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VERIPAX VIEWPOINTS

VERIPAX WEALTH MANAGEMENT

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Cut & Paste Performance

There are a lot of things in life that we never stop and think about. Why does a bottle of rat poison have a tamper-proof seal? The word "bed" looks like a bed. When we're young we sneak out of the house to go to parties. When we're old, we sneak out of parties to go home. Another thing we rarely think about is investment performance. Sure, we look at it. Usually we either wish it was better or we're glad it's not worse, but seldom do we really think about why we look at investment performance and what it means. It turns out that performance is a philosophical topic as much as it is a number.

Why We Look At Performance

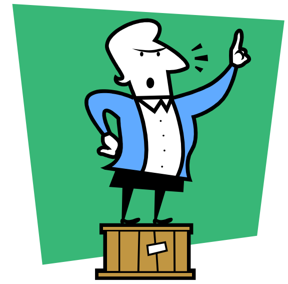
Performance should be straightforward. How have the investments done over a timeframe that's long enough to filter out some of the randomness? Is it what we expected given market conditions and our financial goals? Are we on track? These questions are all focused on goals. But if we're honest with ourselves, these are not the questions most of us ask when looking at performance. We want to know how we did relative to something else we might have done. Often something with way more risk than most people could ever tolerate, such as the S&P 500. Why do we do this? For the last 10 years, the riskiest strategies tended to do the best, so comparing performance to the S&P 500 simply made most people feel like they were missing out on something. In the 10 years prior to that the riskiest strategies did the worst, so comparing a diversified portfolio to stocks would have produced a good feeling. Here is one of the problems. We don't know whether the stock or bond markets will help us accomplish our goals, and yet we put our selves in a situation where they dictate whether we're happy or sad about our financial life.

What Do We Expect?

Here is the philosophical part. When we look at performance, what do we think it is telling us? After giving this a lot of thought, I'm convinced that most of us believe past performance will tell us what will happen in the future. In one respect, this isn't a bad assumption. Given the same conditions as the time period we're looking at, and assuming no changes to investments, there's a good chance past performance can give us clues about the future. But this is not what we do. When analyzing performance we tend to look at two points, *ending* at wherever we are now, and then we "cut & paste" this performance *beginning* at wherever we are now. In other words, not only do we assume that performance will repeat itself, but we also assume that market conditions will repeat themselves. Does anyone think that the last 10 years, with $3.2 trillion in stimulus and zero interest rates, will repeat itself over the next 10 years? If so, then the only logical strategy is to borrow as much money as possible and load up on technology stocks. If it's possible the next 10 years will look different, then we need to pick a performance period where market conditions are close to what we expect in the future. Do you expect a recession in the next few years? If so, then performance starting in, say, 1999 or 2007 would be a better predictor of the next 5 or so years. Expecting performance to be a cut and paste of last year or last decade will probably lead to some really bad decisions, so meaningful performance analysis just got a lot harder. If we want to use historical performance simply to make us happy or sad, it's easy. Using performance to give us clues into the future is way more complicated.

Something to think about:

"If you go for a run at 11pm you're considered a night person. If you go for a run at 5am you're considered a morning person. If you go for a run at 2am you probably did something illegal."



Market Comments

The financial world is almost always playing games with performance, and right now we're getting a double dose. A lot of mutual funds and investment managers are touting their Year-To-Date performance, especially if they are beating the S&P 500. But what is that telling us? First of all, the implication is that there is something significant about measuring performance since Jan 1, which of course there isn't. Measuring year-to-date performance is primarily for entertainment. However, because performance measurements have as much to do with the starting point as the ending point, good year-to-date performance in 2019 is a pretty good indicator of how bad the fund or manager did in the 4th quarter of last year. The market recovered (this time), so the lower the starting point the better the performance will look this year. It's not telling us a thing about how good the fund or strategy is doing, and perhaps the exact opposite. The same can be true when we look at the "long-term" performance of mutual funds, which usually means their 10-year performance record. Ten years is a long time, but that puts the starting point at the bottom of the financial crisis in 2009. A fund with a 6% annual performance record that didn't lose much money in 2009 is probably a better fund than one with a 10% track record that crashed in 2008/2009. This is why "draw down," or the amount of money a fund or strategy has lost in the past, is actually a more important statistic.

The market is showing quite a bit of volatility lately, which is understandable given the political turmoil and some key indicators that show global growth is slowing. Since I doubt very much that the political landscape is going to calm down over the next year with an election and potentially an impeachment going on, I would not be surprised at all to see volatility continue. From a technical standpoint, the S&P 500 recently had a "double top," which is not a good sign for those expecting the market to head a lot higher. The Russell 2000 is in a downtrend with lower highs and lower lows, meaning there's substantial selling going on. So, from a technical standpoint, things don't look good, but given the political landscape all bets are probably off.