Successful Investing Is Not About What Was or What Is. Successful Investing Is About What Will Be.

To keep one's sanity as an investor, one must first come to terms with what type of market participant he or she wants to be. All market participants are not created equal by any stretch of the imagination. In fact, over time, our capital markets have become much more perplexing for the average investor due to the change in the composition of the participants and which ones have the most influence over short-term market dynamics.

It used to be, for equity investors, that the actions of the buyers and sellers of stocks determined the direction of the broad markets. Over the last 40 plus years, index investing, mutual fund and ETF investing, and more recently, option and derivative trading have become the dominant way most institutions and individuals put money into the markets. Today, the roles are reversed, and the broad market determines the short-term direction of individual stock prices. For the manager of individual security portfolios, this fundamental change in how funds flow into the markets must be acknowledged, understood, and incorporated into buy/sell decisions.

All one has to do to see how equity investing is characterized by the "so-called experts" is turn on CNBC during the trading day and listen to what is not being discussed. You will rarely hear any pundit or trader discuss the price of a security relative to a well-constructed valuation thesis or discuss how well one company invests its free cash flow versus another company. The subject of most discussions and debates on CNBC will be technical indicators of the stock price, such as the 200-day moving average or what is occurring with options contracts and how this information may be a window into the bets that supposed large, intelligent investors are making. Much of the message that CNBC and other financial news programs convey is simply focused on the security, what its price has done, and what that past price action portends over the short-term. This is the narrative of a trader/speculator, not an investor.

As an asset manager for individuals, we encounter three primary motivations in people when it comes to their money. Those motivations are saving, investing, and speculating. For many clients, we combine all three motivations into a comprehensive investment strategy, and the mix of those three motivations dictates an investment objective. Let's define the three motivations:

- Saving – The primary goal of saving is to have immediate liquidity, low price volatility, and a positive inflation-adjusted rate of return over a short, intermediate, or long-term time horizon.
- The primary goal of investing involves assets that are expected to be held over an intermediate or long-term time horizon. Liquidity is less of a consideration compared to saving. With a longer-term time horizon and less of a liquidity demand, these assets are expected to produce a return well above the risk-free rate, which in normal times will approximate the expected inflation rate.
- The primary goal of speculating is to expose oneself to more of a binary outcome financial transaction than investing. A binary outcome transaction could be buying a small clinical-stage biotech company's stock, which over a specific time period could become virtually worthless if its research does not result in a successful product or could be worth five, ten, or more times its current value with a successful clinical trial. Options are often binary wagers on both timing and price movement of a security where the upside can be significant over a short period of time, but like a non-winning lottery ticket, the option can expire worthless.

For most individuals who we work with, we blend saving, investing, and speculating to arrive at a portfolio or combination of portfolios that serve to meet their short, intermediate, and long-term financial objectives. With the savings component of their wealth, we design portfolios of liquid securities, producing low aggregate volatility, high relative dividends, or interest. Through active management, we strive to minimize taxes and generate a total return over and above the income yield through security price appreciation. Typically, the investment component of a client's portfolio is the most significant and is constructed using predominately individual securities, some special-purpose ETFs and mutual funds, and various forms of alternative investments. Within this investment category, we routinely include a more speculative class of securities ranging from 5-10% of an investment portfolio. These more speculative securities are typically held using a smaller than average position size, allowing for greater diversification of company-specific risk.

Our portfolio allocation decisions are made very purposefully. The choices made are not materially driven by studying the market. This approach alone separates what we do for clients from that which is commonly called investing by the mainstream financial media. That is not to say that we ignore the markets entirely; we do not. We routinely find individual security opportunities created by what we see as the markets' inherent unpredictability, inefficiency, and herd mentality.

The stock market over the last couple of months has been moving up in aggregate. However, underneath, at the individual security level, that market has been struggling to find new leadership after investors, in response to the pandemic, crowded into the stocks of companies perceived to benefit from a stay-at-home economy and vaccine development. This struggle has taken its toll on many of the stocks of companies whose business model helped them prosper last year. Some of these companies will see the growth they experienced following the pandemic slowdown, while others will continue to benefit after the pandemic is long gone. Overall, a slowdown should have always been expected, but with the stock market, momentum kicked in late last year, and many pandemic beneficiary companies saw their stocks go hyperbolic. The market has yet to come to terms with how much of a slowdown will happen with those companies. This uncertainty, and the lingering worries about the timing and durability of the reopening of the economy, are currently hampering the handoff of leadership from stay-at-home and work-from-home winners to economically cyclical "reopening stocks."

We are now in May, two and half months after this rotation began. While certain holdings in our portfolios have gotten caught up in the rotation, we are primarily focused on making investments looking into 2022 and beyond. After almost 25 years of building and managing individual security portfolios, each day begins with the knowledge that successful investing is not about what was or what is. Successful investing is about what will be.

The recent 2021 Strategic Investment Conference that I attended virtually has reinforced the outlook for the economic and market backdrop I see for the next several years. The conference speakers on the economy included Rosenberg Research and Associate's Chief Economist, David Rosenberg, and KPMG's Chief Economist, Candace Hunter.

Rosenberg and Hunter both reinforced my following assumptions for the economy and market backdrop:

- The current strong uptick in inflation will turn out to mostly be transitory, as the Federal Reserve is forecasting.
- Pandemic-driven technological investments and higher expected fiscal investments in infrastructure and research & development will lead to sustained productivity growth higher than the pre-pandemic levels.
- A higher sustained level of productivity growth will lead to a higher potential GDP growth level over the next several years.
- Higher potential GDP growth should support a higher range for interest rates than we saw for the decade following the Great Recession.
- Higher interest rates can be a headwind for the equity markets. However, higher interest rates coupled with relatively low inflation and higher GPD growth have historically been a good backdrop for equity markets.

Attending conferences, such as the Strategic Investment Conference, help me fine-tune the assumptions that I rely upon to make forward-looking investments confidently. Always being forward-looking is the key to successful investing. Overly second-guessing past decisions and fixating too much on current market dynamics can poison an active investor's decision-making process by allowing short-term noise and past results to distract focus away from process-driven conviction.

Over the last two months, the relative calm and upward trending market averages have masked a very unsettled, and at times violent rotation at the individual stock level. Worries about inflation, higher interest rates, and fiscal policy are weighing heavily on certain segments of the stock market. This unsettling dynamic will pass as the economy emerges from this unusual pandemic period and equilibrium begins to return to supply chains. This will happen as the supply of goods catches up with demand and the service economy comes back online. The backdrop for equities looks quite attractive on the other side of the current transition-related turbulence.

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