

A Tree Grows in San Francisco

On April 4 my daughter Audrey

turned two. Immediately our home became a showcase for the Julliard School of Drama as our formerly calm child began throwing daily tantrums, replete with tears and agonized wails. She declared that she didn't want her diaper changed "ever! again!" She threw oatmeal at the dog because she couldn't have marshmallows for breakfast. She flushed my entire box of Q-tips down the toilet.

Her behavior has been exhausting and Rick and I wonder how long it will last. But we realize our navel-gazing isn't helping. What has kept me patient (mostly) is knowing that Audrey's behavior is normal, that she will probably turn out fine and that these tempests will pass. Rick and I have resolved to deal with the outbursts as they happen, but to always consider them within the context of expectations for her age so that we don't over-react.

I've been a family financial advisor many more years than I've been a mother. And the extreme volatility of the last decade has been exhausting and sometimes anxiety-producing. So



how should we all be thinking about these declines? And are they normal, or should we actively change our behavior as they happen?

The short answer is – they are normal. There have been 13 bear markets ranging between 21% and 52% in annual decline since the end of World War II.¹ The average annual drop is 32%. To sum it up, every once in five years we've had a bear market. And every four in five, a bull market.

The writer Nick Murray compares investing to a tree. Growing this protective structure that we enjoy for decades demands pruning and occasional re-arranging, but mostly needs water,

light and patience. You don't dig up the sapling every few months to check its progress. You don't uproot it in panic and store it in the house during a cold snap, then rush it back to the ground when other trees are thriving. You treat it well and leave it be.

Growing wealth is similar. It requires good selection, occasional rebalancing, and smart decisions regarding tax, cash flow planning and diversification. But mostly it needs time. I believe that most of the world-class companies in the portfolios we own will be valued much more highly in ten years than they are today. That said, I don't know when. And I have no idea what will happen to the markets before the end of the year. As a planner I make gradual adjustments to portfolios over time as fiscal and tax changes occur and as your life situations develop and change, in order to grow savings efficiently. But we don't hide in cash until "uncertainty" is gone, and we don't over-react. Trying to

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time markets is statistically useless and delays our progress.

“Long-term” investing is unappealing to some folks because who wants to wait 10 years? Well, you do. Chances are excellent that you and I will both be here in 2022. If we apply historical inflation rates, in 10 years our current \$100-worth of groceries, gas and medicine will cost \$145. Another way to see it – we’ll only bring home 69% of goods for the same dollar amount.²

Our wealth must win a footrace against inflation, and goodness knows we’re going to live well beyond 10 or 20 years. If you pick a team with only cash and bonds, especially in the current interest-rate environment, you’re likely stacking the odds against yourself. You might be better off for one year, or two. But in the end, I believe you’ll likely lose.

Today most global equities are inexpensive by historical valuations. Financial markets have been pricing in concerns about the fiscal cliff, Euro-

pean inaction and a deceleration of growth in China. A positive side of these market declines is that strong companies with durable competitive advantages can be purchased at reasonable valuations.

I personally believe that it would take a permanent broad-based change in our way of living for valuations of global companies to *not* increase long-term. I’m not speaking of merely the release of housing figures or a political party turnover in Congress. I think it would take a significant fundamental shift which would cause people to stop consuming – food, transport, housing, medical care – as well as cease purchasing stuff they don’t need but *like* – entertainment, leisure travel, cell phones. This would assume that lower-income classes in India and China immediately stopped aspiring to become middle class. This would assume that social status stopped mattering to all of us and brands had no value. This would assume companies would stop seeking profits

and growth and stop finding clever ways to induce us to buy things. Essentially it assumes we would cease to improve and advance. Sure, it’s possible. But unlikely.

Since earnings have historically driven equity markets, and consumption and innovation drive earnings, the market path is up and down on the spiral of a permanent uptrend. Of course we will encounter more bear markets. But having well-reasoned confidence that declines are normal and will pass might help manage the discomfort.

The upside of mothering a screaming 2-year old is that someday I will have a healthy young adult ready to march out into the world. Until that time I will try to tolerate the ups – and downs – in between.

Because I might look back and wonder if I worried needlessly. And because I know that it’s just part of the cycle.

—Sincerely,
Adrianne

San Francisco, July 30, 2012

¹ Hartford Funds, 10 Things You Should Know About Bear Markets. ² U.S. Bureau of Labor Statistics; 3.8% inflation based on CPI from 1962-2012

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