. Just think how many times it looked like a bargain between almost $1000 and zero in five years!

The Power of Patience

Fidelity has studied which customer investing accounts performed the best: They were the ones held by people who had forgotten they even had Fidelity accounts, and so did no buying or selling from them.

When O'Shaughnessy told that tale on Bloomberg Radio to Barry Ritholtz of Ritholtz Wealth Management, Ritholtz responded that he'd noticed something similar with families fighting over inherited assets. Because of extended court battles, in some cases, the accounts couldn't be touched for 10 or 20 years: No buying new investments or selling old ones. Those families subsequently found that the period of inactivity was the time when their investments performed best.

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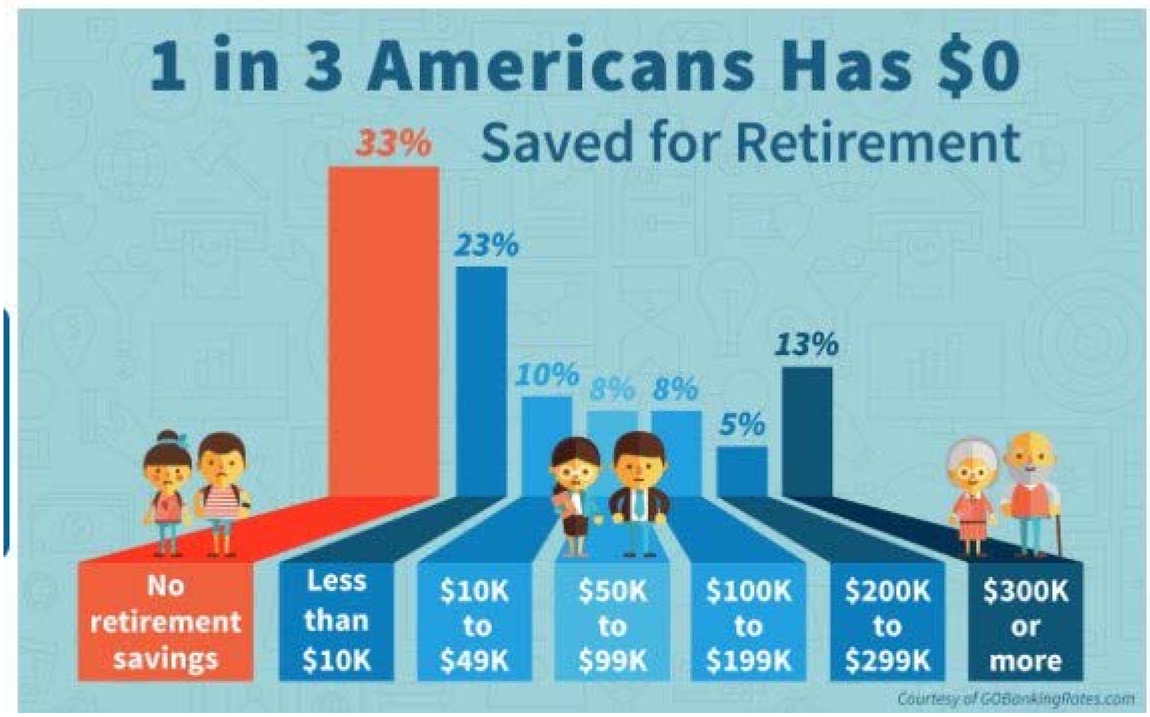
Things of Interest



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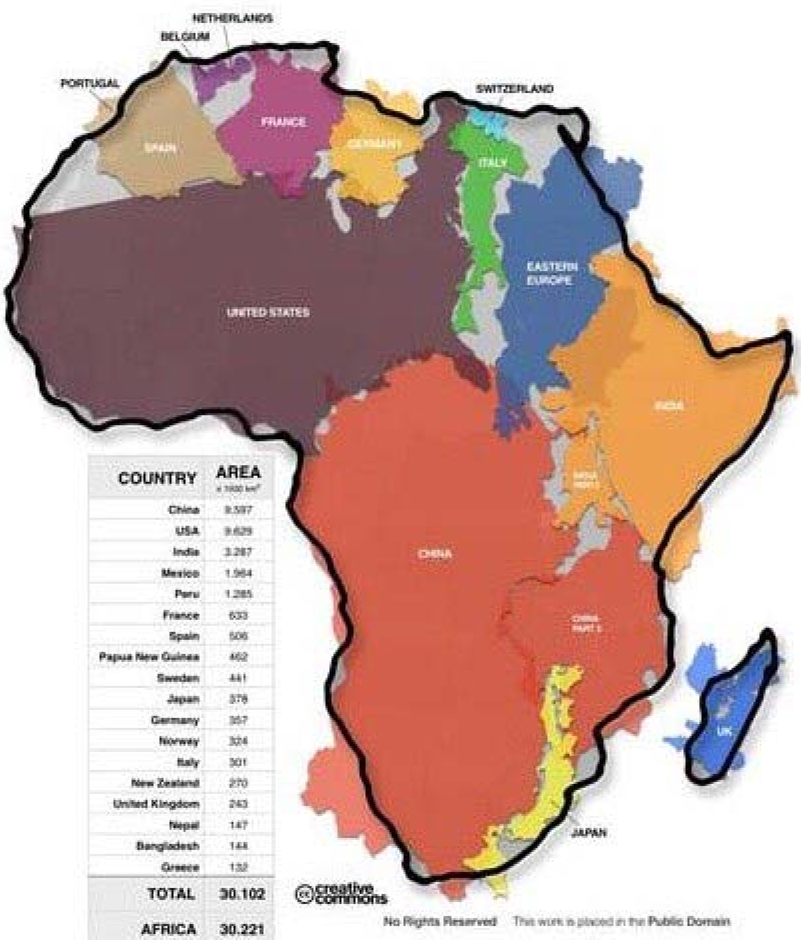
How Big is Africa?



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Random Thoughts

The human condition: Optimism

My friends, I have a question: What's the alternative?

We are living on a chunk of space rock traveling at 80,000 miles per hour around an exploding star. We influence and control none of that, and scientific and religious argument notwithstanding, we don't actually understand very much of it.

Hence, it's rewarding to be optimistic each day, canine-like in our eagerness to exploit the new morning, because it's the only sane way to live. If you oppose suicide, then why throw your life away piecemeal by worrying about every conceivable issue and assuming and fearing the worst? Every day those of us who drive engage in a huge display of positive faith by driving on roads at 60 miles per hour or more with those around distracted, on phones, angry, having consumed alcohol or drugs, daydreaming, depressed, stressed and doing the same within mere feet of our cars.

Ergo, we all exhibit at least a cautious optimism. We believe we can avoid accidents and are willing to take the small risk of someone acting recklessly around us. Our portmanteau is actually filled with reasonable assumptions and safe predictions. One of my favorite apothegms is: "This, too, shall pass."

I believe in giving people the benefit of the doubt until and unless they prove unworthy of it. I'd like the same favor extended to me. I believe in temporary setbacks and not fatal mistakes. I'm an opportunist by nature, and if something unanticipated is in my path, I don't avoid it, I think about what I can do with it. (A dog will try to eat it and, failing that, play with it and, failing that, urinate on it. My hierarchy is somewhat different.)

Therefore, what choice do you really have? Are you going to face the morning as another long, slow, crawl through enemy territory? Or are you going to sprint into what light we have?

If the latter, that figure out there ahead of you would be me.--Alan Weiss

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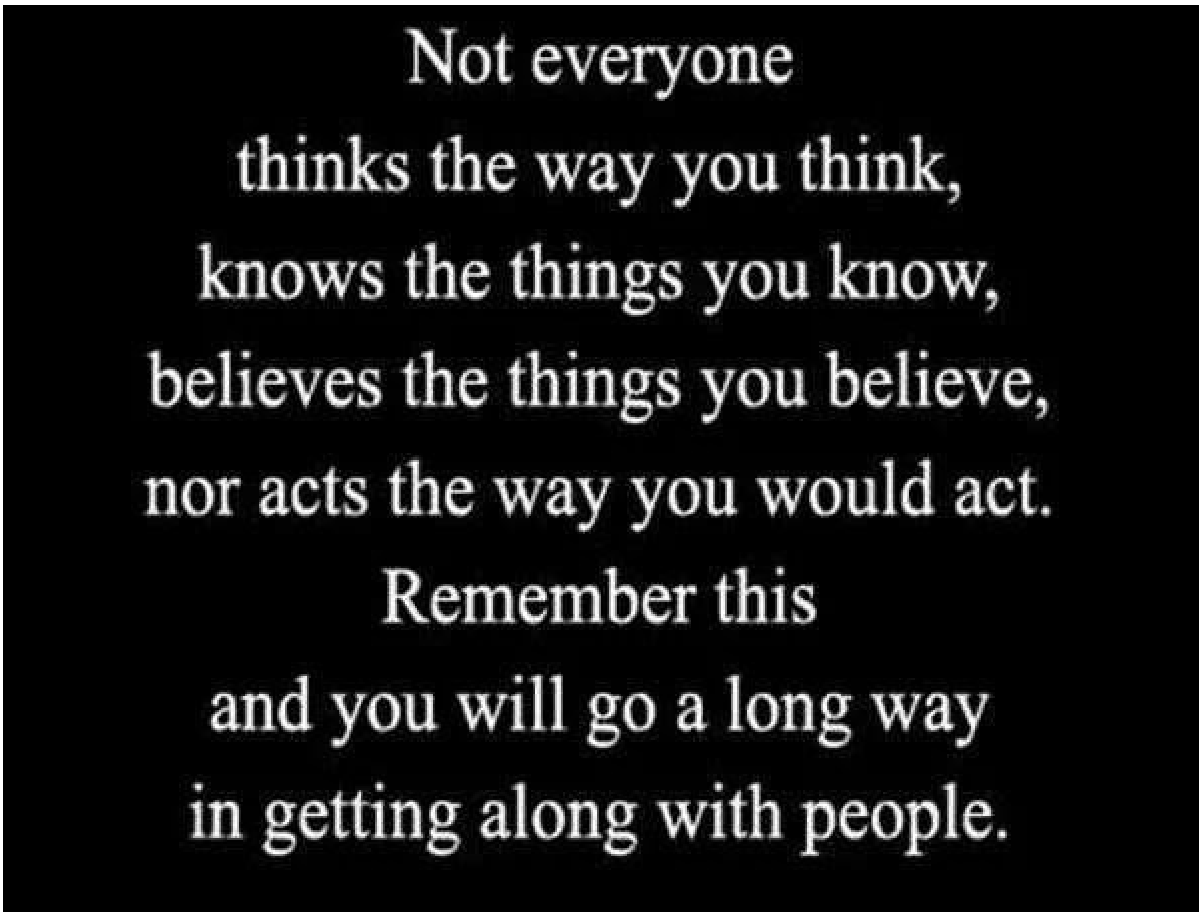
How to think about long-term investing: The labors of your past self-work hard while your current self does nothing so your future self will be better off.--Morgan Housel



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