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Escape Artist

Sometimes there are things that you just can't explain. At a secular level, an example might be why the stock market declined so much lately when the economy remains so strong? At a spiritual level, the everyday miracles of life and nature often elude practical explanations. And, at my farm, we have a bit of a mystery lately that we discuss often but cannot explain rationally.

A couple years ago, over the winter, a weasel kept getting into our chicken coop. It ate two chickens each night. In the morning, I would try to figure out where it was getting in, and how to tighten up the coop. All to no avail. We lost almost all of our chickens in short order. Unfortunately, weasels can get into very small spaces, and I was not able to close up all the potential holes in our old barn.

Last spring, before I put our new chicks into the barn, I spent quite a bit of time putting chicken wire all around the inside of the barn, installing new plywood flooring, and generally making sure the coop was as tight as possible. It may not keep out every weasel, but it should be impenetrable to most chicken-loving critters.

Now that winter is upon us, I have closed up our free-ranging chickens for the season. And yet, there is one critter that routinely bypasses my heightened security measures. One chicken somehow sneaks out of the coop every day. We find her happily pecking and scratching around the barnyard when she should be tucked safely inside. Each afternoon we put

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Should I Stay or Should I Go?

The stock market declined by 4.4% in 2018. It was the first year stocks posted a loss since 2008. The S&P 500 rose 20% in 2017, 12% in 2016, and more than 13% annualized over the last decade. Yet, a one-year decline of 4% has caused all sorts of consternation. I admit that the peak-to-trough loss was much larger (17.5% so far), and the fourth quarter was one of the worst on record (down 13.5% in just three months).

The last quarter was a sobering reminder that investing in stocks involves risk. Most people understand that when the market is going up, but some seem to forget when it drops. Remember, there is no upside return without downside risk. Safe investments like T-bills and CDs pose no significant risk of loss to principal. Accordingly, they return very little. The yield on one-year CDs currently averages less than 1%. Certainly, everyone wants significant upside return with no downside risk. My daughter would like a fluffy unicorn to live in our barn… how fun would that be? Unfortunately, neither one exists. In order to get solid long-term returns, risk is necessary. Controlling risk, but not eliminating it, is the real objective.

A recent report showed that non-institutional investors flocked to bond funds in 2018, particularly ultrashort-duration and money market funds. Perhaps this shouldn't be a surprise given the volatility and declines in the stock market. It makes sense that investors would embrace the safety of short-term bonds.

But does it make sense? Consider widely-cited research by Dalbar Inc. that shows retail investors, over a 20-year period, earned average returns of 5.2% compared with a gain of 9.9% for the overall stock market.

The Dalbar study showed that individual investors tend to buy into the market as it is rising and sell when it is falling. That means people would rather buy high and sell low, which is counterintuitive. I know from many client conversations over nearly two decades, that very few people believe market timing works. Indeed, there are numerous academic and real-world studies indicating the fallacy of such a strategy. In a rising market, everyone seems to accept that notion. However, when the market falls, emotions take over and acting in our long-term best interest seems to take a back seat to short-term comfort.

When we meet new clients for the first time, we always talk about the risk of the stock market. It is how we come up with target asset allocations for our clients. These discussions involve a review of historical losses in the stock market, and show that stocks can and have declined by 50% or more in really nasty periods. We then come up with a long-term strategy based on each client's goals and risk tolerance. Yet, despite those discussions, market dips tend to trigger calls and meetings with the underlying question: Should we get out of the stock market?

The answer is always no. While it is your money, and you make the final decision, we always think getting out of the market entirely or lightening up on stocks because of market fluctuations is a bad idea. While it may sound self-serving, the real reason we believe this is that it will ultimately result in our clients having less money. We often hear stories of how folks got

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Portfolio Review

Stocks posted their worst returns since 2008 last year. Most of the damage occurred in the fourth quarter when stocks dropped 13.5%. This was the 12th worst quarterly performance since the Great Depression.

Smaller-capitalization stocks and value stocks fared even worse last year than the overall stock market. International stocks continued their streak of lackluster returns.

Whether this is normal volatility or the start of something more significant remains to be seen, but so far what we have experienced is not unusual. Since 1987, the average returns for the S&P 500 have been 11%, but the average intra-year drawdown has been 10%. The downturn we just experienced was higher than that, but not unprecedented. The market was down 18% at one point in 2009, but ended the year up 26%. 2011 saw a 16% drawdown, but returned a positive 2% for the full year. Since 2011 the market hasn't experienced intra-year declines of any particular note, which is likely why the fourth quarter of 2018 seemed abnormal.

As we noted in our emailed communications over the past few weeks, we can't come up with a good reason for the recent market turmoil. Yes, interest rates have been rising and valuations have been relatively high for certain market segments. But the economy is still quite strong, interest rates remain historically low, inflation is tame, corporate earnings are robust, and most importantly, unemployment is at very low levels.

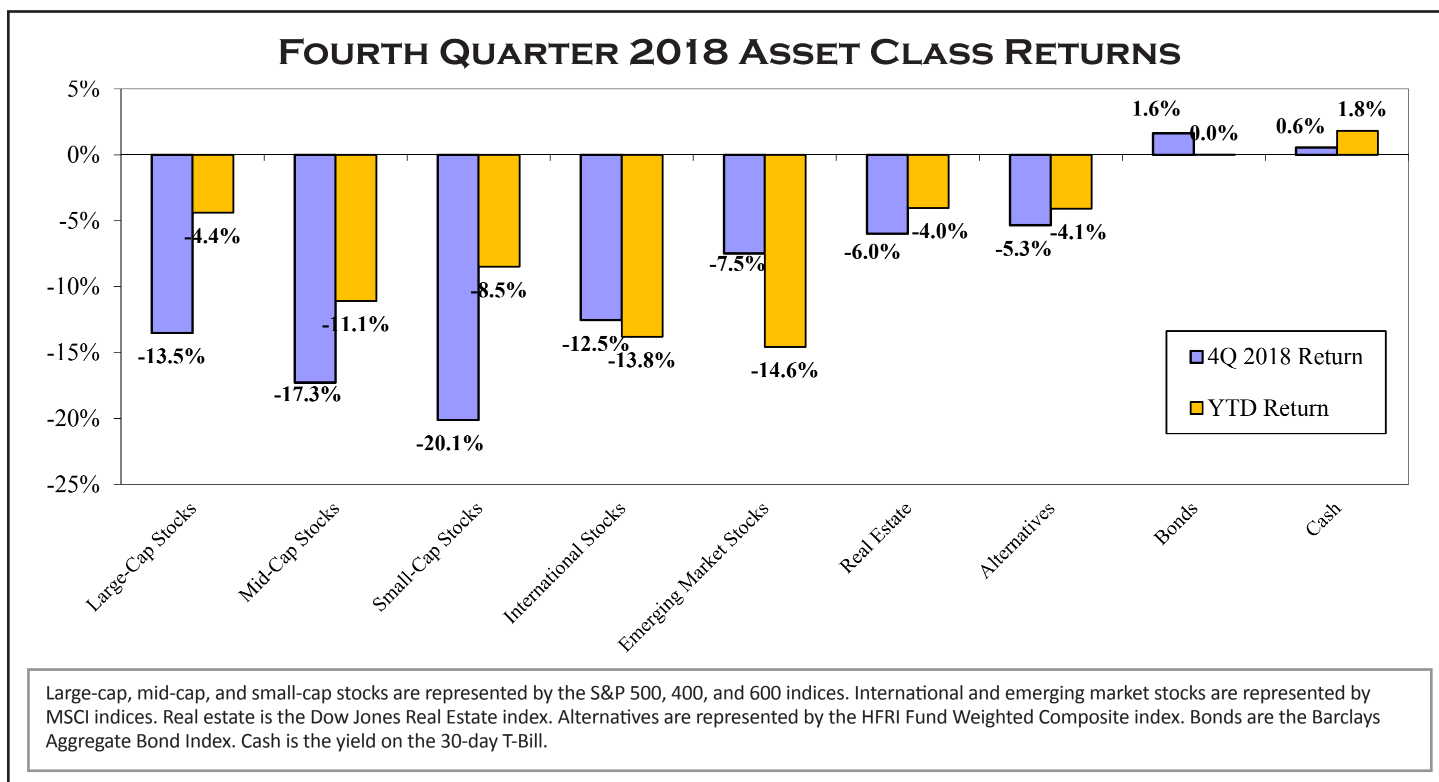
Both the corporate and consumers sectors remain healthy. An economic slowdown may be underway, but it is far too soon to declare that with any authority, and the risk of an all-out recession seems remote for at least another year.

Changing investor sentiment seems to be the real reason for the stock market's downturn. Nothing else was really different from the peak of the market last September to the trough in late December.

The good news is that the market has already started to recover. No one knows for sure whether more turmoil will ensue, but it seems that cooler heads are prevailing, at least for the moment. There is good reason to believe the recovery could continue. As mentioned above, the fundamentals of the economy and corporate America are sound; stock market valuations are now much lower than before, and there is historical precedent for a rebound in returns.

While the fourth quarter posted the 12th worst returns in many years, the 11 worse periods were generally all followed up by solid recoveries. In each instance, except one, the market was higher 12 months later. In every period, stocks were higher three and five years later. And, the subsequent returns weren't just modest recoveries. Returns were generally well above average in the wake of these market downturns.

We can't say for sure that history will repeat, but for those invested for the long haul, it seems reasonable to believe that today will look like a buying opportunity when viewed a few years in the future.



Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indices. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Alternatives are represented by the HFRI Fund Weighted Composite index. Bonds are the Barclays Aggregate Bond Index. Cash is the yield on the 30-day T-Bill.

Alternatives Out of Focus

They say all the world loves a clown. That may be true, but one thing I know that is even truer is that all the world currently hates alternative investments.

We have been using alternative investments—securities that don't fit neatly as either stocks or bonds—for the last seven or eight years. Over most of that period, the returns aren't bad. They've generally been better than the bond market, but certainly below the types of returns we expect. Lately, however, returns from alternative investments have been quite poor.

Add to this that these investments often come with high fees, are generally tax-inefficient, may be liquidity constrained, and many of the strategies are difficult to understand. That's a recipe for unhappy clients (ask me how I know).

Yet, despite recent performance, these investments continue to make a lot of sense.

First, they offer a tremendous diversification benefit. The correlation of returns between stocks and alternative investments is quite low, which means their returns move in different patterns. So, if stocks rise or fall, it doesn't necessarily mean that alternative investment returns will do the same. A couple of the funds we use can be defensive when the stock market falls, but most of the funds offer returns that are largely independent of the stock market.

Also, the expected returns, which cannot necessarily be inferred from the returns of the last couple of years, are quite attractive. Many of these investments offer long-run expected returns in the high single-digit range. Some, like our private real estate investments, have done even better. While returns generally should be below that of the stock market, they should be well in excess of the bond market. With the 10-year Treasury bond yielding less than 3%, the outlook for bond returns is not great. Alternative investments offer a compelling way to control the risk of the stock market, but with long-run returns that should exceed that of bonds.

As for recent performance, I'll point you to the nearby article on risk and reward ("Should I Stay or Should I Go"). Every investment, even bonds, has the ability to lose value over certain periods. High-quality bonds lost almost 13% from July 1979 through February 1980. That was followed up by a loss of 9% between June 1980 and September 1981. They subsequently went on to earn very significant returns over the next five years, during the Paul Volcker era at the Fed.

With any investment, there is a chance that you will lose money over shorter time periods. However, all the strategies in our alternative portfolio have been well researched, and have long histories of positive returns over time.

It may be hollow succor, but it isn't just us. The entire alternative investment industry has experienced unsatisfactory returns the last couple of years. In fact, the returns for the HFRI Fund Weighted Composite Index were down more than 4% in 2018. That isn't a great benchmark for how we are investing, but it is an industry-standard way of measuring alternative investment returns.

There's an old saying that the markets can remain irrational longer than you can stay solvent. We don't take the types of risks that will result in insolvency, but the point is that we can't tell you when the returns will improve for our alternative funds. We're hopeful that the environment is changing currently, but no one knows what the future holds in the capital markets. Despite what the near-term future may hold, we still believe strongly in the diversification benefits and long-term return potential of an allocation to alternative investments.

Should I Stay or Should I Go?

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out of stocks just before the 2008 downturn, or that their gut feelings have never steered them wrong. However, we haven't heard much about the times those calls didn't work out. We haven't heard many anecdotes about people's losses in Las Vegas, either. The point is, we tend to remember the good calls we make, but forget the bad ones.

The Dalbar study, and others, are data-based reminders that when you consider all the calls we make, good and bad, the results are expensive. This isn't just true of individual investors, there are numerous studies showing how even the most qualified investors are fallible (see "Beware of Experts Bearing Forecasts" article on our website).

The way to avoid these pitfalls: Tune out the noise and create a long-term plan that works for you and your family and stick with it in all market environments. There certainly will be uncomfortable periods, but they have happened many times before and the market has always found a way to rebound. Think back to how difficult 2008 was, and yet somehow we recovered and the market rose to new highs. There is no reason to suspect this time will be any different.

Flourish Cash Management: Earn Higher Rates

Interestingly, cash was the best performing asset class in 2018, earning 1.8%. That's a pretty meager return, but it was better than losing money in stocks or breaking even in bonds.

Don't be fooled by that return; cash is not a good long-term investment. Even with the honor of being 2018's brightest star, cash returns are not keeping up with inflation, which means you lose purchasing power every year.

That said, there are good reasons to hold cash. Liquidity for near-term purchases, an emergency fund, or simply having the security of knowing you always have plenty of money on hand are all valid reasons to hold cash.

With interest rates low, the returns on cash have hovered around zero for many years. This has been a frustrating environment for savers. But there is a new offering that our clients can take part in that addresses that situation.

"Flourish" is a cash-management offering that currently pays 2.3% on cash balances. It also offers FDIC protection on up to $1.5 million for individuals or $6 million for couples. It is fully liquid, so you may access your cash anytime. It pays the same rate, or better, than many CDs, but you don't have the lock-up that CDs incur.

This is not an Armbruster Capital offering, rather it is for cash balances not held in our accounts. If you have significant cash in bank accounts, you could link them to Flourish and electronically move money back and forth any time. Armbruster Capital does not charge a fee for this, as we are not managing these assets. Flourish does charge a fee, but the net return to investors is 2.3%. This rate will rise and fall with the Fed Funds rate, but it is not a promotional rate that will diminish after six months. Rather, given the recent direction of the Fed, it is likely to rise in the future.

There is no minimum to invest in Flourish and there is no minimum holding period, but it is best used for somewhat larger balances that will be held for a while.

Cash invested in Flourish will be swept into bank accounts at partner banks that are all large, national institutions.

If you have an interest in Flourish, let us know and we can send you an e-mail invitation to participate.

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Escape Artist

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her back in the coop. The next morning, she is back outside.

I thought she might be squeezing out of the barn door by pushing the bottom out. So, I propped a piece of firewood up against the door and forcibly pushed it into place to prevent the bottom from swinging out. The chicken still escapes.

My son Omar thought she might be flying to the top of the coop where there is a gap in the chicken wire, and then landing in an adjacent part of the barn. But then she would have to open another door to get outside. We have propped that door as well. The chicken still escapes.

We thought maybe the electronic door was opening somehow, despite being turned off for the winter. I removed the battery so there would be no way the door could operate. The chicken still escapes.

Despite several thorough inspections of the coop, and much head scratching, we still cannot figure it out. The only remaining theories are that the chicken was actually Harry Houdini in a previous life; she is an enlightened Buddha who can transcend matter, or that the chicken was somehow imbued with magical properties that allow her to transmogrify into a smaller being (perhaps a weasel) that can fit through small gaps in the barn's siding.

At this point, we've decided that, whatever the method, the chicken deserves to come and go as it pleases. We're a little worried about a run in with a fox, but I guess if it is smart enough to transmogrify, it should be smart enough to elude a few foxes.

Now, if we could just figure out what's going on with the stock market.

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