INVESTOR NEWSLETTER Armbruster Capital Management, Inc. 1ST QUARTER 2019

# The ACM Journal

## An "Alternative" Investment

Noted investor Howard Marks remarked that "a hugely profitable investment that doesn't begin with discomfort is usually an oxymoron." Indeed, I have learned several times over the course of my professional life that investing, while rewarding over the long term, can cause quite a bit of discomfort from time to time.

I recently found that this feeling extends beyond investing. While some may be born to travel, others have travel thrust upon them. And, as someone who largely likes to be at home, I'm firmly in the latter camp. Yet, somehow, I found myself in Anchorage, Alaska last month.

My son Omar qualified for the Junior National Nordic Ski Competition, which was held in Alaska this year. It is a prestigious event, and we were committed to sending him. What we didn't realize is that the mid-Atlantic region does not travel as a team to the Junior Nationals. That meant that our 15-year old had to somehow materialize across the country with just a few weeks' notice. What that really meant was that I also had to go to Alaska.

I could think of many other things I would rather do in the dead of winter. Getting on a 13-hour flight, with two layovers, just to land in a frozen wasteland wasn't at the top of my list. Making matters worse,

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## Economic and Investment Overview

Lately, the stock market has been a lot like the weather in Rochester, NY. If you don't like it, you only have to wait three months for things to radically change. The fourth quarter of last year was one of the worst since the Great Depression. But we didn't have to wait long for redemption. It arrived early this year, with a 13.6% gain in the first quarter (see market segment returns in the nearby graph).

However uncomfortable this sort of volatility can be, it is a lesson that stocks don't only rise. In order to reap long-term returns, we have to suffer the slings and arrows of occasional short-term downturns. Unfortunately, this late into an economic cycle and bull market, it is likely we have not seen the last of the volatility.

We have been making the case for the past couple years that the stock market is feeling a lot like the late 1990s. That is because of the dominance of large-cap growth stocks, particularly the largest technology stocks. Anecdotally, the drawdown last December makes the comparison even stronger. Stocks declined sharply from February to April 1997 at the onset of the Asian Contagion.

Economic problems in Asia in 1997, many thought, would drag down economic growth around the world. Similarly, the stock market drop last December was largely because of concerns that global economic growth was declining.

Despite more lasting turmoil in the Asian markets, the U.S. stock market went on to return 33% in 1997, 28% in 1998, and 21% in 1999, before starting a three-year decline in the early 2000s. Despite those strong full-year returns, the Asian Contagion was not the only speed bump.

Mega-hedge fund, Long-Term Capital Management, imploded in 1998. The event sent shock waves through the financial markets. Unwinding this fund, and the complex derivatives in which it invested, caused much uncertainly and required intervention by the Federal Reserve and many of the largest Wall Street investment banks. The stock market declined 18% during the turmoil, but as mentioned above, went on to generate strong returns for the full year.

We expect further parallels to the late 1990s to unfold in the years to come, particularly as IPO activity picks up. However, that doesn't imply that this bull market will end the way the Dot-Com Bubble ended. At least for now, the largest technology stocks are real companies with solid assets and earnings. The late 1990s were marked by far more speculation, when internet companies were going public with few prospects of ever marking money.

The lesson today is more that markets rise and fall, even during strong bull markets. A downturn will eventually come, but we won't be able to predict the timing, duration, or magnitude of that event. In order to reap the impressive long-term returns of the

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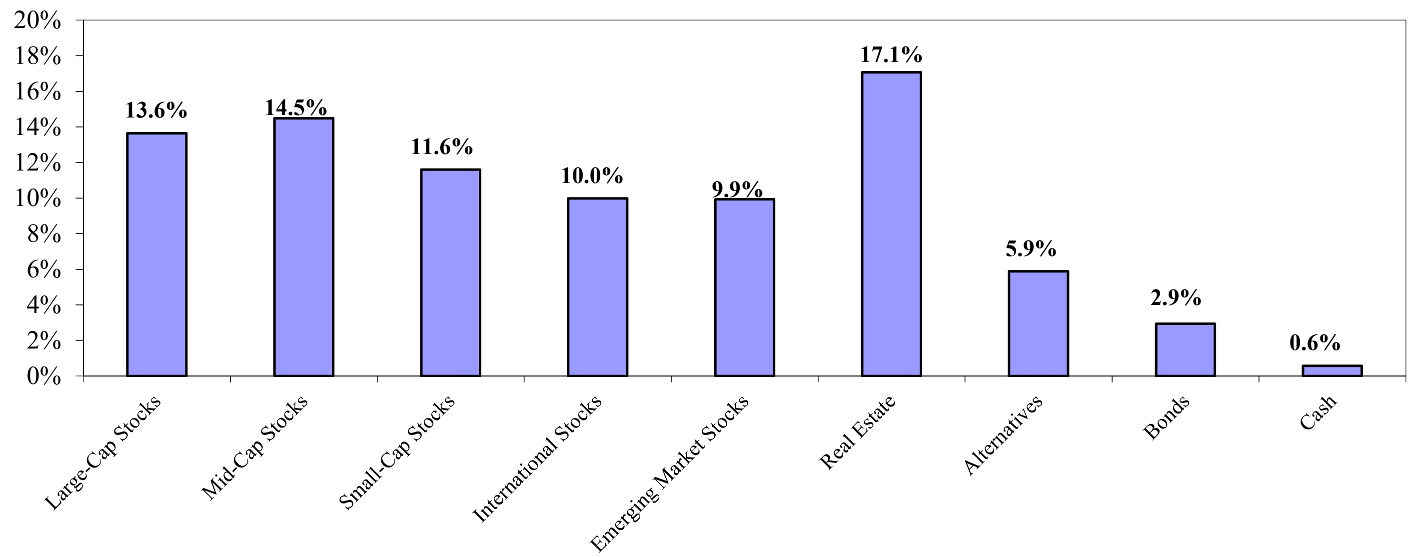
## First Quarter 2019 Asset Class Returns




Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indcies. 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.

## Economic and Investment Overview

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stock market, we have to stick to a disciplined plan, no matter how uncomfortable that can be at times.

That said, another lesson from the 1990s is that economic expansions and bull markets can last longer than anyone expects. An extension of the current bull run wouldn't be surprising. The economy remains fairly healthy, even if growth is slowing somewhat. There are also strong vested interests in keeping the good times rolling. With an important election less than two years away, and economic success a large part of our incumbent's platform, it would not be surprising to see the government pull out all the stops to juice the economy.

Already, the Fed has reversed course and indicated it will not raise interest rates further in the foreseeable future. Whether this is because of pressure from the Oval Office remains a matter of debate. However, the capital markets have responded. Stocks rallied and 10-year Treasury bond yields fell from 3.23% last November to 2.41% at the end of last quarter. Low interest rates can be strong fuel for stock market growth.

Also of note, is that traditionally riskier corners of the stock market are showing signs of life. Small-cap value stocks rose strongly in the first quarter, after what seemed like a very long drought. It remains to be seen if this is a blip or a trend, but smaller stocks generally perform best at the beginning of bull markets, so renewed strength could indicate a renewed bull market phase.

We wrote previously that despite the duration of the current economic recovery, the rate of economic growth has been tepid at best. Historically, severe economic downturns have been followed by strong economic recoveries. It may be that we'll see a strong recovery, just stretched over a longer-than-expected period. If we are to achieve average economic growth during this cycle, the expansion could last for another three years. If we experience a recovery similar to those that have followed severe downturns, the recovery could go on for another 8 years.

Even if this proves to be correct, it bears repeating that it likely will not be a smooth ride. There will be more volatility in the stock market. Just as we endure the ups and downs of rollercoasters for the overall fun they provide, there is a reason to be invested in stocks. Building long-term wealth requires fortitude and patience. So, buckle up and enjoy the ride.

# A True Investment Loss

Perhaps the fiercest advocate for the individual investor and shareholder rights ever to walk the planet died during the first quarter: John C. Bogle, who preferred to be called Jack by his legion of friends, founder of the Vanguard Group. Jack was best known for launching the first index mutual fund in 1976. This new approach to investing would ultimately revolutionize the entire industry.

Investing used to be quite expensive. While many would argue it is still too expensive, historical trading commissions, bid/ask spreads, and professional investment management all cost far more than they do today. Jack's index fund addressed many of those fees, even for very small investors. Merely buying all 500 stocks represented in the S&P 500 Index didn't require fancy offices, cutting-edge technology, or high-priced investment staff. The cost savings accrued to the investor. Since the investor is the one taking the risk, it seems appropriate that he should reap the lion's share of the returns. However, that was not the rule when Jack started his investment career.

Today, the Admiral class shares of the Vanguard S&P 500 Index fund incur an annual management fee of 0.04%. That compares with an industry average of over 1% for domestic stock funds. And, as Jack said frequently, in the investment world "you get what you don't pay for." The poor performance record of the actively-managed fund industry illustrates this point. Keeping costs low puts more money in the pockets of investors by improving net (after-fee) returns. The low trading activity within index funds also can result in significant tax savings, which is frequently the largest cost of investing.

due in large part to Jack's advocacy efforts over several decades. In fact, Warren Buffet commented back in 2009 that "if all investors heeded [Jack's] ideas, they would be hundreds of billions of dollars better off than they are now."

Bogle's many books, articles, and speeches have served to educate an entire population of individual investors. There's even a loyal following, known as the Bogleheads, with an active online discussion forum dedicated to spreading the Gospel According to Jack.

Interestingly, Jack was not an overnight success. Vanguard was born as a result of Jack losing his job at Wellington Management. He launched his index fund two years later, hoping to start with over $100 million. Instead, he attracted only $11 million in initial investor dollars, earning the fund the derisive nickname "Bogle's Folly". Indexing has been much criticized over the years as "settling for average," unAmerican, and even Marxist. Nevertheless, Jack's tiny fund from 1976 was the seed that grew Vanguard into the world's second largest asset manager with almost $5 trillion in managed assets today. (Fun fact: the GDP of Germany is $3.4 trillion.)

Jack came to Rochester a decade or so ago, and I was fortunate to be able to spend some time with him. He addressed a group of more than 100 people that included professional investors; many CFAs and CFPs; individual investors; and business school students. Jack spoke articulately without notes. In characteristic fashion, he offered provocative remarks and invited the audience to disagree with him. He loved a good debate. I still have a picture of the two of us at this event that hangs above my desk.

Later that evening, I had dinner with Jack. I asked him about a recent article saying he left $10 billion of personal wealth on the table when he set up Vanguard as a mutually-owned company. Fidelity, Vanguard's biggest competitor at the time had an estimated value of around $10 billion, and was privately held by the Johnson family. The article speculated that Jack would have had a similar net worth if he had established Vanguard with a more typical corporate structure. Jack didn't care about the money though. He told me that he had earned plenty throughout his career, and noted the pleasure he took when small investors thanked him for being their champion.

Jack earned the respect of small investors, billionaires, and even hedge fund managers. He was truly a man, a myth, and a legend, but also an extremely nice person. The investment world won't be the same without him.

## What is ACM?

Armbruster Capital Management, Inc. (ACM) is a boutique wealth management firm serving high-net-worth individual and institutional clients. The firm's innovative "Passive Quant" investment approach incorporates cutting edge financial research to help control risk and pursue superior returns. ACM uses index funds, exchange-traded funds (ETFs), and other investment vehicles to build portfolios designed to reduce investment-related costs and taxes in order to maximize net returns.

Located in Pittsford, New York, ACM is employee owned and independent. Acting as a fiduciary, the firm creates truly customized investment portfolios tailored to each client's unique objectives.

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I would have nothing to do once we got there. Usually when I go on ski trips with the kids, I help out in some way. I wax skis, give coaching tips, or just help keep everyone organized and on schedule. However, this trip had several highly qualified coaches, rendering me all but useless. I also wouldn't be staying with the team, so I wouldn't see much of Omar, and would have to occupy myself for a full week.

After much moping and complaining, I finally hit on the solution. I decided to ask my younger son, Amer, to come with me for emotional support. With him signed on, I started to see the trip in a different light.

The travel was still something to endure, rather than enjoy, but once there, the trip was a wonderful experience. Amer and I skied every day. The snow wasn't great in late March, but the trails in Alaska seem to go on forever, and the terrain is unlike anything we have here. There were lots of great hills and breathtaking scenery with either ocean or mountains.

One of the highlights for us was spending an afternoon dog sledding. We had to drive quite a way out of Anchorage, but it was worth it. We met a dog that ran the Iditarod last year, and got to play with some 7-week-old puppies who were future Iditarod champions. It was not easy to pry Amer away from the pups.

We also went horseback riding in the Alaskan wilderness, and had planned to do some kayaking in the ocean. Unfortunately, the kayaking was canceled because of rough seas and rain, but I think Amer was secretly relieved about that.

As important, Omar had his own terrific trip. He bonded with his team and really enjoyed the races. We knew he wouldn't be competitive against this field, some of whom will ski in the Olympics one day, but he had strong races and placed well above his ranking. Amer and I were there to cheer him on and catch up with him after he was done each day.

As the week wound down, we realized this was the first trip any of us had ever taken where we were sad to see it end. Amer and I felt we had gotten to know Anchorage quite well, and had some really fun one-on-one time. Omar spent the week doing what he enjoyed most, and made a lot of new friends.

The flight back, a red-eye, was even more uncomfortable than the flight over. It really didn't matter though; this investment had already been hugely profitable for the Armbruster boys.

## Compliance Corner

We are in a highly regulated business, which causes a few headaches, but regulations are largely good; they offer our clients important protections. There are certain disclosures that we are required to make regularly regarding our policies and procedures. A couple of them are below:

The nature of our business requires us to obtain sensitive personal and financial information from our clients. As a registered investment adviser with the United States Securities and Exchange Commission (SEC), we must adopt policies and procedures to protect this nonpublic, personal information. Our policy mandates that ACM employees are prohibited from disclosing nonpublic, personal information to any person or entity outside of our firm, except as authorized by our clients or an appropriate regulatory institution. We also take all reasonable measures to ensure secure transfer and/or disposal of documents containing sensitive information about our clients. Please let us know if you would like to see our full privacy policy.

Additionally, registered investment advisors are required to file Form ADV with the SEC or state securities regulators on an annual basis. A copy of our updated Form ADV is available at any time upon request. A copy of this brochure is also available on our website. We encourage each of you to read it. Please let us know if you would like us to send you a copy.

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