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"When things are going well and prices are high, investors rush to buy, forgetting all prudence. Then when there is chaos all around and assets are on the bargain counter, they lose all willingness to bear risk and rush to sell. And it will ever be so."

—Howard Marks, author of "The Most Important Thing Illuminated" (Jan.2013)

To our clients and friends:

First, a personal note: A few weeks ago, I had the privilege of attending the 2nd annual Elite Private Wealth workshop in Orlando hosted by Private Wealth magazine, an industry leader catering to the clients of wealth managers. I use the term "privilege" because I was one of about 50 or 60 advisors from around the country in attendance who were fortunate enough to witness the brightest minds in our industry discuss timely and cutting-edge topics for the affluent investor.

Among the personal highlights for me was meeting two individuals well-known to the investing community. The first was Dan Fuss, the legendary manager of the \$23 billion Loomis, Sayles bond fund and former Morningstar Manager of the Year. Many of our clients have profited from owning his bond fund over the years. It turns out that Mr. Fuss graduated from Marquette University with my father in 1955—he's also a Red Sox fan—two tidbits you'd never find in the financial press. As Morningstar so aptly put it:

"We think [Manager Dan] Fuss is one of the best bond fund managers in the business, with his nearly 50 years of investment experience providing an invaluable perspective on the markets. He is a disciplined, patient, and independent thinker, willing to stand apart from the market consensus when his analysis indicates it will be profitable to do so."

The second highlight was meeting Ron Paul (you've all heard of him before). Dr. Paul spoke at our luncheon of the "big picture" (as opposed to focusing on the stock market *per se*) and spent most of his time emphasizing the importance of protecting personal liberties in our society. Whether you agree or disagree with his brand of political philosophy, he conducted himself in a gracious and open-minded manner with those of us who had the opportunity to speak with him personally. It was an honor to hear him speak.

First Quarter 2013: More of the Same

The financial markets continued their furious 2012 year-end rally right into the beginning of 2013. By the end of the quarter, on March 31, the Dow Jones and S & P 500 had both surpassed their all-time highs, originally reached in 2007.

This achievement was the result of an exceptionally strong performance to start the year. In early January, Congress voted to avoid the “fiscal cliff” that would have required dramatic reductions in spending and also risk throwing us back into recession.

Here’s how first quarter performance looked:

Monthly Returns	U.S.	Europe	Emerging Markets	World Markets
January 2013	5.3%	5.1%	1.0%	4.9%
February 2013	1.3%	0.9%	0.0%	1.2%
March 2013	3.8%	0.9%	-0.8%	2.3%
TOTALS: Q1 2013	10.7%	7.1%	-0.2%	8.6%

Source: MSCI returns including the price gains plus dividends, all returns in local currency

One word of caution: In 2012, the market was up by 13% in the first three months before giving back almost all of those gains in the second quarter, in large measure due to concerns about Europe.

And another note about Europe: In spite of recent headlines about the banking crisis in Cyprus and ongoing issues in Greece, the European market was up by 7% in the first quarter. While Cyprus and Greece continue to attract the media headlines, the bulk of Europe’s economic performance continues to be driven by the larger countries.

Investors’ Knack for Making Emotional Decisions

Howard Marks is a market veteran who was interviewed by *Barron’s* magazine on March 11, 2013—a fascinating read for those of you who are interested. He is also the author of the quote opening this newsletter (*see above*). There are two important components of Mr. Marks’ quote which bear noting.

The first point he makes is that in good times (which we are currently in—or certainly approaching) those *not* participating in the market gains are intensely regretful for having missed out.

The second point is a harsh reminder of 2008—that is, historical hindsight tells us that the average individual tends to bail out at the point of greatest pain. Sadly, this is also the point of greatest opportunity for those with both the resources and risk tolerance to persevere (think March 2009).

Conflicting Signals

Adding to investor confusion are conflicting signals from the financial media. As an example, several weeks ago, Jeff Reeves, a columnist at MarketWatch.com, ran two parallel stories at virtually the same time. One story was entitled “10 Reasons to Run with Wall Street’s Bulls”. The other story was “10 Reasons a Correction could be coming”.

The inherent conflict in those two titles alone is enough to drive investors crazy. But Mr. Reeves' point is, I believe, to illustrate the lunacy of trying to "pick sides" and trying to time the market—particularly in the case of trying to predict short-term moves.

Nobody knows what is going to happen next. Markets are highly complex and their direction primarily depends on the actions of thousands of institutional money managers. All it takes is one news story or one bit of analysis to change the collective minds of a few big institutional money managers which can then turn the direction of the markets rapidly, at least in the short-term.

The brutal truth is that nobody knows with certainty what is going to happen next. Gurus are a dime a dozen, and there is no shortage of opinions. The best course of action is to base your investment plan on solid data, and not on the opinion of gurus. It is better to follow analytical frameworks that have shown a proven track record of success in both bull and bear markets.

Look Past the Uncertainty

Uncertainty often preoccupies many of those in the media. This then tends to distract investors from focusing on what's important. It also serves to dampen the willingness of American businesses to invest. Uncertainty has been a constant in the United States since 1776. The only variable is whether people ignore the uncertainty (which typically happens in boom times) or fixate on it (which happened in 2008 and 2009 and in times of great emotional distress or political or social upheaval).

Warren Buffet, in this year's annual letter to investors, has cautioned us to "stay in the game". It's important to remember his famous *New York Times* article in the fall of 2008 entitled "*Buy American—I am*". That article appeared in the throes of the global financial crisis and its great uncertainty. Now, in better times, he says: ... "*don't try to dance in and out (of the stock market) based upon the turn of tarot cards, the prediction of so-called experts or the ebb and flow of business activity.*" He also writes that (since the long-term outcome of investing in stocks is so overwhelmingly favorable) "*the risks of being out of the game are huge compared to the risks of being in it.*"

A Word about Risk

In last quarter's newsletter, I stated that investors need to manage their **risk** allocation as much as their **asset** allocation. This means that instead of focusing *only on returns*, we should be focused on **risk-adjusted returns**. These are the returns in excess of those commensurate with the risk taken.

In the simplest terms, if you invest 100% of your money in the S & P 500, you assume the entire risk of the S & P 500. If you invest 50% of your money in that index, you will only be taking 50% of the risk. Therefore, if you are invested in a 50/50 portfolio (50% in fixed income), but end up gaining 60% of the S & P 500 gain, you have exceeded your investment expectations given the level of risk taken. Your **risk-adjusted return** is in excess of the expected market return given your 50% allocation to the S & P.

Another twist on this idea is that unless you happen to be one of the best stock pickers in the world, it is more important to focus on *strategic* asset allocation. This is accomplished by having a thorough, well thought out written Investment Policy Statement (IPS) based on factors like your age, risk tolerance and time until retirement.

Finally, you should consider spreading this asset allocation across the globe into non-correlated assets as much as possible. In other words, allocate between assets that do not typically go up and down together. This is yet another great way for you to diversify.

Adhering to Your Plan

During the first week of January, 2012, in light of attractive stock valuations and a perceived risk in bonds (*which turned out to be wrong*), we recommended that clients increase equity weights to the upper end of their risk tolerance range. This was over one year ago and was clearly timely given the strong performance of the stock market since last summer. At this time, we are carefully monitoring current developments to try and determine whether clients should continue holding their maximum equity weightings.

It should be noted that continued strong performance by stocks means that some investors may now be above their recommended equity allocation. In those cases, and regardless of what happens to markets in the short term, investors should stick to their investment parameters and make the necessary adjustments to their asset allocation.

Conclusion

To invest successfully and to avoid emotionally-based decision making, consider leaving opinions (yours and others) at the door. Instead, be driven by hard data. Opinions are an investor's biggest enemy in achieving investment success. No one likes to admit it, but often an opinion is inadvertently formed first and then justified by convenient data—the data supporting the opinion is considered right—and contradictory data is discarded.

I will close with one other quote from Howard Marks: "*Risk control is the best route to loss avoidance. Risk avoidance, on the other hand, is likely to lead to return avoidance as well.*" This means that if an investor uses *risk controls* to insure higher *risk-adjusted* returns, they are likely to minimize their losses in a bear market. But if they decide to totally avoid risk altogether, they will certainly minimize their losses in a bear market, but will also be assured of earning no return in rising markets.

Thank you for allowing me to be of service to you.

Sincerely,

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Past performance is no guarantee of future results

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