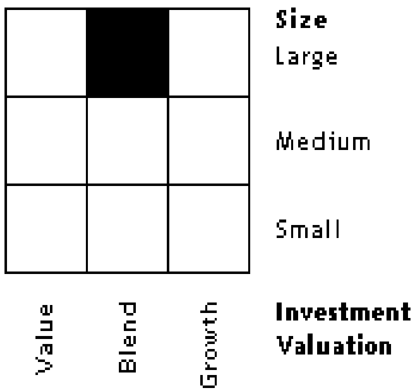
Asset Class vs Sectors discussion

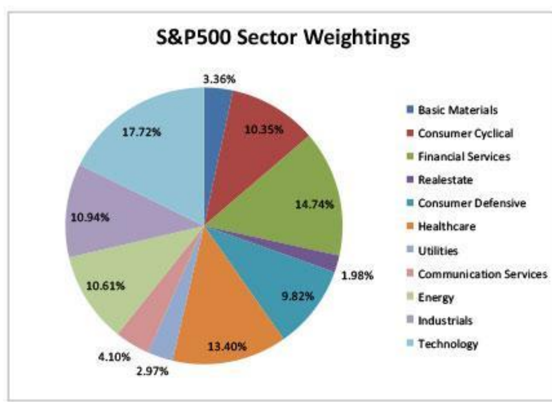
We've all seen the 'tic-tac-toe' boards on our financial statements…you know, the rows are labeled Small-, Medium- and Large-cap. And all of the columns are labeled Growth, Blend and Value.



Well, ALL stocks fit into this grid…but what does that tell us.

We think, NOT enough.

Well, there's another matrix—Sectors. Standard & Poor's (the creators of the S&P 500) declares that there are 11 sectors:



- Basic Materials
- Consumer Discretionary/Cyclical
- Consumer Staples/Defensive
- Energy
- Financials
- Health Care
- Industrials
- Real Estate
- Technology
- Telecommunications
- Utilities

So why do we differentiate between Asset Class & Sectors…because we believe that by focusing on the sectors which have 'built-in drivers,' we can invest in the areas that will outperform the other sectors.

So what are 'Built-in Drivers'? I believe that a Sector with a 'built-in driver' is one in which most people, *regardless of political, social, racial or religious differences*, still want to acquire.

Let me explain in greater detail—as we all know, we are investing our life's savings with two central goals—1) to provide income from our portfolios during retirement, and 2) to have a nest egg for the times when an emergency arises…hopefully never.

But how and/or where do we invest those funds? Statistically, the stock market has given the best long-term results…but it has also taken our breath away along with sizable chunks of our portfolios, in times of major economic stress. Sometimes, as we've seen recently, it just takes back solid gains just because a Wall Street 'black box' (computer trading) decides that it's time to exit the stock market.

The IMPORTANT note is to remember that the stock market has always come back from these doldrums.

Here's our basic three step process to how we invest.

Step 1) Let's examine the demographics of our society…i.e. **who has the greatest need of their savings and investment portfolios?**

We believe that it is the group closest to retirement and may leave the workforce. In the current case, the ones facing imminent retirement are the Baby Boomers, followed by Gen X and Gen Y, with the Millennials as the newest group in the workforce.

NOTE: we recognize that EVERYONE has the greatest need for their savings and investment portfolio. The KEY difference is that a younger person can and does continue to add to their savings, etc. A RETIREE may not have that luxury of time, so if it goes, it may well be gone…

In terms of size, the Baby Boomers still are #1, with the Millennials following close behind…though recent data suggests that the Millennials are actually outnumbering the Baby Boomers.

Step 2) this leads to the next demographic question…**who's got the money?**

[And while I'm NOT including the federal government spending; this is a key component in the next question.]

I suspect that we can all guess this answer—the Baby Boomers. It's not a surprise because we've seen this phenomenon throughout our lives…the oldest generation has the money (through a variety of reasons—savings, inheritance, high paying jobs with bonuses, etc.) and those assets get passed down to the next generation.

Step 3) this leads us to the final question regarding where the money flow is occurring:

What do the Baby Boomers buy? And as I alluded to in the previous question…**what does the government buy?**

This led me to my basic investing thesis regarding sector allocation for a retiree. Let's go back to the 11 Sectors.

In our opinion, there are several sectors which directly impact our decisions on how we spend our money. We believe that *Peter Lynch*, the long-time manager of the Fidelity Magellan fund, was correct in his thesis—one should invest in those areas in which we are spending our money.

So let's look at the sectors themselves: I always find that examples are helpful so for illustration purposes, I will list a couple of names in each of the sectors, hopefully names that you'll recognize.

Then I will label them as "**Personal Use**" or "**Corporate Use.**" These designations are MY OPINIONs only. The idea here is to guide you through my thought process when I construct a portfolio…I'd love to hear from you if you think I mislabeled anything.

Basic Materials: **Corporate Use**

DowDuPont, Monsanto, Newmont Mining Corp.

Consumer Discretionary/Cyclical: **Personal Use**

Amazon, Home Depot, Walt Disney, McDonalds

Consumer Staples/Defensive: **Personal Use**

Proctor & Gamble, Coca-Cola, Colgate-Palmolive

Energy: **Personal Use**

Exxon Mobil, Chevron, Halliburton, Schlumberger

Financials: **Personal Use**

JPMorgan Chase, Berkshire Hathaway, Citigroup, Bank of America

Health Care: **Personal Use**

Johnson & Johnson, UnitedHealth Group, Medtronic, Pfizer

Industrials: **Corporate Use**

Boeing, 3M, Honeywell, Caterpillar, GE

Real Estate: **Limited Personal Use**

American Tower, Simon Property, Public Storage, Digital Realty Trust

Technology: **Personal Use**

Apple, Microsoft, Facebook, Alphabet (Google), NVidia

Telecommunications: **Limited Personal Use**

AT&T, Verizon, Vonage Holdings

Utilities: **Limited Personal Use**

DTE Energy, Duke Energy, American Electric Power

Wait, I know you're wondering about my labels above, let me explain:

Limited Personal Use: Why I labeled Real Estate, Telecommunications and Utilities as Limited Personal Use

My reasoning is actually straight forward…they are ALL interest rate sensitive. Each of these areas tend to pay the investor via dividends rather than growth of the stock price.

That's was GREAT as interest rates were falling. People on fixed incomes exited the CD and bond market because rates were falling and they couldn't make enough income.

As rates fell, people rushed into these sectors in search of yield…and they got it. Even better, as more people entered the stock, the stock price was bid up and these folks got an excellent dividend yield PLUS the stocks went UP.

HOWEVER, we are NOW in a rising interest rate environment. At some point, we will see retirees flee the risk of the stock market because interest rates will have raised high enough to attract those investors.

As perceived "safer" income sources become available with higher rates (i.e. CD's and bonds, etc.), those same people will exit these sectors and jump back to their fixed income choices.

Corporate Use: I labeled Basic Materials and Industrials as Corporate Use because, quite simply, you and I aren't these categories main drivers, other companies are their drivers.

Yes, I realize that companies like 3M make lots of stuff that we use routinely but more often than not, other companies are their drivers. Look at Boeing, a MAJOR market leader in recent months—so while we travel, the jets we're on are probably made by Boeing, it does NOT mean that we buy Boeing products.

Personal Use: I've labeled Consumer Discretionary/Cyclical (**CD/C**), Consumer Staples/Defensive (**CS/D**), Energy (**E**), Financials (**F**), Healthcare (**HC**) and Technology (**Tech**) as "Personal Use."

Here's why I feel this way—think back to late 2008-early 2009—arguably the worst economic timeframe in our lives—we still did certain things and bought or used certain items.

We bought our toilet paper and toothpaste and laundry detergent (**CS/D**)…as always.

As things improve economically and on the home front, we then have the opportunity to splurge a bit, we buy things on Amazon, or improve our homes at Home Depot, or we go to a Disney movie and have a bite to eat at McDonald's (**CD/C.**)

We are always considering the cost of gasoline to fill our cars and natural gas to heat our homes (**E.**)

We are ALWAYS concerned about our money and what's being done with it…bank, brokerage, credit cards and insurance companies (**F.**)

As we age, our healthcare costs are projected to be high…national statistics say that a couple aged 65 will face between $250,000 and $465,000. As CFP®, I always recommend that we prepare for the healthcare costs that we will likely face in retirement. (And I know from whence I speak as I've had a hip replacement…and it was covered by insurance but it was still expensive.)(**HC**)

And finally, I'll address technology. I guess I can sum this one up by telling you that my father bought a new iPhone…at the age of 91. I think tech is here to stay. (**Tech**)

As a final note to this missive…I'd like to address government spending. To me, two key areas of federal spending have been and will continue to be Defense, and hopefully in building out/repairing our Infrastructure…both of which tend to be in the "**Industrial**" sector.