OUR FAMILY PERSPECTIVES

INSIGHTS FROM CANADA'S LEADING FAMILY OFFICE

Is It Too Late to Sell Stocks?

April 22, 2020

I hope this finds you well and coping in these extraordinary times. This may, perhaps, be the only piece that you've read in the last two months that will not mention the Coronavirus.

Do you remember Warren Buffett's Two Rules for Investing?

Rule #1: Never lose money.
Rule #2: Never forget Rule #1.

The question is: How can we put these rules into practice? Few have a definitive answer, but I will try to help you respond to the question yourself, by giving you a few things to think about.

Allocation to Asset Classes

Most of your wealth is created and maintained through your strategic asset allocation – that is, the percentage of your net worth that is invested in each of the many asset classes that exist. The asset classes to which I refer, include, but are not limited to, traditional asset classes like cash, stocks, and bonds, but also include non-traditional asset classes, like real estate, diversified income, mortgages, direct lending, private equity, hedge, and absolute return strategies. Most people only focus on the traditional strategies.

The reason to understand the different asset classes is that they each have varying degrees of risk associated with them. Risk is often defined as volatility (standard deviation), but we also look at drawdown, which is the amount of negative return an investment experiences over time. Equities (stocks) have among the highest volatility/risk. It can be measured daily, but also over much longer time horizons. It's a number that can average 15% to 20% (standard deviation) and varies depending on whether you are considering large-cap or small-cap stocks, or different geographies such as the U.S. or Emerging Markets, for example. Other asset classes have risk numbers which are a fraction of, certainly much lower than, stocks. It's important to understand this and the many alternatives to stocks.

One would think, based on media attention and the obsession with the stock market, that equities, or stocks, are the only asset class available in which to invest. Of course, this is not the case.

This reminds me of the "Law of The Instrument". Although attributed to Abraham Maslow, it has also been accredited to Mark Twain, Buddha, and Bernard Baruch: **"If all you have is a hammer, everything looks like a nail."**

Life After the Bull Market

The longest Bull Market in history, which recently ended, is now but a memory. It has been a wonderful ride since the Great Recession of 2009. The risk-on bet paid off well – until it didn't. Now what? The market has sold off and many have already decided that we are at the beginning of the New Bull Market. Not so fast.

Many of us who have been in the investment world for a long, long time (five decades in my case) have seen this movie before and we know how it ends; always with more questions than answers. You see, having been through this many times before, I can say that we just don't know. Let me posit this: The Bulls (those who believe the market only goes up) have a short memory. Some might believe that the stock market is the only game in town. While there is a place for equities in most portfolios, there are many other investments you can make with much less risk, and some have the prospect of an even better return than the stock market, over the next five years.

As for the equity markets or the economy today, we have as much visibility on a recovery as a driver in a pea-soup-like fog. **Let's play the "pick a letter game." Will it be a V-, U-, L-, or W-shaped recovery?** No one knows. At this stage, it's only guesswork.

Every year there is a one-in-a-hundred-year event – so it seems. These are also known as a fat tail, black swan, or a three-standard-deviation event. Isn't the word *risk* more important to you today than ever before? Risk to your health, risk to your family, but also risk to your wealth. You are probably focusing on it now more than ever. This tends to only happen after you've experienced a loss. Risk is what we think about most, and it has served us well.

It's paramount that we understand the relationship between risk and return. Your financial advisor likely talks to you more about return and may not help you to understand the risks associated with your potential return. **Do you know the Rule of 72, how long it takes to double your money?** If you are down 40%, did you know you have to earn 66.6% just to get back to where you were? This happened twice in the decade from 2000 to 2010. So, risk can't be ignored.

Today, could we retest the bottom? How would your investments respond if the market declined another 20% or 30% from here – and how would you feel?

A key to success today is to hold fast to a prudent investment philosophy. Be consistent, whether you are in a bull market or bear market. How you implement that philosophy with tactical moves like "risk-on" (more equities) or "risk-off" (less equities) will change from time to time, depending on circumstances and the environment that you are in.

Looking Back in Time

Looking back over the last year, we asked many questions, all of which seem to be as relevant today, as they were there then. We asked questions about the long-in-the-tooth bull market and the relationship between risk and return. As a firm, we made many comments about these issues, which are worth revisiting.

As you take the time to read these brief excerpts, recognize the common theme – a theme of focusing on clear risks and not solely on returns.

Second Quarter - July 1, 2019 Investment Letter

> *At Our Family Office (OFO) we organize and build portfolios with a focus on the level of risk you are assuming for the return you expect. Risk-adjusted returns matter, and we are conservative in our approach to wealth preservation and growth. Studies have shown that investment success is not primarily about how much you make, but how much you avoid losing.*
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> *Our co-founder Neil Nisker was recently asked if he enjoys gambling and whether he goes to Las Vegas often. He responded: "I like the shows and restaurants, but don't really gamble much. My gambling philosophy is very much like my investment philosophy: I hate to lose much more than I like to win."*
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> *Behavioral economics suggests that most investors end up feeling the same way about their portfolios once they've experienced some losses. We believe, at this point in the cycle, that it's prudent to spend more time analyzing what can go wrong than what might go right.*

Third Quarter – October 1, 2019 Investment Letter

> *We are reminded of the expression: We know what we know, and with humility, we know what we don't know.*

What we at Our Family Office are most concerned about is the "unknown, unknowns".

If you haven't already started thinking about the other "R" word, you should. In the late stages of any bull market, it's not return, but risk that should be top of mind.

We believe you should ask yourself these five questions:

1) *How does the longest bull market in history end?*
2) *What happens if negative interest rates spread globally?*
3) *What are your capital market assumptions for the next 5 years?*
4) *How much risk do you wish to take in the future?*
5) *Are geo-political risks greater today than in the past?*

We ask ourselves these questions on a daily basis. We are in unchartered waters and believe that for every unit of risk you take, you should understand what your future reward is expected to be. It's most important to understand the relationship between risk and return. We recommend looking forward, not merely in the rear-view mirror.

February 14, 2020 Market Outlook and Review

Mercifully, we're not in the business of calling market tops and bottoms. Our role is to provide prudent portfolio allocations that stand the test of time, i.e. Our Family Office All-Weather Portfolios. Accordingly, we continue to reduce allocations to traditional equities in favor of non-traditional capital appreciation opportunities. These types of investment strategies provide returns that are not dependent on how the market performs, making them an ideal tool for protecting client portfolios.
Reducing market risk and portfolio volatility during later stages of the longest bull market in history observes our predilection for avoiding unnecessary risk and capital impairment. Re-allocating to Multi-Strategy Absolute Return mandates aims to continue delivering reasonable portfolio returns throughout what may prove to be a more challenging next few years.

The future is always uncertain, but today the uncertainty is greater than ever. We can only be sure about a few things:

- the world has changed, and there is no going back;
- we will all get through these most difficult times;
- the economy will recover eventually;
- the stock market will be higher ten years from now than it is today, and
- in the short term, we can only guess whether the market has bottomed or not.

With these thoughts in mind, make sure you cling to a prudent philosophy and build an all-weather portfolio. These are portfolios that focus on an optimal asset allocation which considers risk – not just returns, and have a healthy dose of non-traditional investments that are uncorrelated to public markets to diversify and reduce volatility.

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