Q4 2016 Market Commentary

Most clients come to Northstar because they are trying to accomplish something – they have a goal, or many goals, that they are working toward in their life. But not one of our current clients has expressed a goal called “beating the market” – and if that really is a goal, articulated or not, it is likely that client will find that the way Northstar operates is not in that manner. That is because “beating the market” is not a goal that one can effectively plan for so is not one that drives how we help clients achieve the things that are important to them.

Different types of investments move into and out of favor with the ebb and flow of the economy, and so in any given period, one particular sector may vacillate from favored to un-favored and back again. The areas of the market that performed the best in one period of time may very well be the same area that performs the worst the next time. Guessing where investor money will flow is akin to picking lottery numbers. Some will guess correctly at times but that success is an illustration of chance rather than talent.

Northstar is not built for that kind of investing, which is really the domain of investment banks and hedge funds that charge clients a 2 % annual fee and 20 % of investment earnings for the chance to hit it big in a very short period of time. The irony, of course, is that hedge funds are even less likely to be successful now that there are so many trying to own the same hedged assets, thus taking away the inefficiencies they were created to exploit. And many investment banks will lose money as often as they make it; the successful ones simply have more good days than bad.

Northstar instead is built to provide advice, and the bulk of the advice that we mete out relates to more concrete goals – such as how you are going to get your kids through school or when it might be the right time to retire. So the investment work that we do is nearly always a means to those types of ends and as such we rarely will pick investments purely on the basis of whether or not we believe it will “perform.” Instead we invest client assets in a manner that seeks to provide the return necessary to meet their declared goals while accounting for inflation.

We realize this may sound like splitting hairs but there is a very distinct difference between the two. Investing for the sake of pure performance is taking on risk for the sake of hope. “I hope I make some money.” Investing for a target return is based on a systematic and methodical design that encompasses time frame, risk tolerance, a disciplined savings plan, and an attempt to increase the probability of success by limiting volatility. It is not a “get rich quick” scheme, or a “hit it out of the park” strategy, but instead a long term plan of action that relies upon historical mean return expectations, the use of quality asset managers, conservative projection assumptions and ongoing oversight. So for us there is a distinct difference between performance and a goal-driven, target rate of return.

The obvious question here is if performance as a measure of success or failure is at best incomplete and at worst misleading, why do we continue to report it, analyze it, discuss it or refer to it? The answer lies in how we, as advisors, come to define "long-term" and how both timing and the passing of time affect financial decisions specifically.

First off it is important to understand that the start and end dates that are often used to evaluate performance – a month, a quarter, a calendar year – are linked to the fiscal operations of the companies whose stock or bonds are on the block. The premise is to compare the vast universe of investments as if they are all running across the same, level playing field with the same starting and ending points in a mental horse race.

In reality, the start and end points don't all line up, the field isn't really level at all and some investments aren't even in the same stadium, let alone on the same field, as the universal benchmark of the S&P 500. So our industry has modified the idea of direct comparison to account for these disparities – stocks vs. bonds, or large companies vs. small companies, foreign holdings, commodities, currencies and so forth.

Where the horse race falls apart completely, however, is when we try to relate this wide variety of fields and distances to the lives of our clients or their goals. The entire construct, really, is somewhat meaningless in the face of decisions that our clients need to make for themselves or their families. What XYZ stock did from January 1st through December 31st has no bearing whatsoever on what school their child is going to go to next September.

That said, the year-to-date performance of the entire portfolio, of which XYZ stock is but a small part, might have an impact on how tuition is paid in the year in which we are looking at that performance. And so for immediate decisions, particularly in light of any tax implications, performance information can be helpful and that is part of the reason for our quarterly reporting. Performance information can help us determine what investments we want to sell right now to meet immediate goals or needs whose time have come.

But in the absence of any overriding need to sell something performance reporting serves the same, rather mundane purpose as the blood pressure gauge at your doctors' office – it is one of the primary tools we use to make sure that nothing unhealthy is going on. And just like your doctor, a period of poor performance would prompt us to first make sure that the condition isn't temporary – stress on the job, perhaps – by testing and re-testing under different conditions.

Instead of a wholesale change, a lagging position would first prompt us to ask whether the performance for that period is in line with this type of investment, or if there is an anomaly that is creating abnormal returns. If an anomaly exists, we try to determine whether or not it has long-term implications for that holding. And finally, we would revisit the purpose of choosing that investment in the first place and consider whether we feel the holding is still valid to the plan and its goals despite the current conditions.

We continue to raise the subject of goals and financial planning because we have been providing advice and asset management for decades and as such we have seen a few long-term trends play out in the markets. While there are certainly times that external, market-based conditions will compel us to change our stance within a given portfolio – reducing exposure to an asset class at risk, for instance – our clients' financial well-being has been more directly correlated to how well they adhered to their plan, rather than to how they were invested.

And that is because the large variety of investment options at our disposal are all capable of delivering a client to their target return one way or another – via a tumultuous, sometimes torturous hike, a slow, gentle amble or some combination thereof. The route taken, however, shouldn't be predicated on the nature of that path but rather on the ultimate destination, and the time available to get there. By focusing on the destination we can seek to take the smoothest path we can because together we have defined and declared the goal, determined the return necessary to achieve that goal and can allocate for that necessary return with an eye on the risk taken to achieve it.

But for all the beauty of a well-defined plan, unfortunately the more dramatic the stock market becomes, the less clients are likely to focus on that plan. It's human nature that when the bull has run for as long as it has recently, conversations turn from "am I meeting my goals" to "am I beating the S&P 500." The speedway looks like an appealing route, especially if you feel that everyone who takes it is passing you by.

Investors can forget that it's really not a race; all those speeding past aren't even traveling to the same destination as each of us are as individuals, with individual goals. At the height of a bull market, or in the depths of a bear, we feel it serves our clients best for us to reinforce the idea that investing is a lifetime endeavor for each of us as a personal set of goals. As such proper allocation relative to each client's own, goals-based target return, rather than quarter to quarter performance, is most important.

Should you have any questions regarding your planning or your portfolio Julia and I are always available to talk things through with you. We can be reached by email at julia@nstarfinco.com and steve@nstarfinco.com or by phone at 800.220.2161.

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