

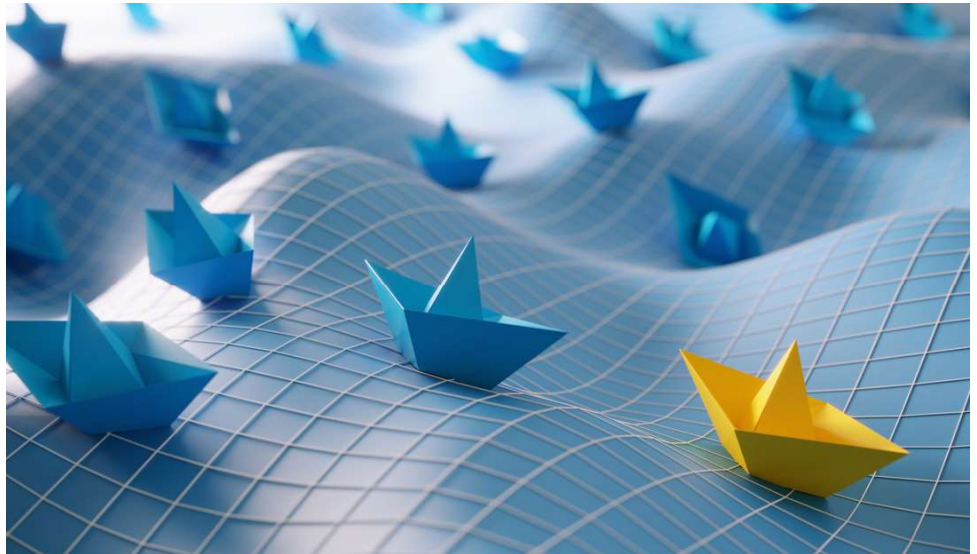
Tailgating & Turbulence

On my way home from work last week, the driver in a white Tesla next to me was in a hurry. When I stopped my car behind a crosswalk to keep it clear, he darted in front of me and blocked the path. When we started moving again, he swerved and weaved between cars, tailgating and honking angrily, desperately trying to gain crucial seconds on his way to his undoubtedly exciting destination.

My stoic father, in whom I have never witnessed a minute of road rage, would have said, “Well, that’s silly. He should have just left 15 minutes sooner. Then he wouldn’t have to drive like a nut.” And of course, Dad would have been right.

The less buffer we have, the more each second matters. The more each second matters, the more short-term our perspective. The more short-term our perspective, the more acutely and anxiously we parse every shred of information to desperately seek an advantage.

This doesn’t make for a productive drive home, or a happy life. How do we avoid this? We build buffers. The financial planning equivalent of starting your trip 15 minutes earlier is putting savings you need in the next few years into safe instruments, away from equity markets. This is why we 1) Determine your specific expense needs first, and 2) Only then do we allocate the portfolios.



“Lack of diversification doesn’t only mean suffering a decline of what you own. You are also foregoing growth from what you don’t.”

- Adrienne Yamaki

Happily, we’ve planned ahead for this.

Market drops are unique and caused by different factors. But their existence itself is never a surprise. Therefore, we’ve already planned for this. We’ve done an expense analysis and identified cash flow needs. And then, we built buffers. Markets are not predictable, and goodness knows life is not either. (For example, in our own practice, last month two separate clients’ job positions were eliminated and another happily discovered, against the odds, that she is expecting a baby through surrogate.) Happy or challenging, our life events become financial events. Hence we build in flexibility.

The good news is that if we have completed a financial plan together, we

have already built in measures of safety. A cohesive financial strategy means diversifying ahead of time. Market volatility does not disrupt our plan; market volatility is built into our plan.

The Planner’s Mantra: Allocate & Diversify

Allocation is the strategy of apportioning between asset classes and one effective way to create buffers. Diversification is owning instruments which fundamentally differ from each other. For an equity portfolio, this means holding companies of various size (small/mid/large), in disparate industries, based in different countries. Proper diversification optimizes growth by offering a breadth of earnings.

Stay the course. Unless your heading is wrong.

Staying the course can be wise. But it is poor advice if you are heading the wrong way to begin with. You don't look around for an umbrella in the middle of a storm. Allocation and diversification cannot be ignored until you're in the middle of a crisis. One should allocate and diversify when crafting a financial plan, not in reaction to external factors. If you aren't diversified now, it's not ideal, but it's not too late.

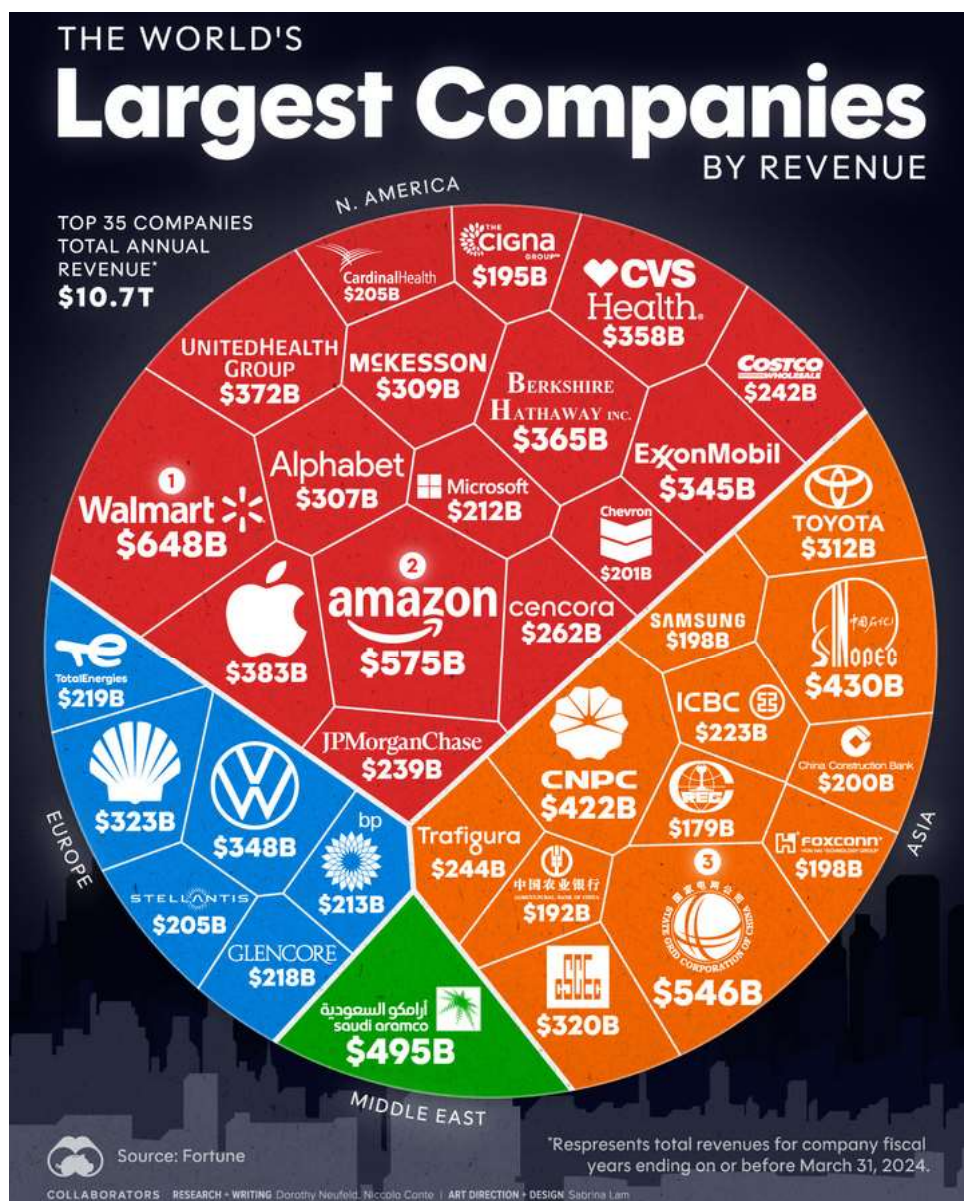
Are you really diversified? Really?

A few weeks ago, a friend asked my thoughts about asset allocation, and I suggested that funds needed for short- to medium-term living expenses not be in stocks, and that equity portfolios always be extremely well-diversified, especially globally. "Yes, I'm diversified," he assured me. "I don't pick individual stocks. My investments are in the S&P index."

But the S&P 500 is not diversification. First, it is highly concentrated - at the end of last year, 37% of the S&P 500 was invested in only 10 companies. In other words, less than 2% of companies comprised 37% of the portfolio - hardly well-balanced. Diversification does not mean spreading your portfolio amongst 50 US-based large-cap companies, nor does it mean holding even larger concentrations than the index does in an attempt to 'outperform' it.

In addition, and more crucially than just being lopsided, the S&P 500 only holds US-domiciled companies trading on US exchanges. So holding this index means you're missing, literally, a world of growth. Some of the best aerospace, automotive, energy, pharmaceutical, luxury, technology and financial corporations are multinational companies domiciled in other countries. And you're not participating in that growth.

The MSCI EAFE (an index tracking European and Asian large-cap



companies) is up YTD by 10.14%.¹ The S&P is down 5.7% during the same period, which means the difference in return between these indexes during this period is over 16%; this number is significant because it includes the cost of not being diversified. Lack of diversification doesn't only mean suffering a decline of what you own. It's also foregoing growth from what you don't.

Quick Checks

Allocation: Typically, funds you need to live on should not be in illiquid or volatile investments such as stock private equity, REITS or real estate. Plan for at least 24 months of spending in

cash or debt instruments, excluding earned income.

Diversification: A broad but reasonable rule of thumb for most investors is to hold 25% - 40% of an equity portfolio in international firms. To some investors, this seems excessive, but one way to think about the scale is to recognize that the US comprises only 25% of global GDP. One could argue that innovation, more transparent reporting and the global focus of US companies justifies a higher percentage of the portfolio. But my view is that due to favorable valuations and starkly different industry advantages in foreign companies, a US home bias will be a drag on performance

¹MSCI Index Data: <https://www.msci.com/end-of-day-data-search>

for years. I made my case for owning international companies on CNBC² last year and Bloomberg Radio³ last week.

If you're heading the wrong way, course-correct now.

- 1 Construct a plan to move funds you will need soon out of stocks and into more liquid, income-producing instruments (T-bills, CDs, short-term corporate and municipal bonds).
- 2 Determine how much of your stock portfolio is represented by US-domiciled companies (there are a number of helpful online tools). If it is more than 80%, think twice. Have a conversation with your advisor and ask him/her to re-assess and perhaps revisit a more appropriate allocation based on your goals. For your bond portfolios, revisit the blend which best matches your needs, tax bracket, and need for income.
- 3 If you are borrowing on margin or spending at too high a burn rate, decrease your risk by paying down debt or moderating your outflow, or both.

My investment philosophy.

Camp A or B

If you are my client, you are in Camp A or B (or at times a blend of both):

Camp A.

You are withdrawing from savings. (You're retired, between jobs, purchasing a property or preparing for a renovation). Whether living off your portfolio or requiring funds for future purchases, the appropriate allocation for these assets is probably not stocks. As a point of reference, the average period between S&P bear market cycles is 3.6 years, and average length of a bear market is 9.6 months.⁴ Pre-planned allocation can remove the fool's errand of timing markets.

Each asset class has a job. Cash provides value consistency. Bonds produce income and offer less volatility than stocks. For money we need soon, we stay out of stocks. No short-term timing needed. No desperate swerving & weaving. Build buffers.

And because we still need long-term growth to outpace inflation, we invest long-term assets in higher growth, higher volatility classes such as public and private companies or real estate. The more conservative investments buy us the safety to use time in our favor.

Camp B.

You are contributing to savings. Market declines can actually help you achieve your goals. It feels counterintuitive but is not. Market drops allow you to accumulate assets at lower cost, which can boost your ultimate return. It's uncomfortable to see one's net worth decline, but I recommend viewing it for what it is – as temporary declines you are using to your advantage to build long-term wealth.

If your heading is unchanged, your plan should be, too.

It is understandable to see sharp drops in equity markets and feel an acute urgency to 'do something.' Acting on this impulse might feel productive, but it can also make you worse off later; in fact, there's a statistical likelihood this will be the case.

Trump: Take 2

The administration is executing sweeping changes, many by withholding federal funding through executive order instead of passing laws. Trump has stated his goals of cutting government spending and increasing America's global influence while reducing international dependency.

However, execution is key and he is poorly wielding improper tools. Trump favors blanket tariffs to increase consumption of US goods and decrease reliance on imports. But because tariffs increase prices on domestic consumers, they decrease consumption, causing demand and profits to fall. The ad hoc way tariffs have been implemented (or not) is causing businesses to postpone capital investment and has set off retaliatory responses, which harms US manufacturers as demand for US goods decline. If Trump manages to persuade US businesses such as US automakers to not raise their own prices, as he's attempted, this will harm those industries further.

Another problem is that the current administration views government as separate from and detrimental to the private sector. This simplistic view belies the complexity and interdependence between the two. For-profit companies rely on the government, but not just for grants and subsidies. Businesses also depend on the US government to introduce new products. Shrinking the patent office means pharma and biotech firms will be delayed bringing products to market, which will hurt earnings. The US government builds and maintains infrastructure that commerce depends on, like transportation channels and communication. Eliminating departments overseeing these areas adds cost and risk to companies' distribution. Lastly, the government

² [https://www.cnbc.com/video/2024/07/12/pro-watch-cnbc-as-full-interview-with-newedges\[...\]anch-and-strategic-wealth-as-adrienne-yamaki.html?&qsearchterm=Discussion+re.+international+begins+at+14:28](https://www.cnbc.com/video/2024/07/12/pro-watch-cnbc-as-full-interview-with-newedges[...]anch-and-strategic-wealth-as-adrienne-yamaki.html?&qsearchterm=Discussion+re.+international+begins+at+14:28)

³ [https://www.cnbc.com/video/2024/07/12/pro-watch-cnbc-as-full-interview-with-newedges\[...\]anch-and-strategic-wealth-as-adrienne-yamaki.html?&qsearchterm=Discussion+re.+international+begins+at+14:28](https://www.cnbc.com/video/2024/07/12/pro-watch-cnbc-as-full-interview-with-newedges[...]anch-and-strategic-wealth-as-adrienne-yamaki.html?&qsearchterm=Discussion+re.+international+begins+at+14:28)

⁴ Source: Hartford Funds, Ned Davis Research, 12/21.

is an important consumer of public companies, buying millions of dollars of IT services, defense, and energy, to name a few.

Because business and government are so inter-dependent, these broad changes will effect businesses and the economy in pernicious ways we have not yet recognized. Yes, running an efficient government is important, but doing it in a careful, analytical and data-driven way is crucial, and missing.

Trump is transactional. He wants quick wins, or at least the perception of quick wins. He has little appetite for methodical consideration. He encourages action and the attention resulting from these actions. Will that matter to voters? It should and it will. But it will take awhile, as natural consequences play out. So we have to be patient, and not overly reliant on these outcomes. Hence our need for buffers, proper allocation, and diversification.

We invest in Companies, not Countries.

We are not investing in the skill of our government. We aren't even investing in a economic outlook. We are investing in companies. Companies are more nimble and unencumbered than governments. They adapt in countless ways to legal and economic changes. There are too many factors to derive any meaningful conclusion of how a policy decision will affect a company's earnings.

Case in point - Japan suffers from an aging population, high government debt and its own inflation challenges – their energy prices are up 10.1% year-over-year and food prices 17.3%.⁵ Yet, Toyota, is one of the most profitable companies in the world, with 2024 revenue of \$305.8 billion. French citizens pay some of the highest entitlement and income taxes in Europe, but multi-billion dollar firms such as AXA, LVMH, and Hermes are domiciled in France. Nestle and Roche are Swiss, Airbus is Dutch and SAP is German. Diversification

allows us to benefit from earnings wherever they are generated. Over the last 20 years, on average roughly half of the top 50 performing companies are not American.⁶

Looking Forward

There's plenty of political and social uncertainty, but businesses and equity prices are driven by profits. And as much as the current political climate appears unstable, we are still consuming. We are buying groceries, gas and prescription drugs. Companies are still investing in technology, training, marketing and product development. Some people worry that the free market system or democracy itself is at risk; this may be so, but at this point I feel that's a bridge too far to plan for. So let us retain our heading and discipline and focus our energies on the areas of our lives and the world that truly need us, and move forward together as best we can.



⁵ Deloitte Global Economics Research Center, Japan economic outlook, February 2025 <https://www2.deloitte.com/us/en/insights/economy/asia-pacific/japan-economic-outlook>

⁶ JPM Asset Management_GTM Q1 2024

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