SIGNATURE RESOURCES
CAPITAL MANAGEMENT

Commentary: February 2019

SINCE YOU ASKED...

We generally seek to provide in-depth reviews of themes supporting our approach to investment management each month on these pages. We understand, though, that a brief overview sometimes can prove an effective refresher of the fundamental tenets of our work. This month, we will revisit a range of those themes in a "frequently asked questions" format.

The Value of Advice

We understand that the performance of our portfolios generally shoulders the bulk of tangible value that clients may perceive from working with an advisor. Still we believe there are a great many potential additional benefits available to folks who seek support from a financial advisor. We think the following notes bolster that view.

Why should I pay to have someone manage my investments?

Perhaps allow us first to respond with another question: What would be your process for determining what will go into the portfolio and why? We think advisor-driven investment solutions can serve as more efficient alternatives to self-directed portfolios. If statistics regarding the success of individual investors are any guides, the support of an advisor may offer incremental benefit in the pursuit of long-term financial goals.

The investment industry has evolved to provide an immense range of tools for most any investor to fill portfolios with exciting investment products. But, the process of determining what belongs in a portfolio retains a complexity that may not be readily apparent to most, not solely due to the breadth of investment options now available. Ever present remains the pressure to "succeed," but success is measured by the individual and building the path to success can be more critical to that success that simply identifying a desired end result.

Why should I have SRCM manage my investments?

Instead of focusing on proving we're the smartest folks in the room, we'd rather focus on you, the client. Tapping into the wealth of knowledge that investment history and the broader investment industry can provide, we seek to bring clarity and comfort to the investment process in the pursuit of more favorable outcomes for those clients who entrust us with their savings.

Many factors can impede progress toward meeting long-term financial goals. Among the more powerful, we believe, can be indifference to the emotions that surround the investment process. That in mind, we think the primary benefit to managed investments may be the clarity that an investment advisor can bring to the investment process. Even more, perhaps the most powerful force in investing can be the comfort and confidence of knowing someone is looking after your hard-earned monies with your best interests in mind. Our focus on the client experience, which emphasizes both the path and the outcome, we think sets us apart from the work of other investment managers and offers substantial potential benefit relative to investment efforts a client may make on his or her own.

Why would SRCM build a better portfolio than one I'd build?

We generally believe that for most folks such an endeavor is more easily imagined than executed. In our view, one must first determine a level of appetite for market risk. That process should result in a general idea of what sorts and levels of specific asset classes one might want to include in a portfolio. The next step is to sift through the huge number of potential investments that represent each of those asset classes to develop a potential investment opportunity set. We also are narrowing this group to include only those funds that incorporate the sort of tilts (e.g. in favor of smaller, less expensive and more profitable companies) we seek to include in our models. This effort takes not only time, but also precise purpose, along with a substantial amount of math.

We in turn analyze groups of funds across a range of methods in order to develop what in our view are optimal portfolios for a given level of appetite for risk. The process—which is ongoing, as the list of potential investments continues to evolve—further involves direct discussions with various fund managers in order to ensure that, for example, past fund data and detail are reflective of what we may expect from those funds in the future. Altogether, we like to think that we've developed a process from which we think the average investor may find overall benefit in excess of the incremental costs relative to a do-it-yourself approach.

Importance of Discipline

No less important than being a source of advice, we believe, is having a solid foundation upon which that advice is offered. We believe the structure of that foundation must include a methodology that defines the way investments are chosen. Also critical, we think, is candor in expressing the rationale for investment decisions and the resulting impacts of those decisions. Even more, we believe one must be disciplined in adhering to that discipline. The following are some responses to questions related to our approach to investment management.

What's the gist of your approach?

We seek to balance aspirations for market return with acceptance of market risk. We first gauge an individual's tolerance for risk as best we can, then seek to provide broad market exposures aligned to that appetite for risk. In turn we look to garner a bit more return from those exposures by tilting the portfolio to highlight characteristics we think may boost long-term total returns. As an individual's risk tolerance changes over time, we look to alter portfolio exposures to maintain that proper fit.

How do you decide what to put in my portfolios?

We find our approach to investment management to be relatively straightforward in concept and efficient in practice, incorporating only those investments market history and client engagement suggest need to be in portfolios and leaving out those that are unlikely to bolster efforts to meet client-specific investment goals.

All investing carries risk. And the greater the return we seek, the greater the risk we may need to accept. We thus believe clients are best served with an approach that matches their individual tolerance for those risks with their longer-term financial goals. Our investment suggestions thus first focus on matching tolerance for risk with an appropriate portfolio allocation. We then seek to highlight characteristics that over the course of investment history have shown to lead to more favorable outcomes, measured in terms of client satisfaction and in terms of performance.

Gauging Risk and Return

With interest in and media coverage of investible markets so expansive, market volatility has become much more of a shared experience. Actual portfolio exposure to that volatility need not be. The design of our portfolios acknowledges as much, with the range of exposures to investment risk they present offering flexibility to address specific needs of unique investors.

How do you determine an individual's tolerance for risk?

We are quick to admit that the process of determining risk tolerance remains more art than science. Our efforts focus on practical methods to educate clients as to what history has to say about investment risk. We believe that focus, in turn, allows us to foster a conversation with clients regarding market risk in order to support client comfort both in advance of and during periods of market tumult. These conversations, we believe, help clients remain invested during such difficult moments. Adapting where required, but otherwise staying true to original intentions, in our view, is a critical component of achieving long-term financial goals.

How does my portfolio reflect my risk tolerance?

While all investing carries risk, not all investments are equally risky. We seek long-term gains with stocks, but know those expectations come with risk. Bonds are risky, too, but generally far less so than stocks. We thus seek to temper equity market volatility with bonds, thereby bringing overall expectations of an individual's portfolio volatility in line with their tolerance for market risk.

Guesses We Keep to Ourselves

Financial market punditry abounds. With so many opinions to be heard…and ultimately to be proved wrong by random chance…we'd rather stay out of that fray. Far more important to us than publicly buffing our credentials is seeking ways to bolster a positive client experience. While we may offer general thoughts along the lines of prognoses from time to time, we hope readers find that they generally express "setting proper expectations" tones rather than "place your bets now" convictions.

What are your expectations for market returns this year? Next year?

We don't offer such outlooks as we very likely will be proved wrong. As will most others. There has yet been found no reliable mechanism to determine near-, medium- or even long-term trends in markets. We could guess along with everyone else, but where's the value in that? We think such candor serves as stronger support for a more positive client experience than will any shorter-term confidence that client might gain from any "insight" into potential market moves. However, we will often offer the friendly reminder that all investing carries risk and focus more on ensuring we've made our best effort to match our client's individual risk tolerance with an appropriate level of market exposure.

Unconventional Conventional

Would seem conventional wisdom holds that proper investments should be determined by a fleet of whiz-kids banging on computers and that such decisions must be made on a moment-by-moment basis. Ok…most perhaps don't have so frenetic a picture in mind when they envision the average investment shop. Even so, considering the many urban legends we revisit when chatting with folks, that image isn't too far off the mark.

While that depiction may have been appropriate decades past, modern day investing has evolved substantially. In particular for firms such as ours. Gone are the days, we think, when clients are best served by in-house stock pickers. Rather, we have found clients are best served by thoughtful engagement of outside expertise for individual investment exposures within portfolios. That approach leaves us far more time to address the meatier issues that arise over the course of most folks' investment time horizons.

How will you change my portfolio to address [insert near-term concern here]?

At any given moment, investible markets already reflect what everyone thinks is going to happen. We think that the smarter person seeks to benefit from that thinking, tapping into the superior wisdom of the crowd. So we don't attempt to out-guess the zillions of other investors out there. For the relatively meager incremental gain that might be gained even under optimistic scenarios, we understand that market timing is far more likely to lead to disappointment. Instead, we have designed our portfolios with a long-term horizon in mind, focusing foremost on factors that we think matter most in regard to meeting long-term client goals.

Who picks stocks for my portfolio?

Historical data suggest that just about no one is good at stock picking. We're simply honest about that fact. We instead seek to connect clients with the potential benefit of equity investing without all that senseless energy that can come from likely doomed-to-fail efforts to pick winners from the vast crowd.

So no one "picks stocks" for your portfolio. Our own experience and the historical record of the broader investment industry suggests that a focus on individual stock picks tends to lead to less-than-optimal outcomes and underperformance relative to client expectations. Instead, we focus on the broader picture—choosing the forest over individual trees—in an attempt to pave a smoother path toward meeting client investment goals. In that metaphor, the forest is a very broadly diversified portfolio of individual domestic and international stocks that looks much like the broader market in terms of numbers of individual stocks owned. And this broad diversification is achieved, in our view, most efficiently through ownership of equity-oriented mutual funds and exchange traded funds (ETFs).

Why is there not more trading in my portfolio?

There is work to be done during the trading day, but not of the sorts we find folks generally have in mind. Built into our approach is a seriousness that places client investment outcomes and overall experience above such methodological madness. And we think that clients benefit from the thinking that more is not necessarily better. Some may believe that more trading and more emotion should add up to greater performance…more success. On the contrary, whether due to increased trading costs, higher annual tax bills and/or in-hindsight poor investment decisions, greater activity doesn't seem to equate to better outcomes. Instead, we believe clients are best served via an approach that seeks to align financial goals with an investment allocation targeting a relative return/risk assumption appropriate to the time horizon(s) related to those goals. The thinking necessarily leads to an investment approach that similarly focuses on longer-term intentions rather than moment-to-moment tasks.

The upshot is that we generally don't trade our portfolios on a daily basis. And that's more so because we design them such that we don't need to. That does not mean, however, that our portfolios are static. Much like the fluttering feet that propel a duck with relative grace above the water, lots of activity occurs beneath our generally steady list of investments. Still, the lack of visible activity does not mean we are not in the pursuit of better outcomes. Quite the opposite, we believe a calmer approach is key to a methodology that seeks improved investment performance against the backdrop of a more favorable client experience.

Here to Answer Your Queries

We hope that some of the above thoughts address questions that readers may have regarding our work. The above list is, of course, not exhaustive. And we have yet to hear every question that folks may have or will have. We welcome readers to reach out to their advisor to learn more by asking away.

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