Concentus Wealth Advisors
clarity | vision | results

The Wealth Planning Process:

The Role of Financial Guidance, Planning, and Investor Behavior in the Wealth Planning Process

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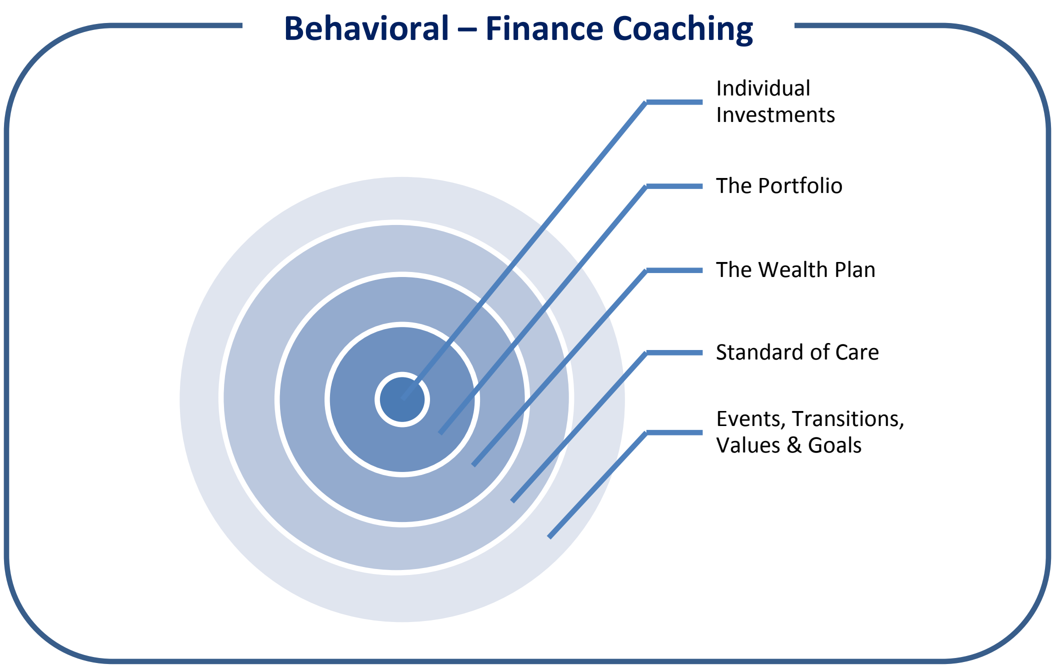
In this White Paper:

Introduction

The Wealth Planning Process

At Concentus Wealth Advisors, we believe firmly that our value proposition is rooted in our ability to help our clients to design and execute a financial strategy based on their family's **Core Values** and most important **Life Goals,** so that they can delegate the management of their wealth to a trusted fiduciary advisor, and focus their time and energy on the things in life which are most important to them.

At the heart of that value proposition is our firm belief in the value of the *Wealth Planning Process*. Our value as a financial advisor should be driven by our level of skill in helping you to deal with the complexities of your financial life, through a disciplined *Wealth Planning Process*. We have created a simple diagram to visually represent the important component pieces of effective wealth management, and in our view any competent advisory platform should be prepared to demonstrate value in each of these key areas:



Individual Investments: The most fundamental task of a Financial Advisor is to recommend investments. Our firm investment committee spends a great deal of time and effort to research investment recommendations, and our role as your fiduciary ensures that only your best interests influence that process.

The Portfolio: The larger foundation of our work together is your investment portfolio as a whole, which is the way we are able to bring together all of your individual investments into a coherent strategy. Portfolio structure is one of the important engines of your future financial security and the foundation of your wealth management.

The Wealth Plan: Of course, the portfolio by itself answers only a few of the important questions that you have about navigating the complexities of your wealth, which is why the portfolio should be built on the foundation of a comprehensive financial plan. While the portfolio strategy may help you to navigate current market conditions, the Wealth Plan sets the stage for a long term strategy for ensuring your peace of mind.

Standard of Care: Mike Tyson once said that *"Everyone has a plan until I punch them in the mouth".* Even the best designed Wealth Plans must be flexible enough to deal with the evolving complexities of your wealth, and changes in your situation over time. As you grow older and your wealth grows, you will inevitably face more complex decisions about your money, as well as your tax, estate, debt, and insurance planning. As this occurs, our "Standard of Care" can act as a tool kit of multi-disciplinary knowledge and expertise to help you think strategically about those decisions.

Events, Transitions, Values and Goals: Life is a constantly evolving journey that presents your family with predictable challenges. There are normal life transitions: stages of life that we enter and leave as the years pass. Developments in each of those stages require us to adjust the plan, the portfolio and other strategies. In addition, there will be unexpected events to which every family must adapt, both good and bad. We pay attention to what is happening in your life, observe it from the perspective of your financial plan, and make sure you get the best possible advice about how to navigate those changes.

Behavioral – Finance Coaching is the glue that helps keep it all together. Research has found that investors benefit from having an advisor to act as a sounding board and as a counselor when they become distressed by volatility in the markets, or short-term losses in their portfolio. Our firm can be a source of emotional strength, self-control, and discipline when you are tempted to over-react to market developments.

Each of these circles informs the others, back and forth, all the time, but each must be present in our wealth management relationship. More importantly, there is a reason that this model is represented by a series of concentric circles explaining each characteristic of an advisory relationship: It is to demonstrate the relative importance of each of these characteristics. In particular, this diagram is intended to emphasize that *the portfolio and the products sold within it are only one small part of a larger advisory relationship* – in fact the portfolio and the products are truly the *servants of* the more important elements of your wealth planning, such as the wealth plan, standard of care, and focus on your values and goals.

Too many people oversimplify the wealth management process thinking that the investment portfolio is the only thing that matters. In truth, investment products and portfolio management are commodity services, and do not particularly represent any unique value. The true value in the advisory relationship is in the insight and wisdom delivered through the more advanced functions of our wealth management process.

Introduction

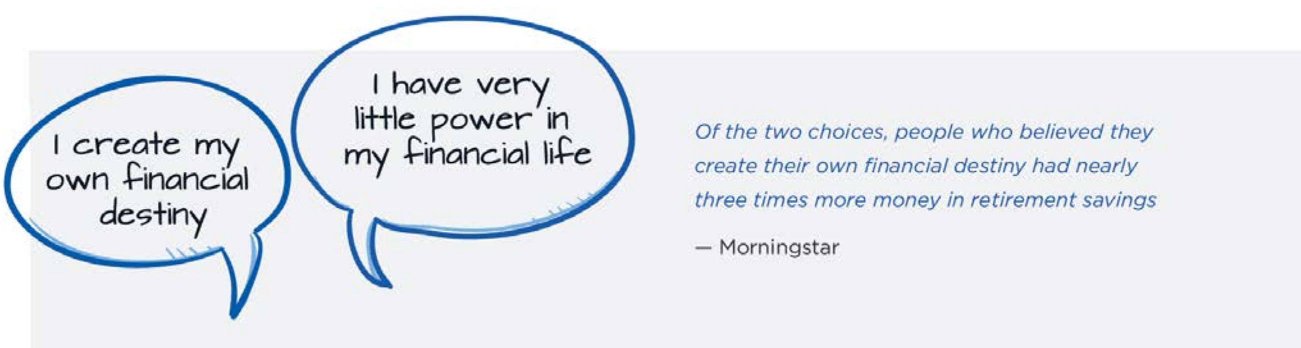
Outcomes, not Alpha

The ultimate utility of the wealth planning process is the achievement of your goals over a lifetime of planning and investing. For most people, such goals include things like achieving a long and worry-free retirement, educating children or grandchildren, taking care of parents in their old age, buying a boat or a second home, or leaving a meaningful legacy to family and the charities that matter to you. Notice that “beating the market” is not on this list.

Long term investment performance may be one important tool that helps you to achieve your goals but certainly not the only factor. Many people mistakenly believe that “outperforming the market” is the only way to achieve their goals, in large part because financial journalism constantly bombards us with messages that investment selection and timing are all-important. As a result, many people become too obsessed with the daily gyrations of investment performance, and distracted from what really matters, which is the disciplined execution of a written long-term wealth plan. It is our view that the only rational purpose for an investment portfolio is its role in the achievement of a written financial plan.

The promise of superior investment performance is unpredictable, and difficult to deliver consistently. Although having an experienced advisor gives you a better *probability* of achieving investing success than if you tried to do it on your own, even the best professional investors in history must endure periods of time when their “relative performance” is disappointing. There is no “black box” or “magic formula” to investing success, and those who choose to use relative performance as the measuring stick for the success or failure of their wealth plan are bound to be disappointed.

Investors are better served to focus on “Outcomes, not Alpha”, measuring their long term success by their ability to stay on track to achieving their goals. The best way to realize these outcomes is to carefully plan for their achievement, and then to maintain the discipline to execute the plan, despite the temptation to abandon the plan when market conditions become emotional. Those who are able to do this often find that their discipline and planning rewards them with investment performance sufficient to deliver their most desired outcomes.



Investing Philosophy

Our Philosophy of Investing

The development of a successful lifetime investment strategy begins with the formation of an *Investment Philosophy,* to be followed by a blueprint for long-term portfolio composition and structure, and a finally a strategy for the selection and management of individual investment holdings. However, there can be no excellence in the pursuit of investing success without a clear and consistent set of beliefs about how capital markets and investing works, which is our *Philosophy of Investing*, which will guide the investment process.

Such a philosophy and belief system can only be formed through rigorous academic study and research, and many years of patient experience and observation – years which form the backbone of the value proposition of an experienced financial advisor who has taken the time to develop such a firm philosophy. Our team at Concentus has developed an Investment Philosophy over many years, to help our clients become outstandingly successful investors. This philosophy is made up of 10 core concepts, which we refer to as the “10 Pillars” of our Investing Philosophy. We believe:

1. **Markets are rational**. Over the long term, capital markets are rational, and are guided by specific principles, or even “Natural Laws”. It is investor emotions which cause most investors to believe that markets are ruled by chaos and unpredictability, when in fact the short-term chaos is part of a larger order, which is rational and understandable.

2. **Successful investing requires a Long View.** All prudent investing must begin with a long-term time horizon in mind. Successful investing requires patience and discipline, both of which require a “long view”. We believe that we are investing for a lifetime, or even over several generations. *Investing success should be measure over years not months or quarters.*

3. **People underestimate how long they will to live.** You are going to live a long time. Invest accordingly.

4. **The only real definition of “Money” is Purchasing Power.** We must protect against the eroding power of inflation. Currency inevitably loses some of its purchasing power every day due to inflation.

5. **Equities are better than anything else.** Equities, or the partial ownership of the great companies of the world, have been more effective than cash, bonds and other fixed income investments at preserving and enhancing Purchasing Power.

6. **Equity Returns are a function of Equity Volatility.** To pursue higher returns, you must accept volatility.

7. **Investor Behavior is a Risk.** The long-term risk of equities is embedded not in the companies themselves, nor in the global economy, but in the emotions of the investor.

8. **The Economy, Markets, and future performance are impossible to predict.** Nobody can consistently gain an edge over the market by going in and out of it based on current events.

9. **Uncertainty is the only certainty.** The world is in a constant state of instability. We must achieve rationality under uncertainty.

10. **Optimism pays.** It is not possible to make a good investor out of a pessimist.

Investing Philosophy

Markets are Rational

As we seek to understand how the capital markets work, we must first decide if we believe in the rationality of markets. We must ask ourselves if there are in fact specific principles or even "natural laws" which markets have obeyed over a long period of time, which can help us to identify consistent patterns to guide our decisions, or are markets totally random and unpredictable. If they are random and unpredictable, then why bother?

We believe that markets are indeed rational and guided by such laws. This idea is certainly counterintuitive, as popular culture and the financial media have taught us all to believe the exact opposite – that markets are ruled by chaos and unpredictability, and that any "rules" or order we might perceive in the markets may cease to function at any moment in time. If this were true, it would of course make investment planning impossible anyway, because one cannot make investment policy out of chaos theory.

Although markets may *appear* unpredictable and chaotic to us, we must accept the possibility that perhaps our emotions may be causing us to misunderstand the chaos, and that it is in fact just part of a larger order which we do not yet understand. As Nobel Prize winner Marie Curie said, "Nothing in life is to be feared. It is only to be understood". The capital markets are never to be feared. They are only to be understood.

> *Do not resign yourself to this battle. Do not see investing as some kind of Sisyphean exercise, in which you are tragically fated to roll the rock of your wealth up the hill in rising markets, only to watch it roll down again when markets crash.*
>
> *Believe that you can triumph, and that all you need in order to succeed beyond your wildest dreams is out there - lost in the darkness of ignorance and fear - waiting for you to shine a light on them.*
>
> \- Nick Murray

So, we begin by establishing the fundamental rationality of the capital markets. That rationality can appear wildly skewed in the short-term by our excess of human emotion, specifically euphoria and fear, which both can cause us to believe that the natural order of markets has ceased to function, and that *this time is different.*

Even during extreme ebbs and flows of emotion, capital markets are not chaotic, but instead are always bouncing around simple and rational norms, to which they will always migrate back. Markets are not only orderly, but their order is simple and logical. The goal of our Investing Philosophy is to identify the nature of that simple order, so that we may take advantage of it over time.

Investing Philosophy

Successful Investing requires a Long View

Time… is on my side
- Mick Jagger

The rationality of markets can only be understood when considering a long-term investment horizon. In the short run, markets are indeed unpredictable and chaotic, and appear completely irrational, but as we extend our vision and time horizon, the unpredictability begins to fade and the rational order becomes clear, just like expanding our vision allows us to see the forest instead of the trees As Mick Jagger famously noted, when it comes to stock market behavior, *time is on our side*. Over the long-term, the variability of annual investment results begins to narrow, and market returns begin to revert to the mean. Our study of market behavior can begin to move from *predictions* about what will happen in the short-term, to *probabilities* that future market behavior will resemble past performance over a long period of years.

All prudent investing must begin with a long-term time horizon in mind. We believe that we are investing for a lifetime, or even over several generations, and *success should be measured over years not months or quarters*, and requires a healthy dose of these two essential investor skills:

- **Patience:** We are investing for lifetime, and even multigenerational goals. The ability to refrain from reacting during even protracted periods when one's strategy is not working, or is doing nothing, is the acid test of the investor's capacity for patience.

- **Discipline:** It is inevitable that there will be periods when an investment strategy is not producing the desired results. During those times it is critical to remain disciplined. In our investing philosophy, "We don't fixate on what is working now, we concentrate on what has always worked."

We believe that all successful investing is *Goal Based and Planning Driven*. An investment program only has use as a tool to achieve the goals of your financial plan. In our work with clients over many years, our clients have expressed the desire to achieve a wide variety of financial goals. However, we have noticed that the most important core goals of most of our clients generally revolve around 5 objectives that we call "The Great Goals of Life":

1. The endowment of a long, comfortable, and worry-free retirement, with little or no compromise in lifestyle or concern about running out of money. A base of capital that continues to grow, even as you draw continuing income from it for an independent retirement.
2. The desire to intervene meaningfully in the financial lives of one's children, during your lifetime or in the form of a legacy
3. The ability to fund the education of one's children and/or grandchildren
4. The capability to provide quality care for one's parents in their later years.
5. The ability to make a meaningful legacy to a much-loved school, church, charity or other institution.

Fortunately, this list is generally long-term in nature, and is likely to be achieved over a lifetime, or even multi-generational period of time. This allows us to place "time on our side" as investors and wealth planners, because the really important financial objectives in most people's lives are likely to unfold over many years – most people will live through 30 or more years of retirement, and their wealth transfer goals will live well beyond even that time frame.

The investor who truly understands the impact of time, and who accurately targets investments to the proper time horizon, has a secret weapon that doesn't rely upon market predictions or prognostications. Instead, they can simply play the probabilities and invest for the duration of their goals, using low volatility asset classes for those goals which have a short duration, and more volatile high growth asset classes for those goals which have a longer duration. And then sit back and wait.

Those who judge their portfolio by its performance relative to some narrow benchmark are focusing on an issue that is largely irrelevant to their ultimate financial success.

The only benchmark that you should care about is one that indicates whether or not you're on track to accomplish your financial goals.

Risk is measured as the probability that you won't meet your financial goal. Investing should have the exclusive objective of minimizing this risk.

- From Adaptive Asset Allocation by Butler, Philbrick and Gordill

People Underestimate their Life Expectancy

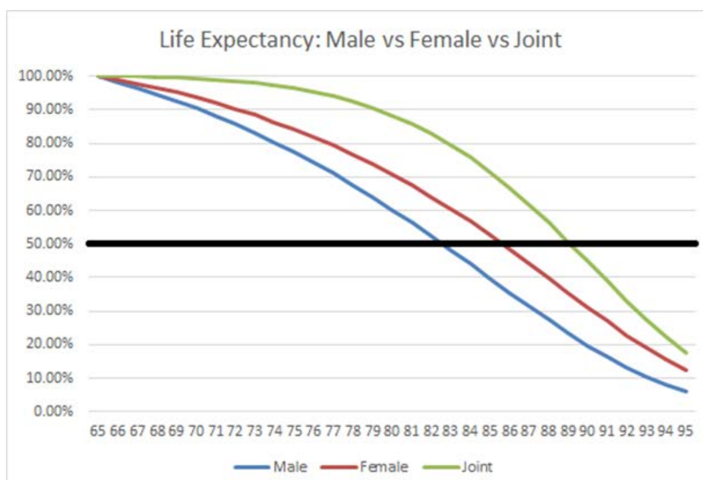
Futurists say the first person to reach 150 years of age has already been born,
and some project that people alive today will live 300 years or even longer.
- Ric Edelman

No matter how much wealth you accumulate, in the long run there will come a day when it's time to harvest from your wealth – when you or your family will draw living expenses from your investments, because your work days are either over or are dwindling. You may not formally "retire", but most people strive for a state of "Financial Freedom" - a day when you could live from an income stream from your investments. When that day comes, there are really only two possible financial outcomes:

> *Door #1: The money outlives the people*. Through this door lies perfect happiness for those who are confident that they are in process of being outlived by their money. This knowledge allows us to preserve the two most important qualities of life we all seek: our dignity and our independence. It also allows us to intervene meaningfully in the lives of those we love, and/or to leave a legacy to a beloved cause or institution.
>
> *Door #2: The people outlive the money.* Through this door lies the gradual extinction of dignity and independence.

The door you get to walk through when that time comes, is largely dependent upon whether or not you have adopted a written, date and dollar specific wealth plan. In that plan, *it is absolutely critical to make a realistic assumption about how long you might live - after all, no one wants to outlive their money.*

Exponential Increases



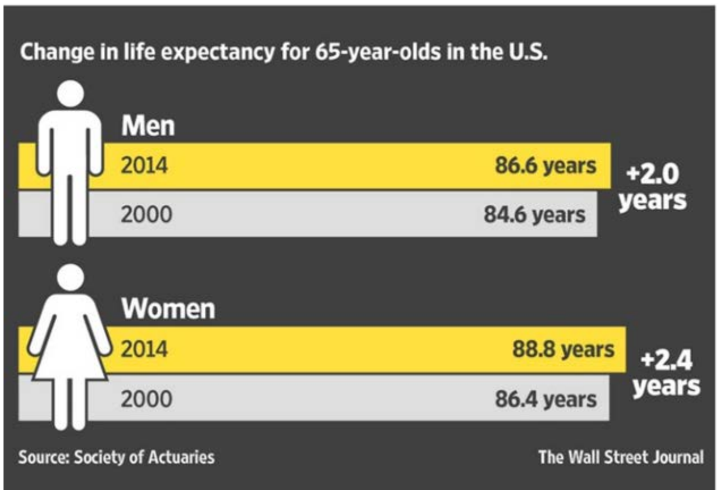
Gordon Moore was the co-founder of Intel, who famously observed in 1965 that the computing power of semiconductors will double about every 18 months. Evidence of the exponential growth of technology is all around us, and it appears that technology is now reaching the point at which the doubling of computing power is creating almost parabolic increases in our technological capability.

Exponential technology is difficult for the human brain to comprehend, because we think the future will look more or less like the past we know – we all seek predictability and stability in our lives, and the idea of world changing technology can be very scary to our view of the world. We prefer to think that the future will approximate the past. One of the most interesting implications of exponential technology is the impact on human life expectancies, which may also be in the early stages of a parabolic growth curve. For most of human history, life expectancies changed very little – but in the last 100 years or so they have begun to show signs of increasing rapidly.

Investing Philosophy

At the birth of the average American male back in the year 1900, life expectancy was 46.2 years. By the time his son was born in the mid- 1930's, his life expectancy was over 62 years. Fast forward to present day, and we find that, using the Social Security Administration's 2013 Period Life Table (the most recent analysis of expected longevity), if you're 50 years old, your life expectancy is 83 for a woman, and 80 for a man.

Remember also that life expectancy is a simple average of how long 50-year-olds will live. Some will live two more years, and others will live 40. The average can be misleading. In fact, 56.4% of all 50-year-old women are expected to live longer than their life expectancy of 83 years, and, similarly, 55.4% of all men are expected to outlive their expectancy, according to the Social Security table. That may seem a bit odd, but it's because the distribution of ages when people are expected to die is not a nice normal distribution. It is a skewed distribution with more people living longer than dying early.



According to the Social Security Administration, 30% of all 50-year-old women are expected to see their 90th birthday and 19% of all men are. In fact, the most likely age for a 50-year-old woman to die is 88 and the most likely age for a man is 85. A woman is more likely to die at age 92 than at her life expectancy age of 83, and a man is more likely to die at age 89 than 80.

As we discussed above, it is critical that we plan our lives, careers, and money to make sure that we can walk through "Door #1", and make sure that we can achieve our long-term life goals so we can fulfill what is most important to us. Life expectancy is a critical part of this planning, as we can only calculate and determine if we have "enough" to reach our most cherished life goals, to the extent we know how long that life is likely to be!

Unfortunately, this is also one of those areas in which most people have a tendency toward *linear thinking.* For most people, if asked the question of how long they think they will live, their mind will immediately retreat to some calculation based on the lives of their parents or grandparents. In fact, many people really don't expect to live very long, say even into their 80s.

Our advice…plan to live longer and adjust accordingly.

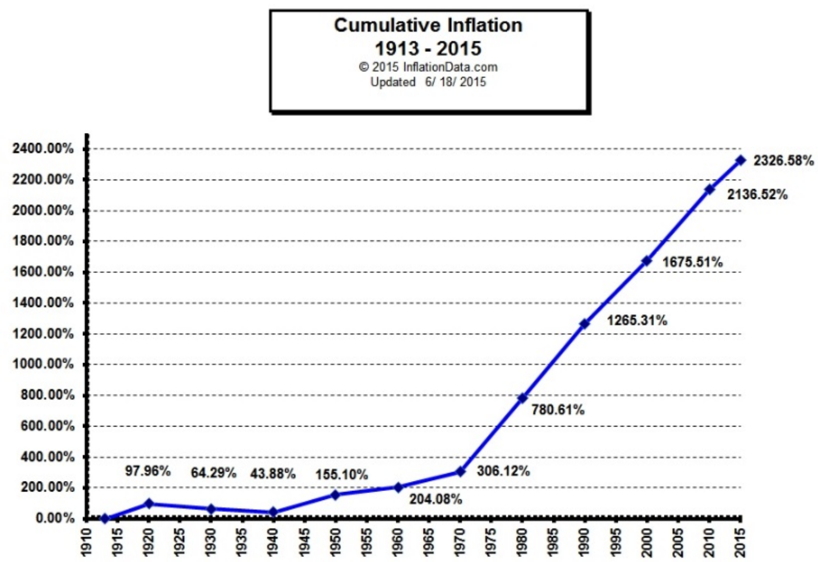
Investing Philosophy

"Money" is Defined as Purchasing Power

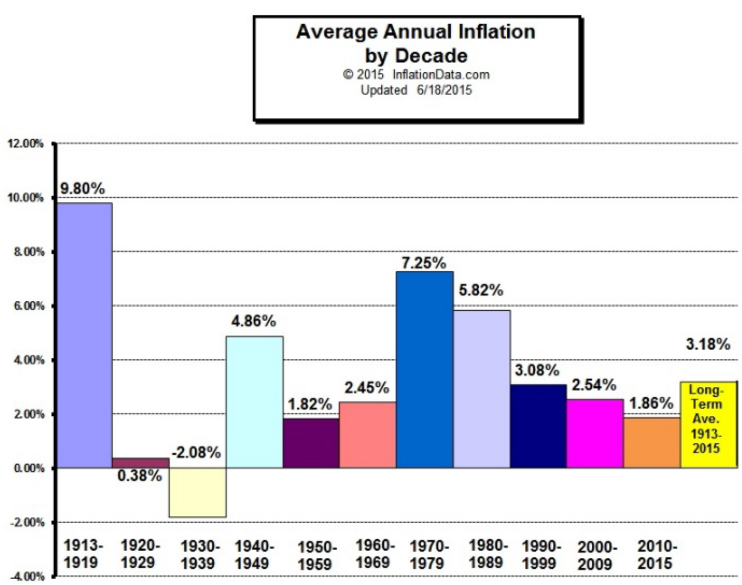
What is Money?

Although it may seem so, this is not a rhetorical question. It is intended to shine a light on yet another point which most Americans and popular culture have totally missed, and fail to comprehend.

This failure to comprehend the proper definition of money is the reason that most investors are doomed to fail in the lifetime quest to preserve and grow their wealth. People think that money is defined as the number of little green pieces of paper with dead presidents on them which they own. They think that "money" is the same thing as "currency", and that if they had a million dollars 20 years ago, and they still have a million dollars today, they have preserved their money, and "kept it safe".



The problem with this definition of success is that this same investor has just lost half of her purchasing power, through the inescapable reality of even moderate inflation. At the average long-term rate of inflation (3%), a dollar will lose roughly half of its purchasing power over 20 years. Currency isn't "money", and it inevitably loses some of its purchasing power every day due to inflation.



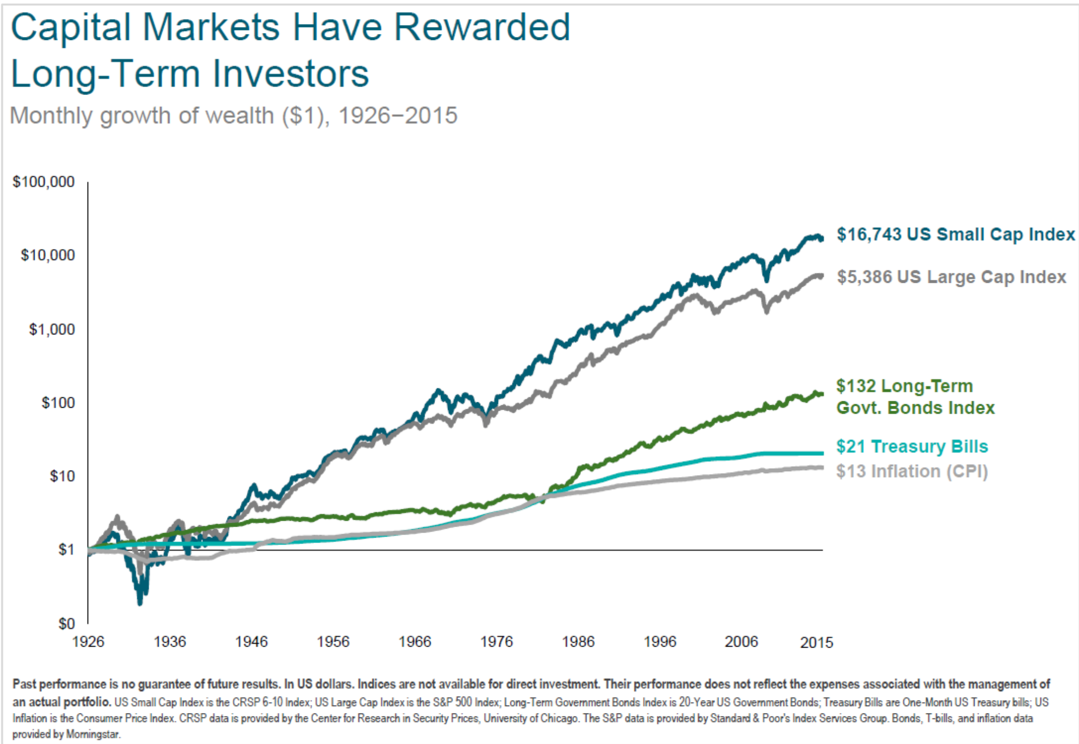
In the long run, the only logical definition of "money" or "wealth", is purchasing power. Our philosophy must be based on the fact that the goal of successful long-term investing is the maintenance – and if possible growth – of purchasing power. This realization is the only key to long term wealth, and rejection of this reality must, by definition, lead to the erosion of wealth over time. Investors who confuse currency with money, and who invest to protect the number of units of currency they own, will almost always have to accept a rate of return which is lower than the rate of inflation, particularly when factoring in taxes.

Investing Philosophy

Equities are Better than Anything Else

Equities, or the partial ownership of the great companies of the world, have been more effective than cash, bonds and other fixed income investments at preserving and enhancing Purchasing Power.

Since 1926, large company equities in the U.S. have compounded at an annual rate of roughly 10% per year. The dividend cash flow from those same companies has also grown at a rate of 5% per year. Over the same period of time, high quality bonds in the U.S. have compounded at about 6%, and inflation has been about 3%.



On the surface, this basic information tells us that stocks have returned roughly 165% as much as bonds for the last 90 years. However, this fact doesn't quite tell the whole story. It is only when we combine this data with our understanding of *Money as Purchasing Power* that the story becomes interesting.

Because we are defining money as *Purchasing Power*, the 3% rate of price inflation must be considered in our calculations. This means that the *Real Return* after inflation of owning good companies – if you will the margin of safety they have provided in excess of inflation – has historically been about double that of owning bonds.

	Nominal Return	Inflation	Real Return
Stock	10%	3%	7%
Bonds	6%	3%	3%

Doing the math: equities have returned 10% per year, which reduces to about 7% after inflation. Bonds have returned 6% per year, which reduces to about 3% after inflation. A real return of 7% is just about 230% of a real return of 3%.

Investing Philosophy

Of course, this analysis also ignores the fact that bond income is taxed as ordinary income, which is taxed at a much higher rate than the capital gains on stocks. The main point, however is that stocks do not produce an *incremental premium return* over bonds, instead they produce a return that is a *multiple of* the returns of bonds.

Of course, this discussion is in no way intended to make a projection that these returns or rates of inflation will persist in the future. It is simply a way of identifying the relationship of returns among asset classes over nine decades of history, so that we may continue to build an understanding of how capital markets work. This relationship tells us that historically, when it comes to the maintenance and growth of purchasing power, stocks have a distinct and significant advantage over bonds.

This is the fundamental reason why, for the lifetime and multi-generational investor, we much prefer to be an owner of companies rather than a lender to them. Although most people think of cash and bonds as “conservative” investments, in the quest to **conserve** our purchasing power after inflation, equities have done a far better job than bonds have historically.

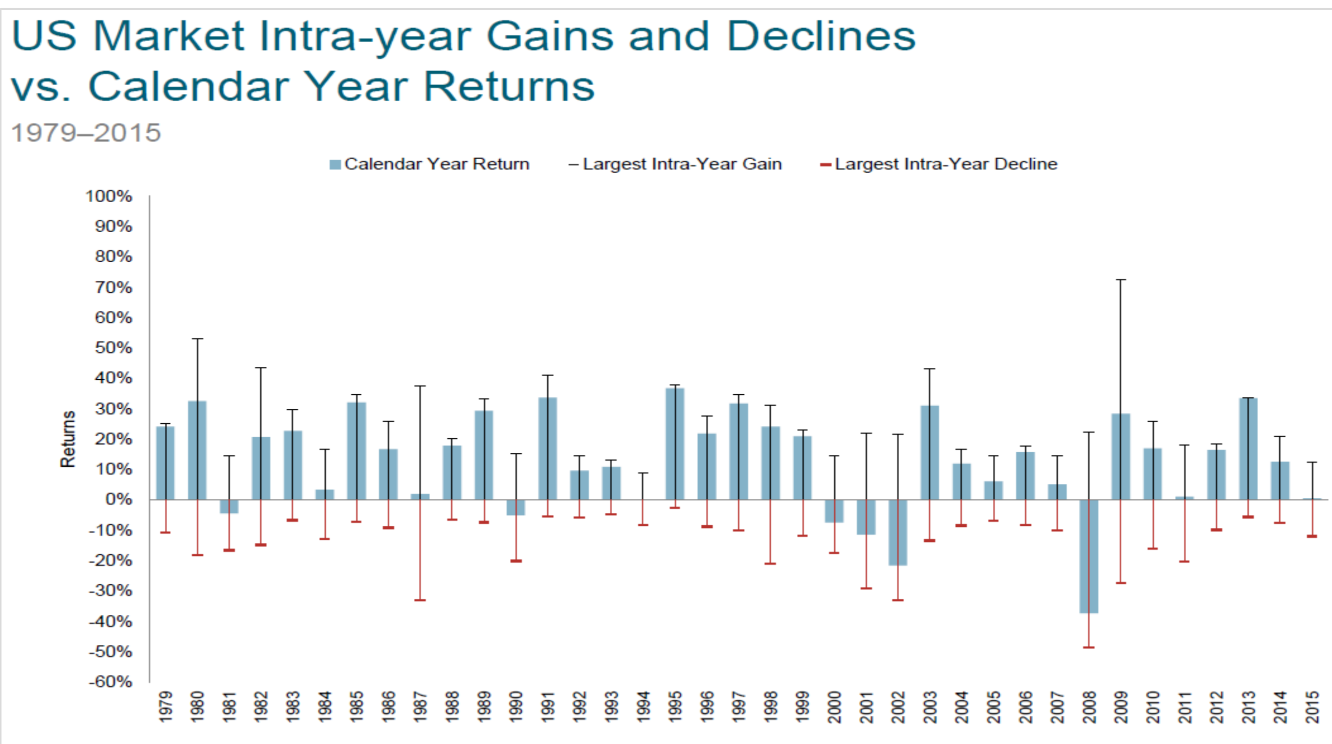
Premium Returns, Premium Volatility

Equity premium returns are a function of – and, in fact, are caused by – equity volatility.

The return relationships described above show that, despite the short and intermediate overreactions to cyclical economic events (and investor's emotional responses to those events), markets are quite efficient in the long run. Over nine decades marked by war and peace, massive geopolitical turmoil, economic booms and recessions and depressions, inflation and deflation, high interest rates and low interest rates, bull markets and bear markets, the return relationship between stocks and bonds has remained more or less constant.

Why is this so? Why does an efficient market pay a stock holder well over twice in real return to what it pays a bond holder? This question presents another opportunity to point out an answer that will likely run counter to most of the "common wisdom" you have heard about investing. Most investors believe that stocks return more than bonds over time, because stocks are "risky", and bonds are "safe". The fact that stocks are "risky" is perhaps the most commonly held misconception there is in the investing universe. It is also the misconception that prevents most investors from becoming as successful as they should be.

Stock prices commonly experience a high level of volatility over short periods of time, and often that volatility can cause significant temporary declines in equity values. In fact, since the end of WWII, large company stocks have annually experienced a temporary decline of an average of close to 15%. They have also declined by between 15% and 20% one out of every three years, and by more than 20% once every five years. But volatility isn't the same thing as risk, any more than temporary decline is the same as permanent loss. Today the S&P 500 stands 130 times higher than it was in 1946, when it started the year at about 18. Even the dividend of the S&P 500 is 65 times higher than it was in 1946. Historically, declines in stock prices have been temporary, while the increases in value and dividends have been permanent.



In US dollars. US Market is the Russell 3000 Index. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes.

Investing Philosophy

It is unclear why most investors live in constant fear that they will "lose money" in the stock market, given that equity markets have never produced a permanent loss of capital when given enough time. While stock markets have declined sharply on many occasions, the average bear market over the last 90 years has taken about 40 months to go from market peak to trough, and then back to the prior peak. However, during other times prices have also risen very sharply. The net effect of all of these declines and advances has been a compound return on large company stocks over 9 decades of roughly 10% per year.

Market Peak (Date)	Market Trough (Date)	Market Peak (Value)	Market Trough (Value)	Duration (Months)	Return %
05/29/46	06/13/49	19.3	13.6	36.5	-29.5%
08/02/56	10/22/57	49.7	39	14.5	-21.5%
12/12/61	06/26/62	72.6	52.3	6.5	-28.0%
02/09/66	10/07/66	94.1	73.2	8	-22.2%
11/29/68	05/26/70	108.4	69.3	18	-36.0%
01/11/73	10/03/74	120.2	62.3	20.5	-48.0%
09/21/76	03/06/78	107.8	86.9	17.5	-19.4%
11/28/80	08/12/82	140.5	102.4	20.5	-27.0%
08/25/87	12/04/87	336.8	223.9	3.5	-33.5%
07/16/90	10/11/90	369	295.5	3	-20.0%
07/17/98	08/31/98	1186.8	957.3	1.5	-19.3%
03/24/00	10/09/02	1527.5	776.7	30.5	-49.2%
10/09/07	03/09/09	1565.1	676.5	17	-57.0%
04/29/11	10/03/11	1363.6	1099.2	5	-19.4%

Note: All Data constructed using the S&P 500 returns. Returns do not include dividends. The inclusion of dividends would render bear markets shorter and shallower.

Our favorite bear market chart, reproduced above, shows the actual short-term downside volatility that the stock market has produced in the past. Since 1946 there have been 14 "Bear Markets" in stocks, which have caused stock prices to drop by anywhere from 19.3% to 57%, and which have lasted anywhere from 1.5 months to 36.5 months. However, despite all of those short-term periods of volatility, the S&P 500 stands roughly 130 times higher today than it was in 1946

Surprise is the mother of panic

The investor who has succumbed to a state of full blown panic is insusceptible to reason, and incapable of making good decisions. It is at moments when emotions are high that rationality is low, and investors tend to make our worst and most regrettable mistakes. So how can we engineer our investment philosophy in a way that avoids the possibility of panic in the face of the volatility outlined above?

Investing Philosophy

We must understand the nature of fear and panic. Particularly, it is most important to realize that the cause of panic is not the "crisis" itself, or the percentage decline in our investments. It is in the surprise – the state of being blindsided by a reality for which we were not prepared. To the extent that we can prevent surprise, we can cut off panic. We do this through constant reminders of the difference between volatility (the normal incidence of temporary decline) and risk (the historically nonexistent chance of permanent loss), and schooling ourselves in the history of market volatility.

The time to do lifeboat drills is not after the ship has struck an iceberg - we must do our lifeboat drills before our ship sails. Specifically, we must understand the historical incidence of stock market corrections, as well as full blown bear markets…

Stock Market Corrections

We define a "Correction" in the stock market as a short term, relatively shallow (20% or less) decline in stock prices. While a 10% to 20% decline in the market may not feel "shallow" while it is happening, we use that number as a way to differentiate from a "full blown bear market", which takes prices down by 20% or more. In fact, such a "shallow" decline can bring forth every ounce of fear and panic among ordinary investors, as corrections are usually accompanied by news of some pending geopolitical or economic crisis which can seriously rattle the emotions.

Fortunately, such corrections tend to be relatively brief, and usually last for only a month or two before they burn out and markets recover. In fact, it is not uncommon to experience one or more such "corrections" during the course of a year in which the stock market advances for the year.

It is very important to remember that such corrections happen all the time, and should be expected on average at least once a year.

Bear Markets

We define a "Bear Market" in the stock market as a more extended, steep (20% or more) decline in stock prices. Bear Markets are the common nesting ground of full blown panic, and can test the emotions of even the most seasoned investors. They are so scary, because they almost always occur during a time when the whole world is convinced of some geopolitical or economic catastrophe which is certain to tear down the fabric of our lives and economy as we know it.

Bear Markets take a little longer to end, and usually last for a year or two before they burn out and markets recover. In fact, the longest bear market since World War II came in 1946-1949, which took 36.5 months for the S&P 500 to travel from its peak to its trough.

Fortunately, Bear Markets happen less frequently, and should be expected on average about every 5 years.

Investing Philosophy

Investor Behavior is a Risk

"The investor's chief problem – and even his worst enemy – is likely to be himself."
- Benjamin Graham

The long-term risk of equities is embedded not in the companies themselves, nor in the global economy, but in the emotions of the investor.

Research shows that the human brain is wired in such a way as to make us naturally terrible investors. In particular, humans instinctively fear that any significant market decline is actually the onset of a disaster, even though as we just learned, all market declines are just temporary. The dominant factor in long-term, real life financial outcomes isn't so much investment performance, as it is investor behavior. In particular, because we are programmed with an irrational fear of equity ownership, most investors don't own enough equities to fund their life goals, and even when they do, most of us have a tendency to want to sell our stocks when volatility strikes.

Why do investors make this kind of mistake in behavior? Given the fact that the stock market has produced such amazing returns over the long stretch of history, why would any sane investor ever panic and sell their portfolio of stocks when they are already down 20% or 30% in a bear market? Does it seem probable that the enterprise values of such great American companies as GE, Apple, Wal Mart of Exxon Mobil have changed that much in a matter of mere months? But, thinking about something as mundane as the enterprise values of companies during times of market stress can be very difficult.

Instead, people fixated on the "crisis". Perhaps it is the mortgage crisis of 2008, or an earthquake in Japan, an Ebola threat, or the so-called "fiscal cliff". Regardless of the event, genuine panic will result any time the following three conditions are met:

1. The world is experiencing a national, or preferably global financial or economic event that nobody can explain or understand.
2. The masses have concluded that the "crisis" is insoluble – that nothing can stop it from bringing down the world economy.
3. In the resulting panic, the world has come to believe the greatest myth of all: ***This time it's different.***

Panic and terror require a sort of magical thinking. It requires a belief that, despite the fact that no financial, political, military, or natural crisis ever in the history of the world has been capable of inflicting permanent loss on stock prices, this one will. Indeed, anyone who has lived to an age to accumulate any capital to invest has already lived through any number of these "crises", and has watched the markets and economy deal with them, muddle through, and surge to new highs. In order to panic, one has to conclude that none of that matters, that we have entered a new world, which is so terrible that none of the old laws apply.

People have a hard time understanding the impact of their emotions on their investing, and for some reason we all have an inflated opinion of our own ability to make rational investment decisions. Most people mistakenly believe that this is a problem for *OTHER* investors, but that they more "sophisticated" than *OTHER* investors.

Investing Philosophy

However, the facts tell a different story. There is a market research firm called DALBAR which annually publishes a report on investor behavior which has become well known in the industry. Year in and year out for the last 20 years, this study has shown that investors consistently underperform their own investments. In fact, the most recent study found that over the last 20 years, the average equity fund investor underperformed the S&P 500 by a margin of 3.5% per year. Over 20 years the S&P returned 8.2% per year, but the average investor in stock funds only got 4.7% per year.

1. DALBAR, Inc. QIAB study, 2015   2. Morningstar   3. FactSet (Feb. 2016)

Historically, these numbers have bounced around slightly from year to year, but the relationship has remained pretty much constant: over 20 year periods, the average equity fund investor consistently manages to capture just about half of the return of the index. In a society that has become obsessed with "outperformance" and beating the market, the average investor is not only underperforming the market: they are underperforming their own investments!

This happens for a simple reason – because the average equity investor is hard wired to jump in and out of their investments at all the wrong times and for all the wrong reasons. Your own behavior as an investor, and your ability to avoid being sabotaged by your own emotions, is likely to be much more important than any other factor in your long-term investing success. One value of a financial advisor is to be your behavior coach.

This is where things get interesting, because there are two industries (the investment management industry, and the financial media), who are constantly bombarding you with the message that the only thing that matters to your long-term success is the timing and selection of the financial products you pick, and your ability to uncover the latest "5-Star fund" which will enable your portfolio to beat the market. On the contrary, we believe that, while timing and selection of your investments may make up 5% of your long-term investment success, your behavior and the actions you take will make up 95%.

Investing Philosophy

The Economy and Markets are Impossible to Predict

"Prediction is very difficult, especially if it's about the future."
- Nils Bohr, Nobel laureate in Physics

The economy, markets, and future relative performance of investments cannot consistently be predicted. No one can consistently gain an edge over the market by going in and out of it because of current events. We never attempt to analyze or predict the outcome of current events, because they are WAY too unpredictable. Instead, we always counsel that if your goals haven't changed, you ought not change your strategy.

We believe that there is great folly in the practice of making predictions, and that most "expert predictions" do little but make the "experts" look foolish. It is a well-documented that expert predictions in areas such as sports, politics, economics, and markets have a poor track record of accuracy. Indeed, there is no shortage of pundits and experts on the "financial news" who feel qualified to tell you how to position your portfolio to react to the latest global developments. In the end, most will make themselves look foolish by trying predict how geopolitical events will impact your investments.

To become a great investor, one must have a healthy acceptance of the fact that investing is an exercise in managing uncertainty about the future, and is an "inexact" science at best. Great investors understand that there is a limit to the effectiveness of analyzing *current information* about the world, as a means to make *future judgements* about asset prices.

The quickest way to identify a wise, intelligent and skilled investor is to weed out the arrogant ones. Unfortunately, smart people know they are smart and often succumb to the character flaw of arrogance. But pride comes before the fall, and since you don't want to fall, it is wise to be brilliant but humble. The simplest way to weed out the arrogant is to discount any expert who makes predictions. The world is way too complex for any individual to meaningfully grasp the future, the analytical power just isn't possible in a single human brain.

This lack of "predictability" about the future may seem daunting, but we believe it is not. Compared to the way your assets are divided between stocks and bonds – and to the overriding issue of your behavior – these variables are relatively unimportant. In practice, the only way to capture the full return of equities has been to ride out their temporary volatility.

Investing Philosophy

Uncertainty is the only Certainty

We firmly believe that uncertainty – in the markets and in the world – is the only certainty.

Most people mistakenly believe that the world is alternately moving from periods of uncertainty to periods of certainty, and that all we have to do is wait for the next period of certainty to get here. The truth is that the world is constantly moving from one "crisis" to the next. There is always a "crisis" happening somewhere, and the world lives in a permanent state of instability.

So how do we discern the rational from the chaos? At the core of our investing philosophy is an unshakeable belief that, as Shakespeare wrote in *The Tempest*, "The past is prologue". We believe that, when it comes to capital markets, the past predicts. Although markets appear to be always changing and presenting investors with new opportunities and challenges, the fact is that markets simply present investors with the same challenges and opportunities over and over, and tempt us to lose our perspective.

We counsel rationality under uncertainty, which just means that history is the best guide to the long-term future. Our firm is guided by two famous quotes…

"The only thing new in the world is the history you do not know".
- President Harry Truman

"Among the 4 most dangerous words in investing are 'this time is different'".
- Sir John Templeton, legendary investor

As we explored in the opening of this white paper, most people don't believe in the rationality of markets. Popular culture and the financial media have taught us to believe the exact opposite – that markets are ruled by chaos and unpredictability, and that any order we might perceive in the markets may stop functioning at any moment.

Although markets may appear unpredictable and chaotic to us, we must accept that perhaps our emotions may be causing us to misunderstand the chaos, and that it is in fact just part of a larger order which we do not understand, and therefore fear. As Nobel Prize winner Marie Curie said: "Nothing in life is to be feared. It is only to be understood". The capital markets are never to be feared. They are only to be understood.

Investing Philosophy

Optimism Pays

The most important cornerstone of our Investing Philosophy is that long-term optimism is the only reality, and it is not possible to make a good investor out of a pessimist.

There is no shortage of reasons to feel afraid and pessimistic about the world today. Simply open a newspaper or turn on the television, and you will be bombarded with bad news, and a scary outlook for the future. We can only wonder which dark calamity will cause the demise of the world as we know it, and the destruction of our quality of life. Will it be global warming that makes our planet uninhabitable? Will it be another debt crisis which will cause an economic meltdown? Civic unrest, income inequality, terrorism? Or will it simply be the mismanagement of politicians in Washington who cannot seem to govern our nation in an effective way?

Pessimism is indeed in a Bull Market in the world today.

Throughout history, it has been fashionable, “smart” and intellectual to be pessimistic, while optimists are generally considered naïve and childish. History holds stories of centuries of famous “intellectuals” who were considered the great thinkers of their time because of their convincing dire predictions for how the world was headed for imminent disaster. Moreover, pessimists possess a unique skill known as “turning point-itis” which enables them to ignore and explain away the facts of human success. Every generation of pessimists proposes that, despite a long history of progress, we are now at a “turning point” in human history, and that the future will be different than the past.

> *“It’s irrational. It’s frankly illiterate to not be optimistic. We’re going to see a blossoming across essentially every front, unprecedented in human technological history. This is not something that’s hoped for. This is baked in the cake.”*
>
> *- Lowell Wood, America’s most prolific inventor*

Pessimists are usually right about the logic behind their predictions, which typically revolves around the premise that, if the world continues as it is now, we are headed for great disaster. What they fail to notice is that the world **NEVER** stays as it is, because of human innovation. The critical mistake of pessimists throughout history is that they ignore the impact of human invention and innovation. *Extrapolations are dead right, but so was the man who (probably apocryphally) predicted ten feet of horse manure in the streets of London by 1950.* Of course, it was right to make a dark prediction that the streets of London would be buried under 10 feet of horse manure, if horses remained the primary means of transportation in London. The problem is that it was wrong to miss the invention of the car.

It is amazing that human beings are wired to believe that it is “smart” to be pessimistic, and that we are at every moment on the brink of some great calamity, when the record of history is that things have consistently gotten better for mankind, and that the most dire predictions of gloom set forth by the great thinkers of every age have generally been wrong. Despite the popularity of Pessimism, the wonderful truth is that human quality of life has gotten better, more or less consistently, for the last 100,000 years. A survey of the past is a great way to make this important point about how far humanity has come.

Consider this: Cornelius Vanderbilt was the Bill Gates of his age – he was by far the richest man in the world. But he could never have dreamed of some of the luxuries we enjoy today. In the US today, of Americans officially designated as “poor”, 99% have electricity, running water, flush toilets, and a refrigerator. 95% have a TV, 88% a telephone, 71% a car and 70% air conditioning. Vanderbilt had none of these things.

Investing Philosophy

Our favorite example is even more relevant today – did you know that the iPhone was only launched in the 2007? It is hard to believe that this technology was only developed just 10 years ago. When I was born, if it was possible to assemble all of the technological capability of an iPhone, it would have cost billions of dollars. Today, everyone has one in their pocket. However, the truly astonishing thing is that even someone with many billions of dollars back in 1969 couldn't have even assembled all of this technology – because most of them didn't exist!

We don't recommend "optimism" in some sort of polyanna way, but as an informed respect for economic history, which demonstrates that long-term optimism is the one world view that squares with the facts. Likewise, this belief is not some lazy extrapolation, or a belief that "this is the way it's always been, so this is the way it will always be", with no supporting rationale. Our rationale lies in the answer to the question: "What is the driving force behind this great history of improvement?" Why has humanity been able to improve its quality of life over the years, despite the obvious challenges which have been cited by pessimists through the years?

The economic trend of progress we see continuing is an essential expression of human nature.
Our optimism is based on the instinctive impulse of all 7.5 Billion humans on earth, to *become more*: To be, to do, and to own. The spirit of capitalism combined with human ingenuity and technology are thriving all over the world. Despite government, politics, financial crises, armed conflict, natural disasters, religious strife, and terrorist atrocities. And yes, no matter who is sitting in the Oval Office.

It's the combination of our human urge to *become more*, together with our natural ingenuity, which has driven the incredible explosion in quality of life in the last 100,000 years. We can be comfortable investing in a future shaped by human ingenuity, because it is a resource that can never run out, and we have not even scratched the surface of what it can accomplish

In the opening of this paper, we explored the difference in historical return that T-Bill investors have achieved, compared to the returns that equity investors have achieved. You may recall that stocks have produced returns which are *multiples of* the returns achieved with "conservative" investments. The reason for this is that equity ownership is the only way to invest in human ingenuity.

For various reasons, many investor don't perceive the nature of stocks as shares of companies, which represent a direct ownership of the earnings, cash flow, and assets of businesses which they themselves patronize. They don't view the "stock market" as a portfolio of businesses with real earnings and real dividends, but instead see stock prices as part of a huge casino. They see stocks not as ownership of businesses but as poker chips. In our quest to become great investors, let us remind ourselves that stocks are actually shares of the profits, earnings, and assets of real companies, made up of real people, with real ingenuity, creativity, and intelligence.

Conclusion

Closing Thoughts

Simplicity is the ultimate Sophistication
- Leonardo da Vinci

When it comes to wealth planning and investing, most people suffer from the *illusion of complexity*, and believe that the achievement of significant financial success will require us to grapple with a great deal of complexity. Popular culture and the financial media would have us believe that markets are a complex problem to be solved, and that the quest to master those complexities as a means of achieving superior returns is our only hope for long term financial success. We have found that many people struggle with anxiety about their wealth planning, and are intimidated by the topic of investing, because they have bought in to this illusion of complexity.

Leonardo da Vinci was one of the most sophisticated humans of his time, and perhaps of all time, and he observed the paradoxical truth that most of the sophisticated problems in life are remarkably simple. In a similar way, the achievement of long term financial success is simple as well, and requires nothing more than the execution of a few very simple tasks.

First and foremost, we at Concentus firmly believe that long-term financial success is defined as the achievement of the most important life goals of our clients, and that those goals are best met by employing a rigorous planning process. It has been said that failing to plan is planning to fail, and this saying certainly holds true when it comes to your wealth. People who sit down and design a date-specific and dollar-specific written wealth plan have a much greater chance of building and preserving wealth than those who don't. The simple truth is that all long-term investment success comes from acting on a plan, while failure is precipitated by reacting to the markets. For some reason many people can't accept this, and discount the value of planning instead are fixated on "outperforming the market". We believe in the importance of "Outcomes, not Alpha".

The second critical task, once your plan is in place, you must develop a specific policy for investing your capital in the classes of investments which have historically provided the returns which will be sufficient to achieve the goals of your plan. As outlined in our Investing Philosophy discussed above, we believe in the compounding power of equities, or the partial ownership of great companies, to deliver such returns.

Which brings us to the final, and most important step in the process:

The most important step is that you must stick with your plan, when you are tempted not to, because of the fads and fears and emotional volatility of the investment markets which can throw you off course.

This last step is indeed very simple: in order to build and preserve your wealth over time, one must remain consistently disciplined to continue acting on their plan, and not reacting to the markets. While this is simple, it is not easy. Human beings are emotionally hard wired in a way that tempts us to abandon our plan in a panic when market corrections or bear markets arise, or in a fit of euphoria when a "new era" bull market entices us to throw caution to the wind and bet our entire retirement on dot.com stocks.

While most people believe that *Investment Performance* is the most important determinant of long term success, it is our firm belief that *Investor Behavior* is the dominant, real world factor in our client's success over time. Our true value as a financial advisor is to act as a *Behavior Coach* for our clients. No black boxes, and no magic performance formulas. Just planning, and behavior management, which are likely to be worth multiples of their cost over time.