# Quarterly Client Newsletter

## 3rd QUARTER 2020 REFLECTION

BY ALEC BETHURUM
SR. PORTFOLIO MANAGER

The third quarter was a very interesting one. Equity markets were generally strong. However, most of the gains were concentrated in relatively few tech stocks. Several well-known companies, including Apple, Microsoft, and Tesla, made new all-time highs. In late September, only 5 companies accounted for almost 25% of the total market value of the S&P500.

We believe these 5 companies, Apple, Microsoft, Facebook, Google and Amazon are excellent business' and we continue to hold several of them for the long term. However, for many clients, we have modestly reduced these positions in Q3. We believe the current extended valuation in these widely held names provides a teachable moment for all.

For clients, it is important to differentiate between a company and the company's stock. You can have a great company but, at a particular price, its stock is not a great investment. This discrepancy is the difference between "speculating" and "investing". Speculating is buying a security with the hope you will be able to sell that security to somebody else, in the short to intermediate term, for a higher price. Investing is placing your capital into a business selling a product or service that will produce profits and sharing in those profits. As time passes, and those profits build, or are intelligently reinvested, the value of your stake will increase.

To illustrate this concept, we'd like to introduce two friends interested in buying houses in the same neighborhood. Our first buyer is a flipper, Joe Speculator. He sees that the houses on the block have been moving up rapidly in price. The neighborhood is a quiet suburb and is benefiting from increased demand. Joe Speculator is unconcerned that the house has doubled in value in the last 12 months or that based on comparable rents the cash flow yield would be less than 2.5%. All he cares about is the hot market and how quickly he can buy the house and flip it to another buyer at a higher price.

The life of Joe Speculator is very exciting. He regales his friend Joe Investor with stories about his large quick profits and teases him for being so timid. More and more sure of his strategy Joe Speculator buys several more houses, using one house as collateral to buy another. The more houses he owns the bigger and faster his windfall.

One day, however, for no particular reason, the number of buyers declines. At the same time, sellers, drawn out by the high prices, list their homes for sale. A local employer decides to move their HQ out of town to a cheaper locale adding more new supply to the market. Houses now languish on the market. Joe Speculator needs to pay off his short term bank loans and now has to sell his houses to whomever he can and at whatever price he can to raise capital and avoid bankruptcy.

His friend, Joe Investor, has plenty of ready cash. Now that the neighborhood's prices have fallen to $300k there is a tidy monthly profit in renting out the houses. With this cash flow Joe Investor invests in upgrades to increase rent and future cash flows. Joe Investor rides the eventual return of prices to their previous highs over the next several years as the supply/demand dynamics equalize, rents rise to meet demand, and new business' move into the area.

We continue to be surprised that despite incontrovertible evidence that Joe Investor is the person to mimic, most fail in that endeavor. The apparent potential of fast wealth and the envy of seeing others appear to generate new wealth, when you aren't, makes Joe Speculator very difficult to ignore. From the Tulip Mania in 1600's Holland to the South Sea Bubble in the 1700's, The Gold Rush in the 1800's and the dot-com bubble in the 1900's, the human psyche cannot resist an investment rising quickly in price, no matter how irrational that price may be. However, while the list of Joe Speculators who manage to keep their profits is very small, the list of Joe Investors passing on significant wealth to future generations is never ending. Our job, as your financial advisor, is to keep you away from the siren song of Joe Speculator and on the proven path of Joe Investor.

## ELECTION IMPACTS

BY FRANK STERNECK, CO-FOUNDER & CHIEF INVESTMENT OFFICER

The question that seems to be coming up in virtually every client conversation is, "What impact will the election results have on the market and what should we be doing about it?'. The fact that the markets are forward looking and discounting future expectations, it is very difficult to predict, analyze and implement an investment strategy that will outperform maintaining a balanced and diversified portfolio. Going to cash and sitting on a bV the sidelines until after the election is also a strategy we do not advocate. Should there be a market selloff, for whatever reason, rebalancing a portfolio will have a more positive impact on long term results than trying to time the market. Our experience would indicate that those that step to the sideline ultimately end up re-entering the market at a higher level than where they got out. Thus, while one may feel compelled to "do something", most often "less is more".

**Required Minimum Distributions "RMD's"**

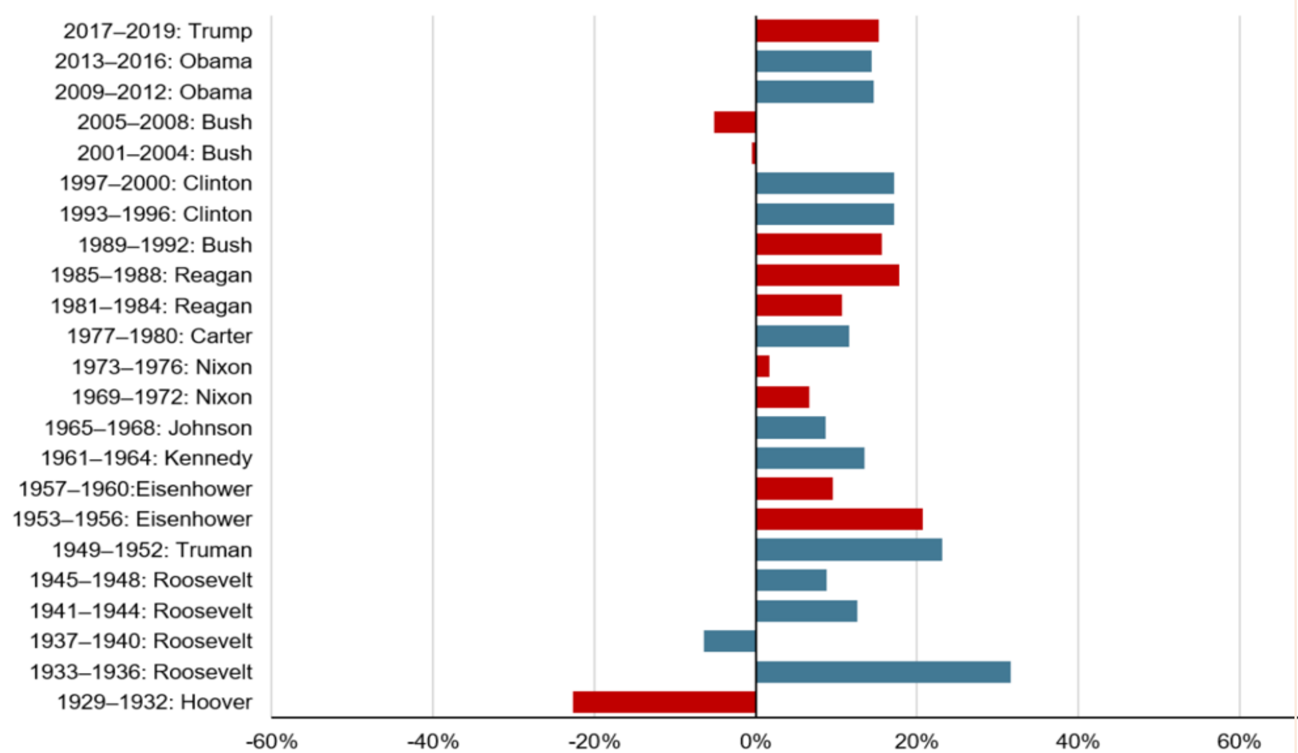
Your Required Minimum Distribution (RMD) is the amount you must withdraw from your IRA, SEP IRA, SIMPLE IRA or Retirement accounts annually when you reach age 72 (70 ½ if you reached 70 ½ before January 1, 2020). However, in response to the COVID-19 pandemic, the IRS eliminated h\Y 2020 RMD requirement via the CARES ACT. The next RMD will not be required until December 31, 2021.

In looking at election year historical data, statistics show that there is little difference between election and non-election years. Additionally, you might think that in the months closest to the election volatility would increase. However, analysis demonstrates the opposite to be true. Furthermore history would dictate that, in the long run, regardless of an election outcome, the market has the ability to prosper under a Democratic or Republican administration.

**Annualized Returns**

*Source: Dimensional Fund Advisors*

**Average Return for Presidential Terms = 10.3%**





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