StraightTalk

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THE HALFTIME REPORT

This is something I began writing last year as an additional communication from my practice. As longtime clients know, I focus the majority of our conversations on your plan, and how your portfolio is meeting the needs of that plan. Rather than spend your valuable time on the minutia of portfolio management changes or investing and asset allocation decisions – we talk about the important things in your life. Sometimes those conversations are about children and grandchildren or caring for aging parents, other times it is navigating a divorce or loss of a family member, while at other times it is travel, entertainment, or planning for and living through retirement, and leaving a legacy.

However, it occurs to me that you might periodically like a high-level update on what is going on *underneath the hood* of your portfolio. Thus, this is the second issue of The Halftime Report – designed to give you a midyear update on market dynamics and moves related to those dynamics.

Even for the casual observer, the significant outperformance of the "Magnificent 7" companies has been hard to miss. As a group, they have had explosive earnings, and even more explosive share price appreciation over the last 18 months. Prudent money management guidelines periodically rebalance the areas of a portfolio mix that have done very well and reallocate those investment dollars to areas that have yet to have their turn in the spotlight. Historically, this rebalancing approach has been proven to reduce risk and improve returns over time.

Remember, the impulse of most individual investors is to buy things that are hot – after they have gone up a lot – whereas institutional investors like to buy shares when they are temporarily depressed in price, for reasons other than fundamentals. In other words, they buy companies when they feel they are undervalued, not after they have shot up 40% or more. Trimming exposure to big winners and adding to out of favor areas (i.e., rebalancing) is a timeless way to potentially smooth returns and reduce risk. It may be helpful to remember that "hot" sectors (or individual stocks) can continue to outperform for quite some time after such a rebalancing occurs, but at some point, the risk for each incremental unit of performance begins to no longer make sense from a prudent investor standpoint.

Watching this continued outperformance can sometimes lead to the question of "Why not just own the S&P 500 Index?" Or taken further, with even higher historic returns, "Why not just own the Nasdaq 100?" Or, to the recent extreme, "Why not just own Nvidia?" since the prevailing news storylines are that Artificial Intelligence will soon solve…everything.

My answer to this is simple, and *in no way constitutes advice to buy, hold or sell any individual stock or index*. History is an amazing guide for those who study it, and history is quite clear that no single company remains at the top for too long. As an example, one of the darlings of the Y2K "dot com" era that survived the other side of that euphoria is Cisco. This is a company that provides the "plumbing" for the internet and has played a crucial role in giving all of us the online experience that we take for granted. But had you bought that stock in the first quarter of 2000, you still have a loss twenty-four years later.

This company has played, and continues to play a vital networking role in our digital economy. In the most recent quarter, they reported over $12 billion in revenue, with earnings of $2.6 billion – however, *more than two decades after the dot.com era*, the stock remains 17% below its all-time closing high. To me, this is a cautionary tale for where we find ourselves today.

The current "hot stock" darling is Nvidia, a leading maker of chipsets needed for the complex computing calculations involved in A.I. applications. While it might be fun at social events to discuss how much you would have made if you invested in that stock at the start of 2020, hindsight investing is always 20/20. Most people have heard that the stock has had a meteoric rise in the last couple of years, but very few have watched the trading pattern closely. High growth companies tend to have significant pullbacks in share price – and given that pattern, how many of these "hindsight" investors would have continued to hold the stock when it *lost 63% of its value* in 2022? I think I know the answer….

No…concentrating your portfolio in the thing that is doing well right now is not the answer to meeting your long-term financial goals. It doesn't matter whether that concentration is in a stock, a sector, or an index – I believe diversification is always and everywhere a better idea.

Loyal readers will know that I often reference the S&P 500 as a proxy for owning the great companies of America, and their astonishingly successful record over time. But just owning that index means leaving out huge parts of the investing universe, including, but not limited to, small and mid-sized companies, and those that happen to be headquartered outside the United States. Your own life circumstances, goals and risk tolerance may also mean that it is a good idea to own bonds to smooth stock market returns and cushion periodic price downturns in the great companies.

As I mention with some frequency, the long-term track record of owning the S&P 500 is quite clear. I also mention, but it may not remain in the memory bank quite as well, that there are frequent, sometimes violent downward price moves in that index. To wit, according to Standard & Poor's Research, there have been sixteen declines of 20% or more since 1950 – which sounds benign enough, until you are riding through one of these periods in retirement while living off your portfolio.

To put a finer point on it, S&P Research also shows that index has declined roughly 30% on an average of once every five years since WWII and has dropped by half three times in the last five decades. As more and more indexed funds and ETFs have been promulgated, and trading has become instantaneous, these emotion-driven selloffs have come faster and faster. As an example, on two separate occasions during one ten-year period in this century, the S&P 500 declined 49% and 57%, and the index also fell by one-third in the month that Covid hit. I am not sure concentrating all your net worth in that index makes the most sense.

Do not mistake this for any loss of conviction on my part in the great companies of America and the world. I still believe them to be the single greatest, most effortless way in existence to build wealth, and enjoy your retirement. I'm simply saying that just because the S&P 500 Index has exceeded the long-term return average recently, is not a reason to put all your eggs in that basket.

Having a process to diversify your holdings and use exhaustive research to rebalance or replace those holdings is a recipe for success, in my opinion. By choosing the right managers who have a demonstrated history of the correct process, people, and philosophy – and allowing them to make time and price decisions on individual holdings is my answer, even in an environment when one stock looks like the easy solution.

Our job is to avoid the "hot idea" and to manage the managers, rebalancing or replacing them as market conditions dictate – and you simply need to trust in the process and try not to watch too much news. Summer has started, so enjoy a week of vacation, or take a day trip to the lake or the beach, or spend time with the grandkids…anything to keep you from trying to guess the next A.I. darling or tech-concentrated indexed investment. The "second half" has started and will likely include some election related volatility. If that happens, free to call me at any time to review why we own the great companies.

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