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Investing in a Time of Great Uncertainty

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SUMMARY: The market hates uncertainty, and we have arguably never had the amount of global uncertainty we are seeing today. Yet, no matter which period we pick from history, the short-to-medium term has always been uncertain. Even when you have a high conviction of what the economy is going to do, that doesn’t tell you what the markets are going to do. The challenge for the prudent investor is identifying where this unusual amount of uncertainty is stemming from.

It’s often said, the market hates uncertainty. We arguably have never had the amount of global uncertainty we are seeing today. The United Kingdom voted to leave the European Union. There are major fluctuations in economic powerhouses around the world, notably China. Interest rates, which are supposed to be how we price risk in the financial markets, have never been this manipulated in history. And, of course, there is a highly contentious U.S. presidential election cycle underway.

Some have stated that if candidate X is elected, the economy could tank. It’s possible, but in this time of uncertainty, anything is possible. And yet, no matter which period we pick from history, the short-to-medium term has always been uncertain. Even when you have a high conviction of what the economy is going to do, that doesn’t tell you what the markets are going to do.

For example, in early 2009, Warren Buffett told the Wall Street Journal that the economy “would be in shambles for 2009” but that “does not tell us whether the stock market will rise or fall.”

As it turned out, the economy was in shambles, and yet the S&P 500 skyrocketed more than 26% for the year. Those not as humble in their ability to predict got burned in a big way. Casey Research points out that 98% of traders in March of 2009 (the month U.S. equities bottomed) thought the market would go lower.

The challenge for the prudent investor is to decipher what is acceptable risk and navigable uncertainty and what is an impending correction. How do we make smart, informed investment decisions when uncertainty reigns?

The challenge for the prudent investor is identifying where this unusual amount of uncertainty is stemming from so that we can understand what a range of bad outcomes could look like. After all, as Charlie Munger likes to say, “the good news will take care of itself.”
The Root of Uncertainty

Much of the current uncertainty that permeates the world stems from the accumulation of debt. That might seem too simplistic, but economic discontent is fuel on the fire of uncertainty. Debt charts show seemingly unsustainable levels of debt, and it just keeps growing. What will the world look like when we are forced to live within our means?

At the same time, debt has caused part of the rising wealth disparity. The primary reason why the wealthy have become wealthier is that since the 2008 financial crisis, asset prices have appreciated in a seemingly straight line. The wealthy own most of the financial assets in the world, and debt is most of the “money” in the system that fuels asset appreciation. When the middle and lower classes feel left behind, that impacts the political system and is a major driver behind the anti-establishment movements seen in many countries.

Even international relations are driven by debt-caused economic stagnation. The “Euro-project” may blow up under its debt burden. Is it any coincidence that China’s saber rattling (e.g., their aggressive encroachment of international waters in the South China Sea) coincides exactly with their debt-fueled economy starting to come under serious strain?

For these reasons, a major part of the uncertainty in the world today (and especially in the financial markets) is caused by the basic human desire to live beyond our means, as well as the governments and central bankers who have enabled us to do so.

Antidotes to Uncertainty in Investing

The first antidote to uncertainty is time. By definition, unsustainable practices eventually hit a wall, and economies go through a painful but necessary healing process, coming out healthier on the other side. Even debt-riddled Greece reached a primary budget surplus in recent years. The chart below is pretty incredible. A U.S. 60 stock/40 bond portfolio has never yielded a negative return over a 10-year period. Despite two world wars, numerous debt crises, presidents shot or assassinated, epidemics, the 9/11 attacks, inflation, deflation, several major recessions, and a depression, if you just had patience, you never took a loss in any single decade. That’s a powerful insight. Of course, the key to realizing consistently positive returns is that at which Americans are particularly poor: patience.
The second antidote to uncertainty is price. Prices can and do fall low enough to where they incorporate awful expectations. For example, during the financial crisis, prices on the French stock exchange dropped so low they were trading for 8-times earnings. At that price, if France’s economy never grew again in its entire future, you’d earn about 12% on your money long-term. That’s pretty darn good for investors, even with economically awful results!

Given a highly uncertain world, here are steps you can take to strengthen your portfolio, regardless of evident risks:

- **Decrease your leverage** – Think of your personal balance sheet. In a highly leveraged world, your personal balance sheet should be as unlevered as possible. With the exception of cheap, long-term debt (mortgage), pay off your credit cards, your margin investment balance, and your car loans.

- **No “stretch” expenses** – Do not increase the uncertainty of your personal situation by buying a “stretch” item now. There are times in history when, due to a poor economy, “deals” in housing, on cars and on other luxury goods have been abundant. Now is not one of those times.
• **Maintain a larger-than-average emergency fund** – Ensure you have plenty of cash to fund your short and intermediate cash flows. That way, if you were to lose your job because of a recession, or if your investment portfolio takes a hit, you can ride out the “bad times” with cold hard cash.

• **Don’t forget the fundamentals** – Bubbles make everyone lose their mind, and along with it, their discipline. In a cycle where U.S. equities have far-outgained other assets classes, everyone today seems to want an S&P 500 index fund. Don’t do that. Stick to the fundamentals and stay diversified. If you haven’t rebalanced in a while, do it now. Rebalancing on a regular basis is one of the most important disciplines to having a robust, resilient portfolio.

• **Have a game plan for a severe recession** – What would you do if the equity markets went down by 20%, 30%, and 50%?

The world will always be uncertain but combining an understanding of the limits of our knowledge with some basic discipline can go a long way to making our personal situations a lot more certain.

**Sources:**
1. Ibbotson Associates, a wholly owned subsidiary of Morningstar, Inc., Robert Shiller and WFAM.
2. Warren Buffet, “American business magnate, investor and philanthropist”
3. Charlie Munger, “American businessman, lawyer, investor, and philanthropist”

**About the Author**
Loic LeMener is founder and President of Opus Wealth Management in Dallas, Texas, a boutique wealth management firm that specializes in personalized client solutions. Loic and his team provide their clients with a targeted needs evaluation to answer important questions that provide a better, more personalized experience. The team focuses on integrity and believes in the following “golden rule” – they won’t do anything for you that they would not do for themselves or their loved ones.

Loic received his Masters in Business Administration from Southern Methodist University, studying Finance, Accounting and Portfolio Management. He also earned the Certified Financial Planner™ certification and the prestigious Chartered Financial Analyst® designation. In addition, he has been quoted in national publications such as Barron’s.

In his free time, Loic is a devout reader, with his favorite topic being “value investing.” His favorite investors are Warren Buffett, Ben Graham, Charlie Munger, Seth Klarman, Howard Marks, and Jeremy Grantham.