Make Prudent Choices and Don't Blink

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"Tom Delonge gave me his guitar!" From the level of excitement in her voice, I knew that my daughter considered this gift a very big deal, but I had no clue why. Looking at her Facebook page after our conversation, I started to see why she was so excited: "Hillary had the BEST weekend EVER with my hubby[…] we went to a Blink 182 concert and I left with Tom Delonge's guitar. You may be wondering how that happened?!? Well, HE HANDED IT TO ME FROM ON STAGE!!!!!! From the magic of YouTube, I was able to relive that serendipitous moment when my daughter's rock star hero pointed her out in the crowd, motioned her forward, and handed over his signature Gibson guitar in front of 22,000 screaming fans."

Life is full of all kinds of twists and turns, and my daughter had no inkling of what lay around one of those corners when she and her new husband blew their honeymoon stash on tickets for their dream concert, with just enough cash left over to rent the honeymoon suite at Motel 6 and dine on a gourmet dinner at In and Out Burger. For this financially struggling couple, life handed them a totally unexpected treat.

While there is no question that getting the guitar was pure chance, this story brings up an important question that is the great debate in investing. Is investing a matter of chance, with price fluctuations that are random and unknowable or is investing a matter of choice, with price variations that have discernible patterns that are predictable? How you answer that question will determine your investment style and market strategies. I think because our investment style is known as "passive investing," too often people take that to mean we don't do anything. But passive investing doesn't mean not making choices; it means making choices that have a realistic chance of success and avoiding those that don't. Therefore, we make prudent choices, not speculative or emotional ones.

- We choose broad diversification because the higher returns made possible by concentration aren't likely enough to offset the much higher expected risk.
- We choose buy-and-hold, with occasional rebalancing, because market timing in most cases reduces instead of increases returns. Getting out of markets at their height and back in at the bottom is an appealing idea that, unfortunately, doesn't work in reality.
- We choose to tilt portfolio allocations toward small and value stocks because of their higher historically returns and their low correlation to the market, which counter intuitively means expected returns can be increased while overall portfolio risk is reduced.
- We choose low costs and good tax management because those are variables we can control and because research shows they are the most important factors in determining net return.
- We choose high quality bonds with short maturities to increase portfolio stability, because the added risk of lower quality, longer term bonds is not worth the slightly higher expected return.
- We choose strategies that take advantage of momentum because research shows that stock price movements, either up or down, tend to have periods of inertia.

Of all the people who have gone to Blink 182 concerts, only one in over a million fans has been given a guitar by Tom Delonge - not very good odds. As investment advisors, we always try to put the odds in our clients' favor. We do that by making prudent choices and by not blinking when things don't work out as planned. Because we know investing isn't a question of choice or chance, it is a question of consistently making choices that increase our clients' chances.

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