



# Financial Alternatives

*integrated wealth management*

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## Year to Date 2016

Most asset classes showed positive returns for the first half of the year in spite of U.S. stocks posting the worst 10-day start to a year in history and the UK voting to leave the European Union. International Developed Market Stocks were the only asset class to post negative returns and we saw a welcomed rebound in Commodities.

During periods of high volatility in stock markets around the world, it's important to remind yourself of a few key points to avoid doing something you may later regret.

## Market Fluctuations

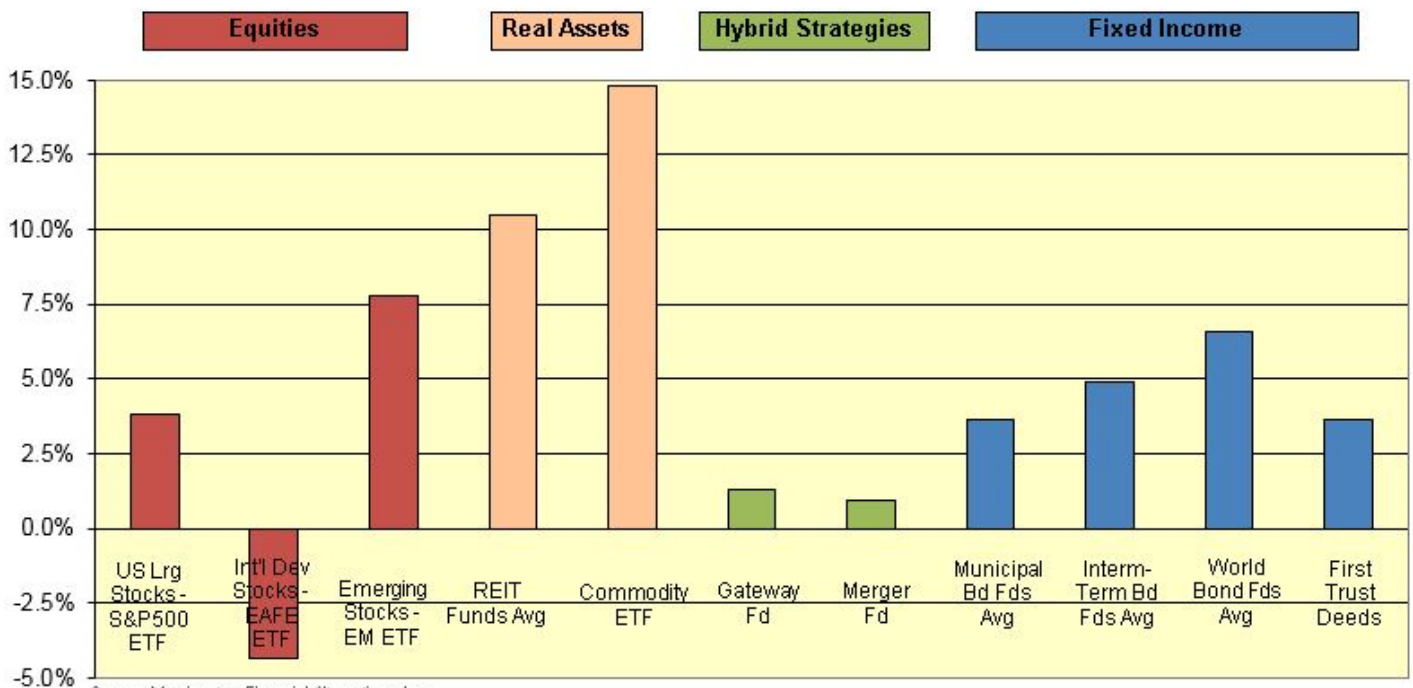
What makes owning stocks difficult is the fact that stock markets fluctuate wildly at times in the short term. Investing pioneer Ben Graham said that "In the short run, the market is a voting machine, but in the long run, it is a weighing machine".

Markets reflect human emotion and changing expectations nearly instantaneously. Naturally, people change what they are thinking and feeling very quickly and often

## Executive Summary

- Despite a historic US stock price drop at the start of the year and the recent Brexit vote, most asset classes showed positive returns for the first half of 2016
- In volatile markets, it's important to remind yourself of what you really own when you own a diversified collection of stocks as part of your portfolio.
- Ideally, a client of ours will have underlying stock ownership in 5,500 – 11,500 companies from all over the world.
- These companies have millions of employees that work diligently day after day and year after year in an effort to increase the earnings of their companies.
- In aggregate, these companies make a profit and part of this is paid out to shareholders in the form of dividends.
- Ignoring the often sensationalist day to day financial news and focusing on the progress mankind continues to make can help you maintain a positive long term focus.

### 2016 Fund Returns (January 1 - June 30)



Source: Morningstar, Financial Alternatives, Inc. Fund or Category Average Return Shown

unexpectedly in the short term. We saw this recently with the Brexit downturn and subsequent rebound all occurring within a week. In the longer term, market performance is more predictable.

## Investing versus Gambling

As we will describe later in this newsletter, investing in the stock market is owning businesses over the long term and benefiting from their growth in earnings and profits. Gambling is trying to predict which way an individual stock or a stock market will move in the short term, and placing a trade that reflects your belief. It is very difficult to make money trading stocks like this and the majority of people don't – and there are a number of studies that prove this point.

More often than not, you only hear about a person's gambling winnings – they don't tell you about their losses. The same goes for stock trading – most traders only talk about their winning trades and you never hear about their losing trades.

Gambling through short term trading is not a good way to plan for something as important as your financial future.

## What Do You Own?

### Stock Funds

By owning diversified stock mutual funds and/or exchange traded funds in your portfolio, you own a collection of thousands of businesses from all over the world. Each business is working hard to earn a profit - and increase it - by providing goods and services to people around the globe. Millions of employees show up every day at these companies and work diligently, day in and day out, year after year, to accomplish the goals of their company.

In aggregate, these companies make a profit and part of this is paid out to shareholders. As a fund owner, you are one of the underlying company shareholders and receive your share of the profit that is paid out in the form of periodic dividends.

Successful companies dedicate themselves to increasing their earnings and profits, and as this happens over the years, their respective stock prices frequently become more valuable because of continued growth in earnings and/or dividends. This sort of progress takes time - years in most cases - and those that own stock have benefited from this long term growth and progress.

Where possible, a client of ours would have three stock funds in the Equity portion of their portfolio: a US stock fund, an International Developed Markets stock fund, and an International Emerging Market stock fund. Depending on the fund company used, these three funds hold between 5,500 and 11,500 companies of various sizes, spread out across many different industries. Because this Equity portfolio is so diversified, you can be confident that aggregate dividend payments will continue since they are not dependent on the success of any one factor such as sector, industry, or country of domicile.

## Emergency Reserve & Conservative Investments

Good overall portfolio design and planning means you also have adequate emergency cash reserves and/or investments that do not fluctuate as much as stocks. This will provide the emotional reassurance you may need when prices are falling rapidly. With sufficient reserves and conservative investments, you will find that you can withdraw from these areas for a long period of time – allowing you to avoid selling your stock in a downturn.

## Never Sell Out of Fear

Let's face it, we are all human and falling stock markets and investment losses produce fear and anxiety. But we must never let fear cause us to sell, because when there is heightened fear in the markets, it is almost always a bad time to sell. As apparent as it may seem, focusing on the underlying assets that you own and what they do for you can help you tune out the day to day (or even month to month) noise of the markets.

## Try to Ignore the Day to Day Financial News

Do yourself a favor and tune out the day to day financial news. The message from daily financial news is that you should either buy or sell and if you don't, you will be missing the boat. This is foolish but it is what captivates listeners, heightens emotions and convinces people that they need to do something to avoid the danger of losing money. But if you already have a good plan, the best thing you can do in most cases is nothing or simply to rebalance your already well diversified portfolio.

## News Coverage and 10 Reasons to be Cheerful

Consider that news coverage, in general, is often negative and focuses on the problems of the world. But what the news often misses is the significant long term positive progress that continues to be made and that we all benefit from. What follows are some thoughts on significant advances made across the world. These points often don't make for lead items on TV news, but they're worth keeping in mind on those occasions when you feel overwhelmed by all the grim headlines.

1. Over the last 25 years ending May 2016, one dollar invested in a global portfolio of stocks would have grown to more than five and a half dollars.
  2. Over the last 25 years, 2 billion people globally have moved out of extreme poverty, according to the latest United Nations Human Development Report.
  3. Over the same period, mortality rates among children under the age of 5 have fallen by 53%, from 91 deaths per 1000 to 43 deaths per 1000.
  4. Globally, life expectancy has been improving. From 2000
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to 2015, according to the World Health Organization, the global increase was 5.0 years, with an even larger increase of 9.4 years in parts of Africa.

5. Global trade has expanded as a proportion of GDP from 20% in 1995 to 30% by 2014, signaling greater global integration.
6. Access to financial services has greatly expanded in developing countries. According to the World Bank, among adults in the poorest 40% of households within developing economies, the share without a bank account fell by 17 percentage points on average between 2011 and 2014.
7. The world's biggest economy, the US, has been recovering. Unemployment has halved in six years from nearly 10% to 5%.
8. The world is exploring new sources of renewable energy. According to the International Energy Agency, in 2014, renewable energy such as wind and solar expanded at its fastest rate to date and accounted for more than 45% of net additions to world capacity in the power sector.
9. We live in an era of innovation. One report estimates the digital economy now accounts for 22.5% of global economic output.
10. The growing speed and scale of data is increasing global connectedness. According to a report by McKinsey & Company, cross-border bandwidth has grown by a factor of 45 in the past decade, boosting productivity and GDP.

*Source: Jim Parker, Dimensional Fund Advisors*

Continuing advances like these will lead to new business and investment opportunities - some will succeed and some will fail. But the important point is that science and innovation are evolving in ways that may help mankind.

## Summary

Although markets were quite volatile on a month to month basis in the first half of 2016, investment returns were generally positive across the board for stocks and bonds. Anxiety and fear stemming from market fluctuations are normal human responses. A clear understanding of the following points will help you cope with short term volatility.

- Holding diverse stock funds means you own thousands of individual companies of various sizes and industries from around the world.
- In aggregate, these stock holdings provide income through periodic dividends to shareholders and potential long term growth.
- Your emergency reserve and/or conservative investments can help provide for your cash needs for a long period of time - so you are not forced to sell stocks during a major downturn.
- News media can have a tendency to focus on negative issues to capture your attention - tuning it out can be a good strategy.

- Despite the problems, we have made significant advances across the world.

Please call us if you'd like to discuss your investments or any other aspect of your financial life in greater detail. We hope you are enjoying your summer.

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