

Boring is Better

On the final day of the year, the Wall Street Journal's headline article stated, "Winners of 2013: Boring Investors." The content of the article made the case that investing in quality U.S. stocks resulted in the best gains for last year. For some reason they seemed to be exasperated that being an investor in well-run, growing companies worked so well. They even went so far to state "the smart way to play the markets has been to follow the dumb money." Since our investment style is to make investments in leading companies or funds and not attempt to out-think the markets, our disciplined approach is considered boring. Considering the results, and more importantly, our clients, we'd rather be boring than excitingly below average.

Did you know?

⇒ The S&P 500 stock index hit an all-time high 44 times last year.

Over the past thirty years, with the growth of the consultant's role in advising institutional investors, a clarion call has gone out promoting complex diversification in all asset classes, including illiquid niches. While this might be logical for the California State Teachers Retirement System or the Yale Endowment with hundreds of billions of dollars to invest and an investment horizon for generations, this isn't the situation for most investors. With the advent of exchange traded funds and specialized mutual funds, it is very easy to slice and dice the market and allow smaller investors to participate in asset classes historically out of reach. With a click of a button you can own shares in a Nuclear Energy Fund, Timber ETF, Egypt ETF, Junior Gold Miners ETF, Rare Earth ETF, or if you prefer, the mortgages of homes in Las Vegas and office towers in Miami. If you are particularly smitten with your knowledge of interest rates, it is possible to bet against the best minds of Wall Street and their trading machines by buying the Double Inverse Treasury ETF, a junk bond fund or currency futures.

While it is easy to get enamored with a new tool in the tool box, not every job requires a battery-powered caulk gun. Sometimes an old-fashioned hammer and level are sufficient. Since we've been building portfolios before most of

these new trading tools were invented, we know how to build the basic foundation of a diversified portfolio. We are not adverse to a better tool to fill a particular gap in an account where needed. However, adding an asset class can also add risk to a portfolio, which we've learned is often times better avoided. Making investments in foreign currencies or precious metals are merely bets with a trader who likely has more information. Since we serve very few clients with the stomach for that kind of risk, it isn't in our tool box.

Perhaps it might appear simplistic to own shares of great companies like DuPont, Boeing, Mastercard, Google, Blackrock, Walt Disney, Nike, Cedar Fair, Charles Schwab and McKesson; although individually, each of their share values increased by over 50% last year. When earnings are rising and money is flowing into U.S. equities, stocks will advance in price. Positioning client capital to participate in this advance is our job. Whether using mutual funds, exchange traded funds or stocks, we'll use the correct tool reflective of the client situation. Last year was a great time to own solid companies and hold onto them. While it might appear dumb to buy and hold, our average turnover last year (amount of buying and selling as a percentage of assets managed) was at the lowest point since 2006.

"Everything intelligent is so boring." - Leo Tolstoy,
Anna Karenina

The article in the WSJ actually stated, "So-Called dumb-money strategies, which involve buying and holding a plain-vanilla portfolio of U.S. Stocks, did much better than the more complex approaches employed by hedge funds and other institutional investors." It specifically mentioned that hedge funds fared poorly last year as did tactical timers of the market. They didn't mention that this trend has held true for the last four years. Basically, if you held yourself out to be smarter than the market, you likely lost. We are not smarter than the market, so you had a good year and participated well in the market advance. We'll do our best to not get too smart in 2014.

LOOKING AHEAD.....With Hindsight

“Lovely day isn’t it?” said Pooh. “If it is a good morning, which I doubt,” replied Eeyore. This exchange sounds strangely like many investors’ reflections on the bull market of 2013. As Ralph Atkins recently wrote in the Financial Times, the “animal spirit” of the economy and investors seems to be that of the perennial pessimist, Eeyore. The year 2013 was a classic one of a stock bull market “climbing the wall of worry.” While it didn’t feel like a bull market because of rampant pessimism, intractable political wrangling and a modest GDP growth pattern – it was.

The S&P 500 index had a total return of 10.5% in the fourth quarter and 32.4% for 2013. Small cap stocks did even better, while overseas markets had more muted results. Taxable bond total returns were dismal, as expected, due to rising interest rates. The Barclays Aggregate Bond index returned zero (0.0%) for the 4th quarter and a negative (2.0%) for the year. Money market yields didn’t change, so the risk-free rate of return remains at zero.

The positives, which enabled such a strong stock market included: very expansive monetary supply; very low interest rates; strong corporate balance sheets; increasing dividends and share buybacks; favorable corporate profit margins; strong residential real estate with price gains; and an improving global economic outlook. The yield on the ten year U.S. Treasury Bond began the year at 1.8% and ended the year at about 3.0%. The move in rates

reflected both the strength in the economy and the Fed’s signals that it will begin slowly to remove its extraordinary stimulus measures.

Market concerns in 2013 featured the fiscal cliff, several bouts of jitters over Federal Reserve policy, the Federal governmental shut down, Detroit’s bankruptcy, turmoil in the Middle East and concerns over China’s economy. Each time, the media and market prognosticators were saying, “You’re really in for it now.” However, the only real losers in 2012 and 2013 were those who stayed on the sidelines for being either too scared or too scarred.

The U.S. economy has pretty fair momentum now with several sectors such as energy, housing and autos contributing. Its acceleration is aiding the global economy, and China has stayed strong. We project that rising longer-term interest rates will not deter the growth nor derail the stock market this year. Even though many sectors are fully valued, the market can ride these peak values and forge ahead as long as the outlook remains bright. We continue to trim selectively to manage risk but we are not yet lowering equity target allocations. We are staying very short in bond average maturities to cushion the impact of rising rates. While 2013 was relatively a smooth ride for equity investors; we expect 2014 to have more bumps in the road.

Unemployment 2013



Previous Four Quarters GDP Growth 2013



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