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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

Despite poor economic growth, the stock market shook off its first quarter consolidation and rose to new highs, while bonds extended their recovery from the beginning of the year. Both markets are relatively quiet now. During this quiet period, it makes sense for investors to review their plans to navigate the more turbulent times that will eventually follow. Our focus in this issue is the importance of considering the element of time in individual investment strategies.

The Economy

Although the GDP measurement is backward-looking, based on prior-quarter data, and is therefore old news the moment it is released, the *negative* 2.9% growth rate during the first quarter was still an eye-opener for those complacent folks who have predicted continually improving conditions. Coupled with the poor GDP reading, the year-over-year comparison of corporate profits also dropped by 2.2%. Many suggested this result was due to a harsh winter. It was also about time for the lagging effects of the government's sequester to show up in the economy. Ever optimistic, securities analysts have paid little attention, however. They are currently predicting corporate profits over the next 12 months to be 10.5% higher than their twelve-month forecast of a year ago. Will the analysts be right? Or is the GDP number a canary in the coal mine? For now, Federal Reserve economists are taking a middle path, reducing their GSP growth estimates from 2.9% down to 2.2%, suggesting we will continue to muddle through in the foreseeable future.

The Markets

The Dow Industrial average rose a bit during the quarter and is now up about 1.5% for the year. The S&P 500 is doing better at 6%. After last summer's dramatic bond sell-off, prompted by the prospects of "tapering" the Fed's Quantative Easing program, a broad bond index has recovered its losses on a total return basis (including interest), with corporate bonds outperforming Treasuries. Likewise, commodities have generally been moving up, as well as international stocks. Last year, performance was heavily concentrated in the stocks representing the domestic indexes. Investors following the good practice of maintaining a broadly diversified portfolio were left behind. Diversification may be vindicated this year.

The Fourth Dimension

Consider the measurement of investment performance. Clearly one dimension is gain or loss. A second dimension is risk. Generally the more risk that is accepted, the more gain (or loss) will be experienced. The third dimension is depth - the depth of portfolio diversification. The greater the diversification depth, the less risk is experienced, and the more constant is the gain or loss. These are the typical dimensions that are usually considered in portfolio construction.

But no investment results are achieved instantaneously. It takes time. A portfolio will achieve different results during different times - the Fourth Dimension. Time is a very important consideration. If you look at mutual fund performance results, you often will see significantly different returns over different time periods. For planning purposes, it is simplistic (if not outright misleading) to assume that your future result will reflect the historical averages for any given portfolio risk profile, particularly if current conditions are not normal.

When listening to pundits discuss their market outlooks, their opinions often seem to disagree, leading one to wonder how they could be talking about the same markets. Often the apparent contradiction is due to their perception of the fourth dimension. Some analysts (typically in the news media) may be talking about the performance they expect over the next several days, while others may be talking about years or anywhere in between. Often they do not mention the time frame they are evaluating, making the collective conversation sound like gibberish.

Adding to this problem is the fact that different time frames will have genuinely different outlooks. Within the fourth dimension exist cycles and trends, with trends largely being the manifestation of the up or down portion of a longer period cycle. If there were always just a long and consistent trend, investing would be easier and a much less emotional exercise. The danger is that there is a human tendency to observe a portion of a cycle and mentally project it as a continuing trend throughout the fourth dimension.

The key for the investor is to be aware of the fact that cycles do exist over multiple intervals, and to match the cycle to their own planned investment period. A long-term, 40-year outlook does not make much sense for a 90-year old investor. Likewise, weekly ups and downs have no impact on a twenty-five year old saving for retirement. However, they may be important for that same twenty-five year old who is saving for a new car.

Likewise, the concepts of risk and valuation must be viewed through an individually appropriate lens of the fourth dimension. The lens you should be using is not necessarily the same one the pundit uses to predict his future view, or the broker who only recommends a buy-and-hold strategy. For example, the value of the Dow Jones Average forty years from now has nothing to do with its value today. It will be defined by the policy decisions, geopolitical and natural events that occur between now and then. That value is a presently unknown, but is nevertheless a future fixed point. When thinking in terms of a fixed terminal value, it becomes obvious that the higher the price is today, the lower the realized return will be over those forty years. While it is comforting to see today's market rise, for those with a long time perspective, lower valuations today would provide better long-term results.

Robert Shiller, Yale professor, 2013 Nobel Laureate, and developer of the 10-year price/earnings valuation measure, looked back in his database and only found three times (1929, 2000 and 2007) when his long-term valuation measure was higher than now. There are other similar measures (i.e. Tobin's Q), where only 2000 is higher over the last 100+ years. Unfortunately, today's high long-term valuation correlates well with poor prospective returns over a term of the next 7-15 years, despite the potentially valid short-term projections of the pundits who use a shorter cyclical/trend or fundamental projection view.

For those who can afford to take a long-term view, the cycles that inhabit the forth dimension will produce opportunities at some point. They will reduce valuation by lowering prices, thereby creating higher expected returns from that point to the future value forty-years from now. Those who must take a shorter view, either because they have near-term expenses or will not still be investing in forty years, must be cautious. If the market drops to more normal valuations, their savings or retirement plans may be upset. If you are part of this group, it makes sense to make sure that your outlook and strategies are aligned with your own personal position in the forth dimension.

In these unpredictable times, the key is to think ahead, adapt, plan and manage risk. A good, well-executed plan and strategy is likely to be worth far more than the cost. *LFM&P* helps clients to create, adjust and manage their individual plans and investments considering all four dimensions: return, risk, diversification, and time. To learn more about our client goal-centered financial planning and investment management services, please call or e-mail. We invite you to visit www.linnardfinancial.com.

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