StaufferWilliams
ASSET MANAGEMENT · LLC

# JANUARY 2013 INVESTMENT COMMENTARY

## YOU MUST BE IN IT TO WIN IT

The end of the year is always a good time to reflect on the past and ponder the future? Since this is an investment commentary, let's start with the following questions:

- In this crazy post financial crisis world, does anyone really know how to invest successfully?
- Why are there so many different opinions and methods of investing?

Let us cut through it all so we can start 2013 with a clear mind. Investment luminaries are not shy about telling anyone who will listen that successful investing is long-term oriented and that it begins and ends with being able to recognize value that the market is not properly pricing. Think about this for a moment. It boils down to performing research, buying low, being patient, selling higher and then repeating this over and over again. Now think about why when you turn on a financial news channel on television that you hardly ever hear anyone make it sound that simple?

It is frustrating to most fundamental investors when the vast majority of advice available to the public has very little to do with investing as we just defined and is much more focused on speculating on the short-term movement of market prices. In a December 23, 2012 Wall Street Journal article written by Carolyn T. Greer, and titled "Sometimes, Enough Really is Enough", the legendary and often quoted Benjamin Graham (Warren Buffett's mentor) was cited as delineating the difference between investing and speculating: Graham said, "The speculator's primary interest lies in anticipating and profiting from market fluctuations. The investor's primary interest lies in acquiring and holding suitable securities at suitable prices." In our opinion, the difference between speculation and investing cannot really be articulated much more clearly than that.

### MONEY IN MOTION

The most successful career investors that are still with us regularly speak out about the fallacies and dangers of "playing the market" and those that are no longer with us, like Benjamin Graham who died in 1976, have documented through their writings what they learned over the course of successful careers. So why do so many investors and financial services companies today seemingly ignore this readily available advice? In our opinion, the answer to that question boils down to business models focused on maximizing revenues and the study of human nature. Money in motion is exciting and money in motion is profitable to market makers and financial intermediaries. The next time that you hear that the most profitable divisions of a large financial services company are those centered on the capital markets, think about why that is? In recent years we have all heard about traders vacillating between "risk off" and "risk on" investments. We hear almost daily on shows like Fast Money how one should change his or her portfolio based upon the uncertainty of upcoming economic releases or policy decisions. Investors should not be fooled by this type of action adventure financial advice television. Traders are paid to trade and this adds up to the reality that more changes in strategy equals more transactions, and more transactions equal more revenue.

To illustrate the money in motion argument, in the same Wall Street Journal article quoted above, the author compared the annual turnover of stocks in a portfolio at the time that Vanguard founder John Bogle began his career versus today. The author wrote "annual turnover of U.S. stocks climbed from about 15% in 1951, when Mr. Bogle entered the investment business, to 100% in the 1990s to 280% in 2008 before dipping slightly to 250% in 2011."

John C. Bogle, founder of The Vanguard Group has recently become even more vocal regarding his distaste for what he sees as an institutionalizing of speculation as an investment strategy. In his latest book, The Clash of the Cultures: Investment vs. Speculation, Mr. Bogle cites another legendary figure, British economist John Maynard Keynes, who drew a similar distinction between investment, or "forecasting the prospective yield of [an] asset over its whole life," and speculation, or "forecasting the psychology of the markets."

### COUNTING CARDS

Let's be honest, speculating is a lot more exciting than buying securities, monitoring them and then waiting for them to appreciate over a number of years. It is much more exciting to speculate what is going to happen next week and trying to "invest" around that speculation. It can be very intoxicating to think that if only I can sell before the price goes down and then reinvest when the price turns around and is ready to go back up. The fallacy of market timing reminds us of counting cards at the blackjack table; very few individuals successfully count cards and very few people can consistently succeed at short-term trading. Even though very few people can count cards, gambling is an adrenaline rush and so is short-term trading. This explains why gaming companies make so much money, even though gamblers know that the house usually wins and why so many investors are infatuated with the allure of short-term trading. Financial services companies, like gaming companies, have figured out how to profit from the study of investor psychology, otherwise known as behavioral finance. Many investors really want to believe that they can time the market or that professional investors can get in and get out of certain investments at the right time. Legendary manager of the Fidelity Magellan Fund, Peter Lynch was quoted once on the subject of market timing and he said, "far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."

On December 24th Bloomberg News highlighted an article entitled "Americans Miss $200 billion Abandoning Stocks". Four years earlier, Curt wrote in his firm's monthly commentary "all of us probably know someone who gleefully admits to selling before the market went into free fall in October. This person is certainly fortunate in hind sight, however that decision to sell, made for all of the wrong reasons, can now be parlayed into a very wise investment decision. To do this, the investor must put fear aside and begin to reinvest at the current historically low levels in the market. If this is not done, and the market substantially recovers before he begins to reinvest, his decision to "get out" was not capitalized on and his panic induced decision can only be described as a lucky reaction". The Bloomberg article looks back over the last four years and states in its first sentence that "Americans have missed out on almost $200 billion of stock gains as they drained money from the market in the past four years, haunted by the financial crisis".

Based upon the data presented in the Bloomberg article, American investors stepped away from equities as a result of the pain inflicted upon them by the financial crisis, and many have largely stayed away from equities and subsequently missed out on a 95% recovery in stocks as measured by the S&P 500 since March of 2009. Active managers such as StaufferWilliams Asset Management tend to get measured against an index such as the S&P 500, but that comparison only tells half the story. Whether or not an asset manager's selected investments outperform a relative benchmark is only relevant if the manager keeps his or her clients "in it to win it". The aforementioned Bloomberg article illustrates that, over the last four years, many Americans were not in and therefore did not win. This fact is precisely why most investors, even ones who access professional management and advice, fail in their pursuit to maximize investment returns over time relative to their risk profile.

We are very proud that we kept our clients invested in their given allocations over the last four years. Although

each client has experienced a unique performance outcome resulting from his or her individual investment strategy, our discipline has kept each client exposed to the market throughout. There were many periods during this time that this discipline was not universally popular. Although we are portfolio managers, and spend a lot of time managing the fundamental buy/sell decisions within a client's portfolio, one of the most important and mostly unappreciated contributions that we make toward our clients' long-term financial goals is minimizing emotionally driven mistakes.

We again face uncertainty today with the "fiscal cliff". This uncertainty is just another, in a series of policy flashpoints that threaten dire economic consequences. Our clients have been rewarded over the last several years by our practical thinking and assessment, which has led to our willingness to look past this type of uncertainty. We see no reason to abandon this winning strategy, and therefore we are looking forward from the cliff's edge, not looking down into the media hyped abyss. If the "cliff" occurs and there is no prospect for legislative action to mitigate its undesirable effect on economic activity, then we would aggressively take tactical actions within portfolios in order to remove cyclical exposure. However, to take action now would be akin to "shooting first and asking questions later" and that is not what we are being hired to do.

## DIVIDEND GROWTH – A NEW STAUFFERWILLIAMS CAPABILITY

In regard to what we are hired to do, Jonathan and I will soon be announcing an expansion of our equity strategy to include dividend growth. Jonathan has been working for several months on developing a screening process to identify high quality companies paying higher than market dividends, with at least a 5+ year history of increasing dividends, with payout ratios and revenue growth capable of supporting further expansion of dividends and various other metrics that we believe will help us avoid value traps. This screen will not focus exclusively on U.S. dividend paying stocks, as most other dividend oriented products do, but consistent with our global, all-cap focus, this strategy will also focus on global opportunities spanning mid-cap companies to mega-cap companies. This dividend growth strategy is designed to be used as a focused strategy for conservative income oriented clients or as a supplement to our core all-cap global equity strategy.

We are very excited to be able to manufacture varying strategies that will enable an expanded opportunity to customize our approach for clients who span the equity risk spectrum.

Happy New Year! And once again, since we cannot overstate it, thank you for your continued trust and confidence.

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