

RITHOLTZ
wealth management



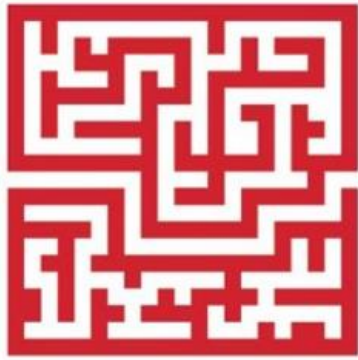
Now What?

By Ben Carlson, CFA



Agenda:

1. Markets Are Hard
2. How to Survive
3. How to Make Better Decisions



A WEALTH OF COMMON SENSE



TOP 50 FASTEST-GROWING FIRMS With More Than \$250 Million In AUM

GROWTH RANK	FIRM NAME	LOCATION	2016 CLIENTS	YEAR END 2016 ASSETS (\$MM)	% GROWTH IN ASSETS 2015-2016	% GROWTH IN ASSETS PER CLIENT
1	Zeke Capital Advisors	Berwyn, Pa.	45	5,448.19	150.57%	323.18%
2	Capital Wealth Advisors	Naples, Fla.	400	717.48	105.63%	53.19%
3	Cornerstone Advisory	Hunt Valley, Md.	590	981.07	100.55%	21.35%
4	Ritholtz Wealth Management	New York, N.Y.	424	440.00	97.31%	-6.46%
5	The Wealth Consulting Group (WCG)	Las Vegas, Nev.	2,500	884.39	95.13%	9.27%
6	Sequoia Financial Group	Akron, Ohio	1,985	2,749.97	80.48%	37.39%
7	Titus Wealth Management	Larkspur, Calif.	1,315	295.68	75.20%	0.86%
8	Strategic Wealth Advisors Group	Sacramento, Calif.	8,000	2,269.35	72.99%	72.99%
9	LeafHouse Financial Advisors	Austin, Texas	370	1,500.00	65.48%	11.81%
10	Platinum Wealth Partners	Tampa, Fla.	1,400	543.70	62.30%	39.11%

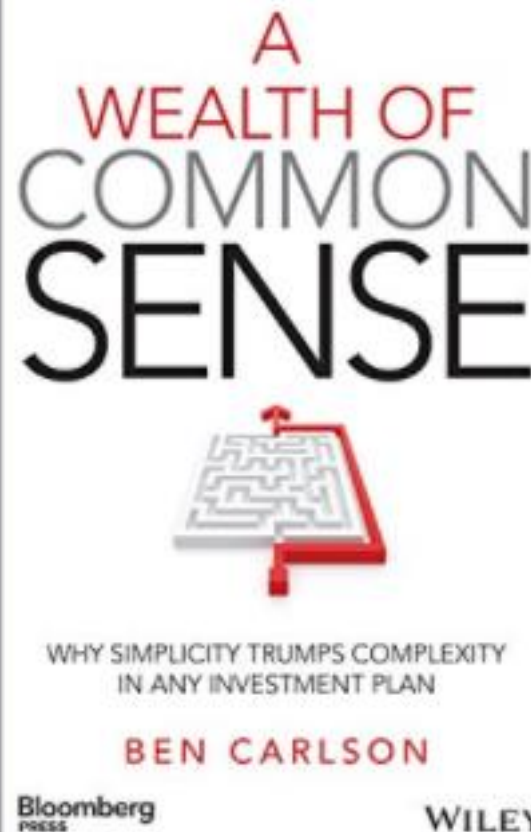
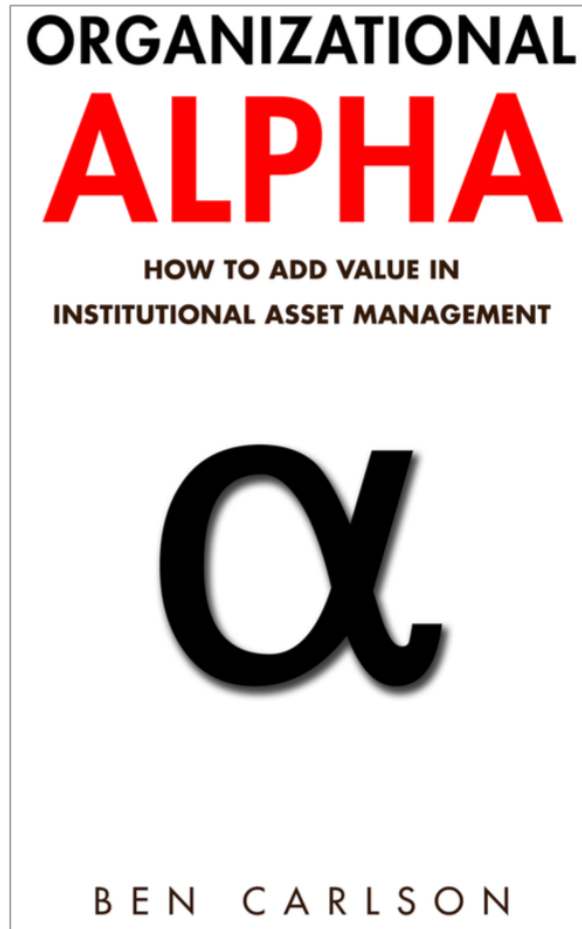


My Books

Organizational
Alpha

CreateSpace, 2017

A manual for institutional investors to improve decisions and add value through intelligent planning and organizational structure



A Wealth of
Common Sense

John Wiley & Sons,
2015

How simplifying the investment process can improve long-term investment results by avoiding complexity



Markets Are Hard

More worried than ever



"By holding interest rates at zero, the government is basically tricking the population into going long on just about every kind of security except cash, at the price of almost certainly not getting an adequate return for the risks they are running. People can't stand earning 0% on their money, so the government is forcing everyone in the investing public to speculate."

"I am more worried about the world, more broadly, than I ever have been in my career."

- Seth Klarman, Baupost Group

A Crash is Coming?

2011: *100% Chance of Crisis, Worse Than 2008: Jim Rogers*

2012: *Jim Rogers: It's Going To Get Really "Bad After The Next Election"*

2013: *Jim Rogers Warns: "You Better Run for the Hills!"*

2014: *JIM ROGERS – Sell Everything & Run For Your Lives*

2015: *Jim Rogers: "We're Overdue" for a Stock Market Crash*

2016: *\$68 TRILLION "BIBLICAL CRASH" Dead Ahead? Jim Rogers Issues a DIRE WARNING*

2017: *THE BOTTOM LINE: Legendary investor Jim Rogers expects the worst crash in our lifetime*

Is the Fed Out of Ammo?

August 18, 2009: [Running Low on Ammo \(Reuters\)](#)

August 26, 2010: [The Fed Running Low on Ammo \(Wall Street Journal\)](#)

August 26, 2011: [DeKaser Says Fed 'Running Out of Ammo' For Economy \(Washington Post\)](#)

July 31, 2012: [Fed Running Out of Ammo \(Politico\)](#)

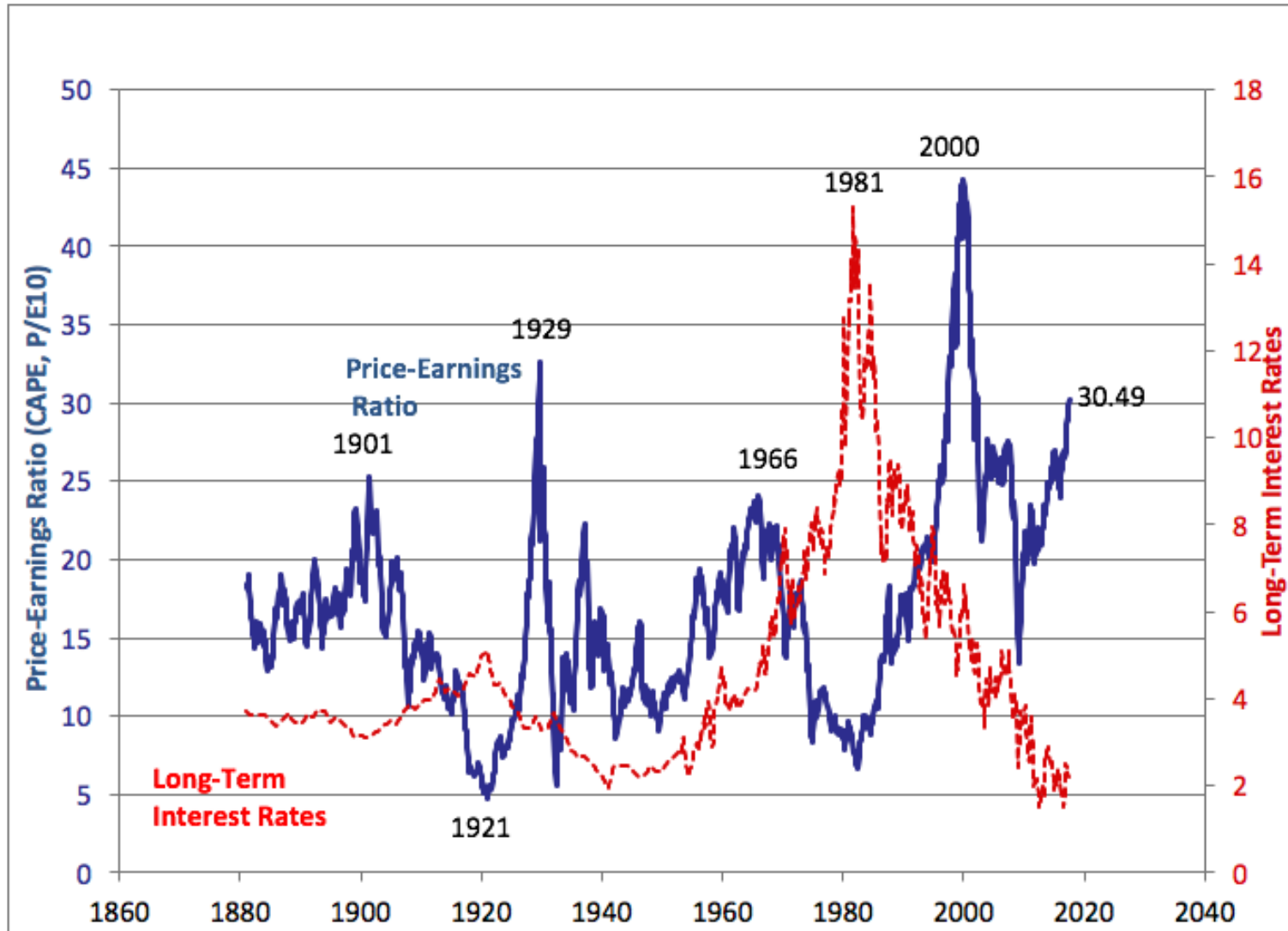
February 27, 2013: [Federal Reserve: What Happens When The Fed Really Does Run Out of Ammo? \(Time\)](#)

March 16, 2014: [Why The Fed Has No Ammo Left \(USA Today\)](#)

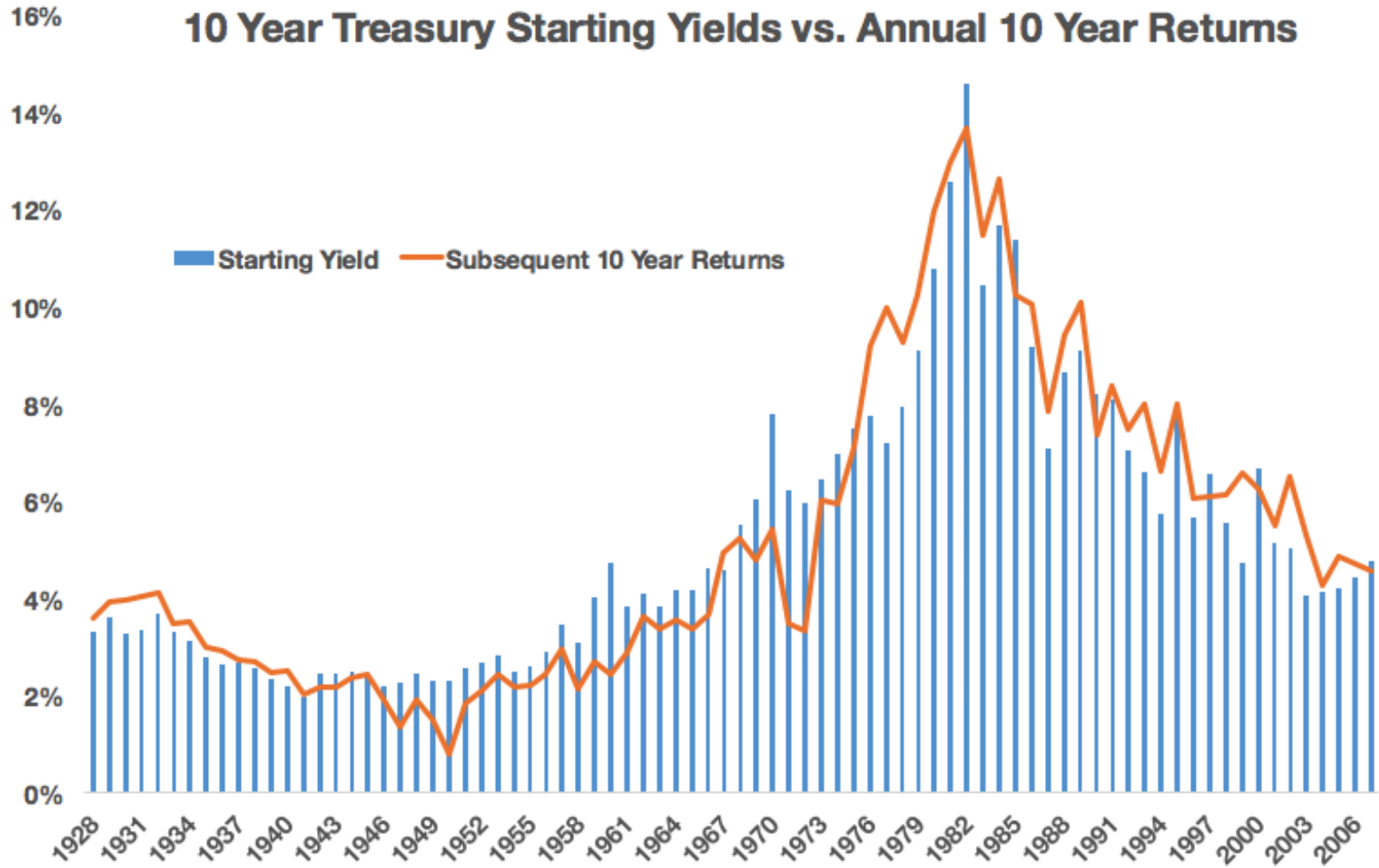
May 13, 2015: [Rate-Hikers At the Fed Are Running Out of Ammo \(CNBC\)](#)

February 9, 2016: [Global Central Banks Are Running 'Out of Ammo' \(CNN Money\)](#)

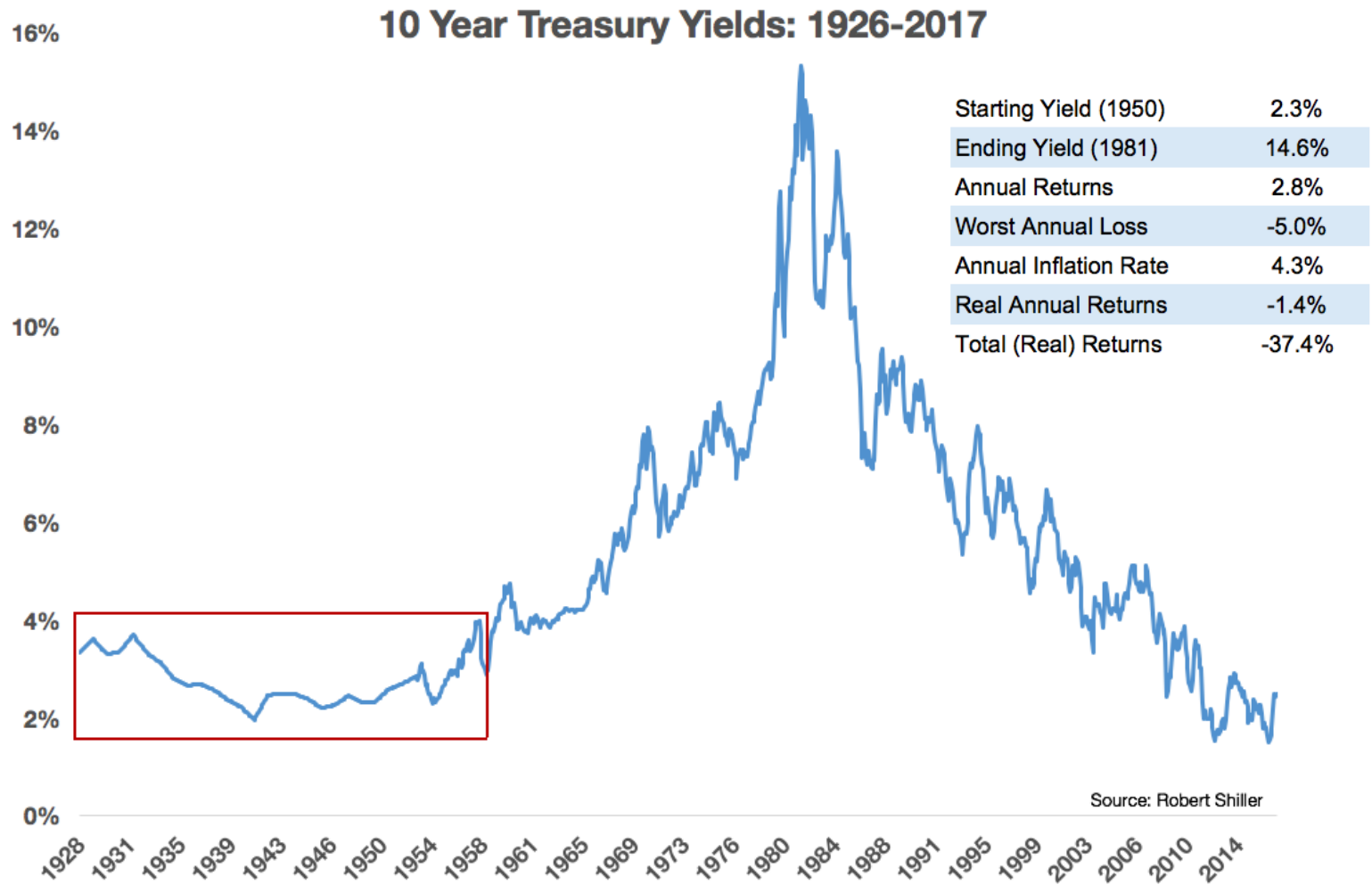
Valuations & Rates, Oh My!



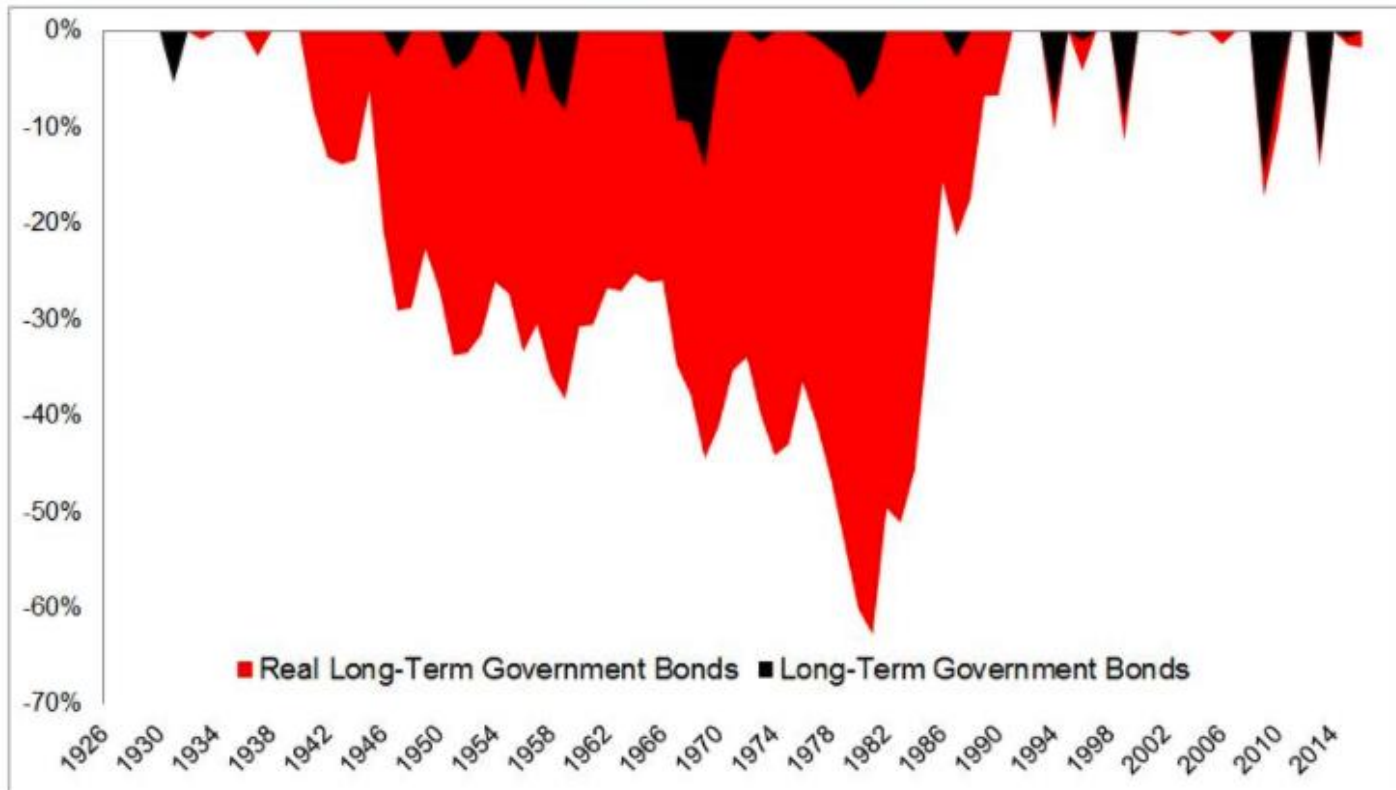
Predicting Bond Returns



Bond Yields



The Biggest Risk to Bonds?



CAPE Fear

S&P 500: 1926-2016 Average Annual Returns

CAPE Ratio	3 Years	5 Years	10 Years
5 to 10	19.8%	18.3%	15.5%
10 to 15	15.6%	13.4%	13.9%
15 to 20	6.9%	8.0%	9.7%
20 to 25	8.9%	8.6%	5.7%
25 & Higher	0.4%	0.7%	3.9%

S&P 500: 1926-2016 CAPE Ratio	3 Years		5 Years		10 Years	
	Best	Worst	Best	Worst	Best	Worst
Below Average (<17.8)	43.3%	-13.5%	36.1%	-17.3%	21.4%	0.40%
Above Average (>17.8)	32.8%	-42.4%	28.6%	-17.4%	17.4%	-4.95%
5 to 10	43.3%	6.2%	36.1%	10.3%	21.4%	5.27%
10 to 15	40.3%	-7.3%	26.7%	-7.7%	20.1%	2.71%
15 to 20	31.1%	-13.5%	27.5%	-17.3%	19.5%	-0.37%
20 to 25	32.8%	-33.3%	28.6%	-16.6%	12.1%	-4.15%
25 & Higher	29.7%	-42.4%	18.7%	-17.4%	9.3%	-4.95%

Caveats on the CAPE Ratio

- No SEC or Federal Reserve for much of this time frame
- The U.S. was once an emerging market. As wealth rises, valuations rise
- Markets are more liquid and transaction costs have fallen substantially
- Over the past 25 years CAPE was above the long-term average 95% of the time
- Through December of 2016 CAPE spent just 16 out of 309 months below 16.8

The Four Most Dangerous Words...



The investor who says, **'This time is different,'** when in fact it's virtually a repeat of an earlier situation, has uttered among the four most costly words in the annals of investing.

Every Time is Different

- In 1957 the S&P 500 consisted of 425 industrials, 60 utilities & 15 railroad stocks
- Until 1988 it was 400 industrials, 40 financial & 20 transportation stocks
- America's largest company in 1902 was U.S. Steel. They generated \$3,340 of sales per employee. Today Facebook generates \$2 million in revenue per worker.
- Mutual fund sales loads average 8-10% in the 1950s and 1960s
- The first stock index fund was created in 1976. The first bond index fund didn't come along until 1986
- The 401(k) is ~30 years old. IRAs haven't been around much longer
- The entire concept of retirement is a 20th century phenomenon. In the past most people simply worked until they died

Context on those Four Dangerous Words



The only way to avoid mistakes is not to invest -- which is the biggest mistake of all. So forgive yourself for your errors. Don't become discouraged, and certainly don't try to recoup your losses by taking bigger risks. Instead, turn each mistake into a learning experience. Determine exactly what went wrong and how you can avoid the same mistake in the future.

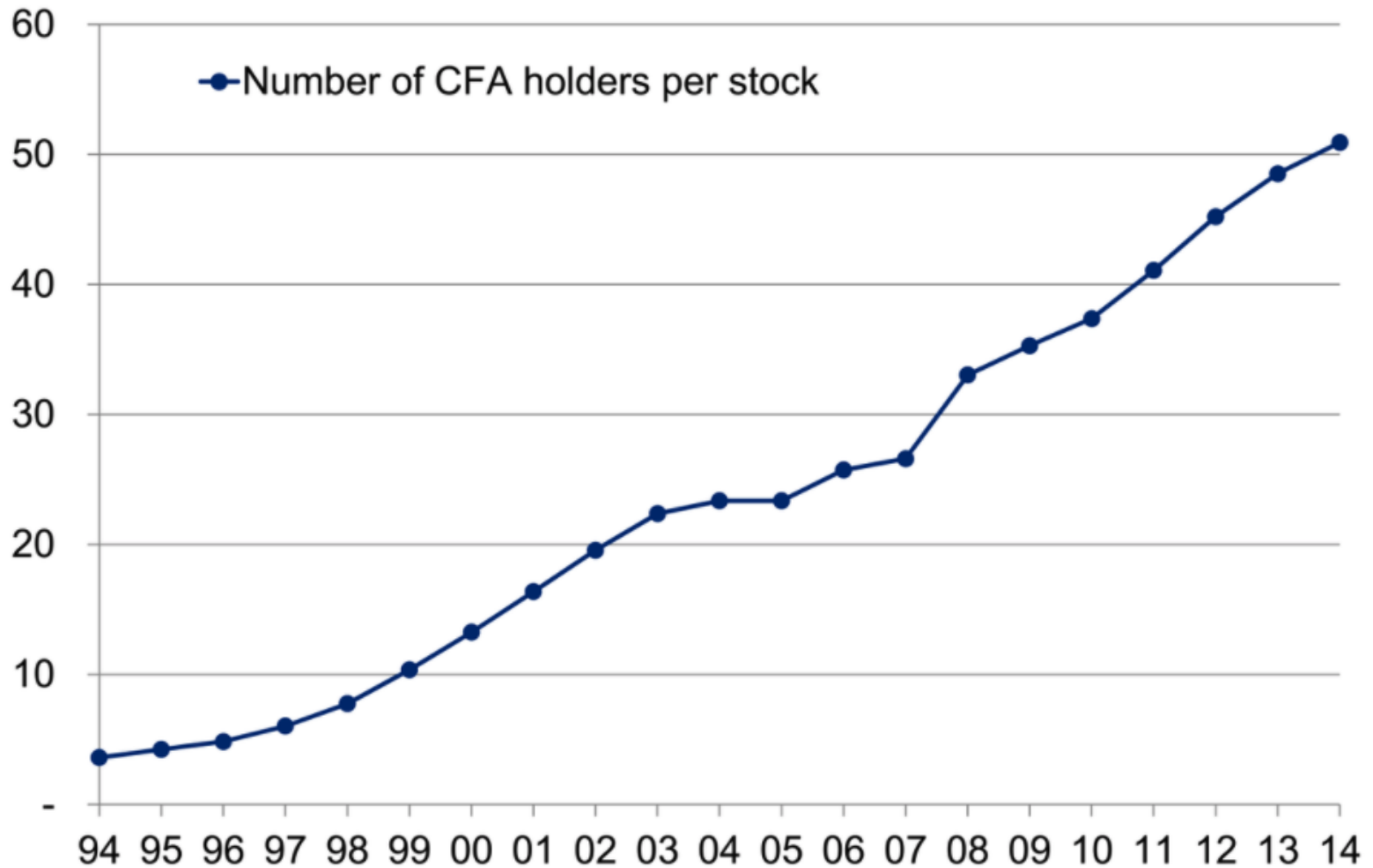
The investor who says, '**This time is different,**' when in fact it's virtually a repeat of an earlier situation, has uttered among the four most costly words in the annals of investing.

The big difference between those who are successful and those who are not is that successful people **learn from their mistakes and the mistakes of others.**

How Things Have Changed on Wall Street in 50 Years

- Trading volume on the NYSE has increased from 3 million/day to 5 billion
- Retail investors accounted to 90% of all trades. Today, 95% is performed by professional investors
- Trading costs have fallen 80-90% since May Day in 1975 when fixed-rate commissions were abolished
- There are more than 320,000 Bloomberg terminals with near unlimited market & economic data available 24 hours a day
- There are more than 130,000 CFA Charterholders with another 200,000 studying for the tests
- Reg FD has required all corporate information be made simultaneously available to all investors

CFA vs. Stocks





How to Survive

Doing Nothing is a Decision



Dual Mandate

Over the long-term...

Over the short-term...

Risk & return are related

Risk & return often not related

Volatility is more consistent

Volatility tends to cluster

Markets are kind of, sort of efficient

Markets are inefficient

How do we grow our portfolio to reach our goals?

How do we survive severe market disruptions?

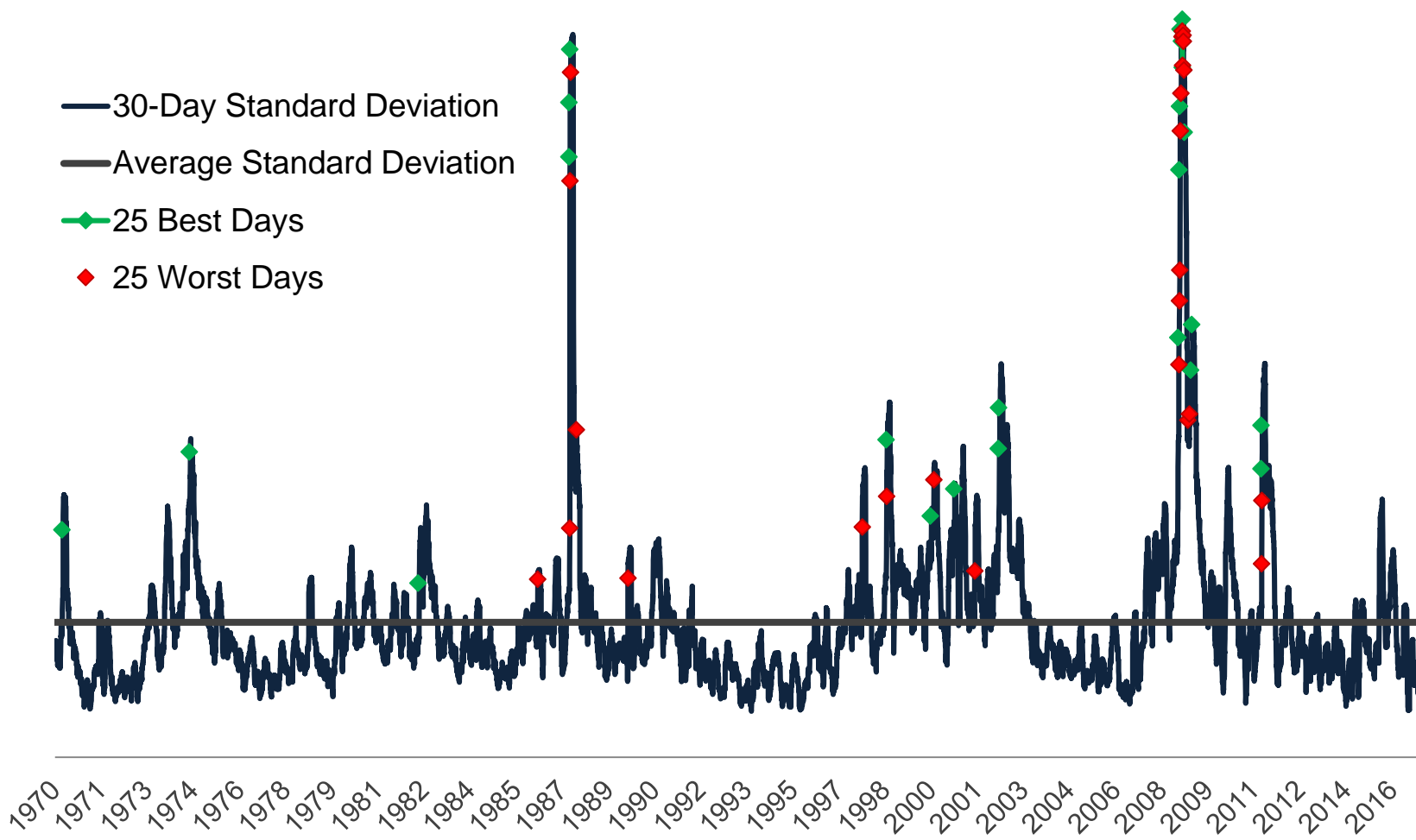
The Shiller/Fama Paradox



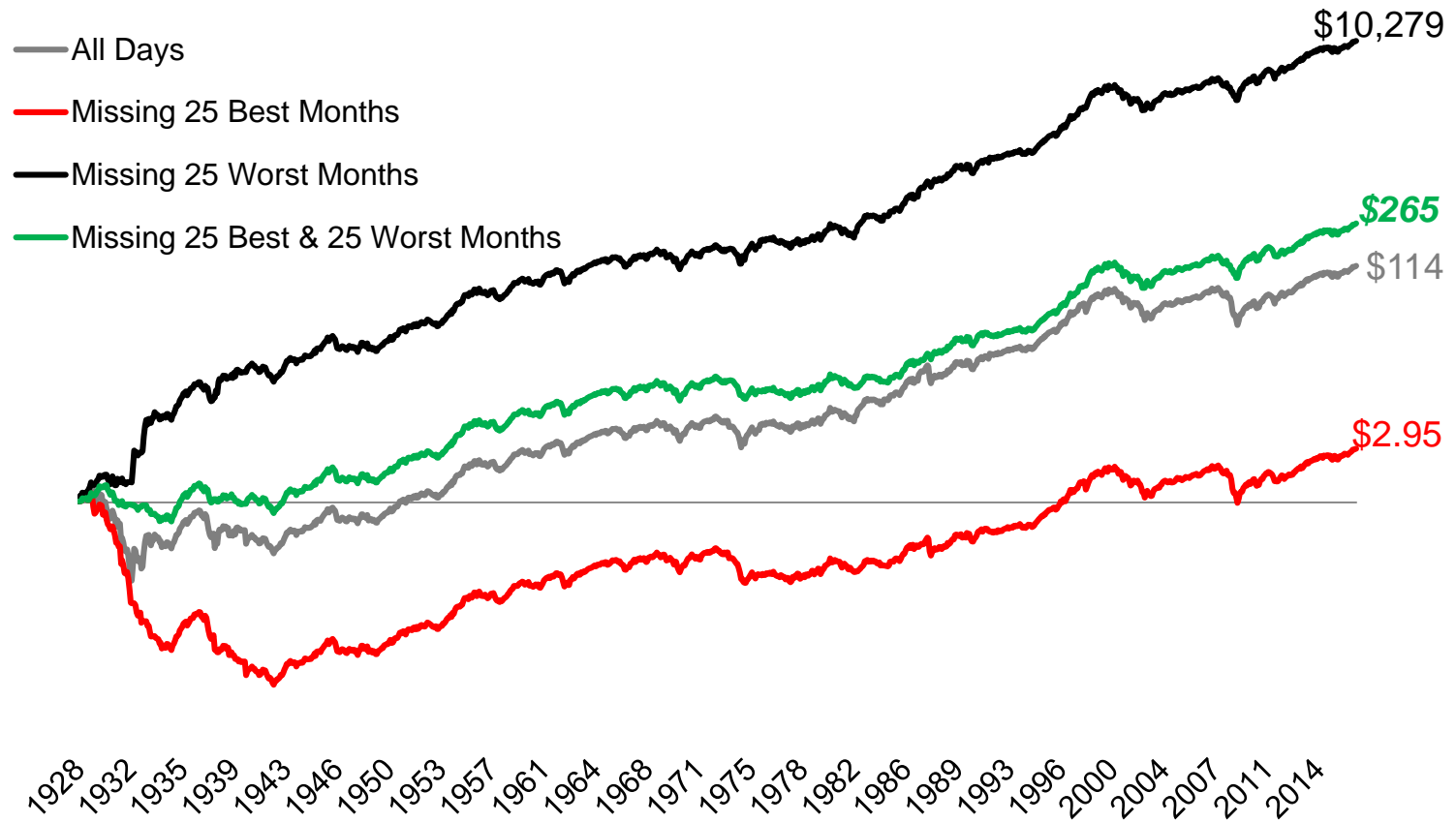
Marrying Tactical & Strategic

- Extreme market scenarios make any reasonable asset allocation look silly or careless at times
- Portfolios should be behaviorally aware to account for the human element
- The great strategy you can't stick with will leave you worse off than the good one you can stick with
- Having a rules-based solution can eliminate the risk of making poor decisions when emotions are running high
- Most tactical approaches seek to beat the market while we look to encourage good behavior

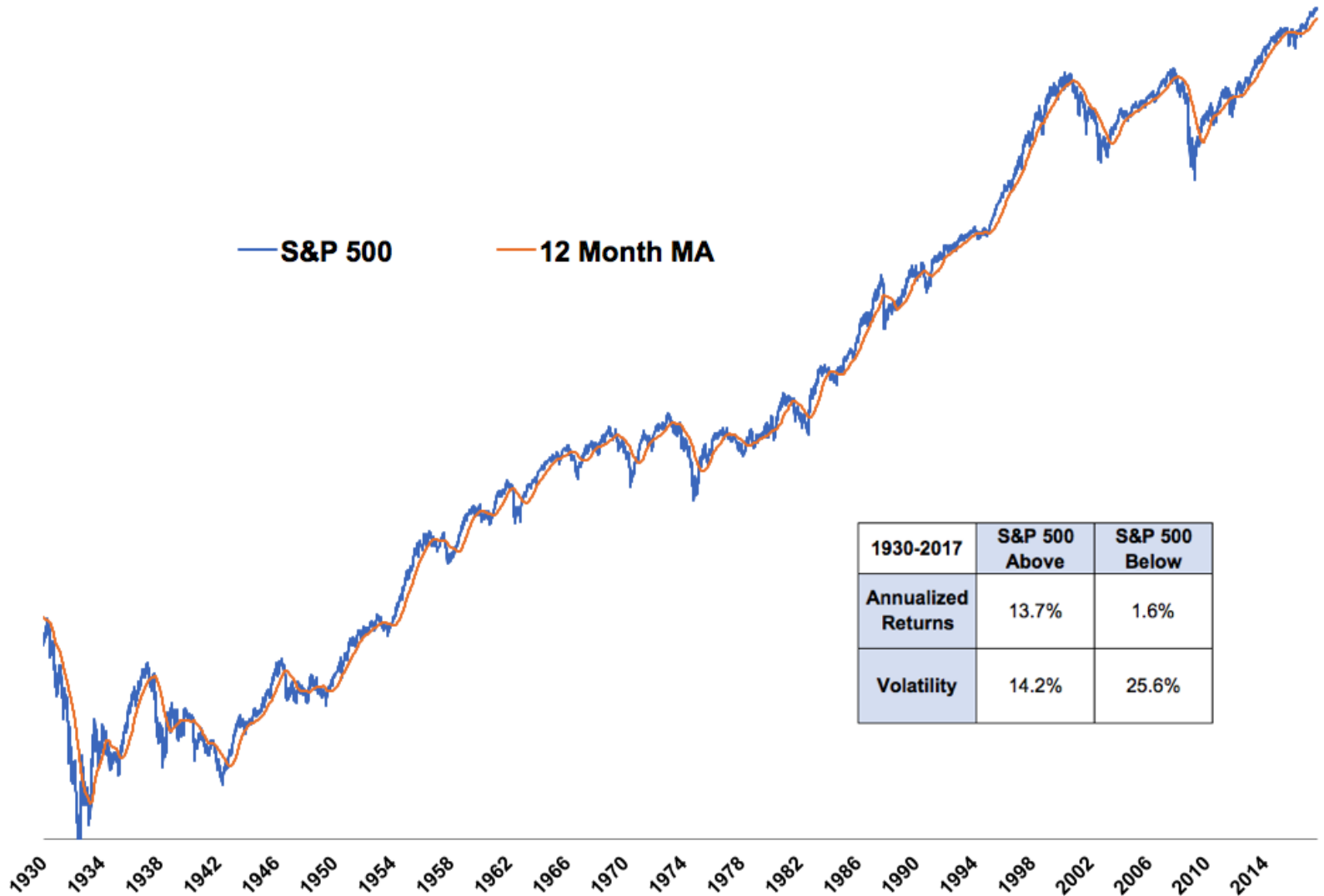
Stock Market Volatility Clusters at the Extremes



Avoiding The Best *and* Worst Months



Trend-Following



Trend-Following

12 Month Moving Average

	Performance			Volatility			Time Spent	
	All	Over	Under	All	Over	Under	Over	Under
1930s	-1.1%	10.4%	-7.6%	37.8%	24.8%	45.7%	44.2%	55.8%
1940s	10.3%	10.2%	7.5%	15.9%	17.1%	14.0%	60.8%	39.2%
1950s	19.4%	22.1%	8.9%	11.8%	12.0%	10.9%	80.0%	20.0%
1960s	7.8%	7.3%	8.9%	12.1%	10.6%	15.1%	67.5%	32.5%
1970s	5.9%	10.7%	0.2%	15.9%	12.8%	19.1%	55.0%	45.0%
1980s	17.5%	19.8%	10.8%	16.4%	16.2%	17.3%	75.8%	24.2%
1990s	18.2%	15.9%	36.9%	13.4%	13.4%	13.5%	88.3%	11.7%
2000s	-0.9%	12.0%	-17.1%	16.1%	9.8%	21.5%	59.2%	40.8%
2010s	13.4%	10.4%	35.7%	12.2%	10.4%	20.3%	86.8%	13.2%
1930-2017	9.7%	13.7%	1.6%	18.7%	14.2%	25.6%	68.1%	31.9%

Why Markets Trend

“Rising prices attract buyers, falling prices attract sellers.”



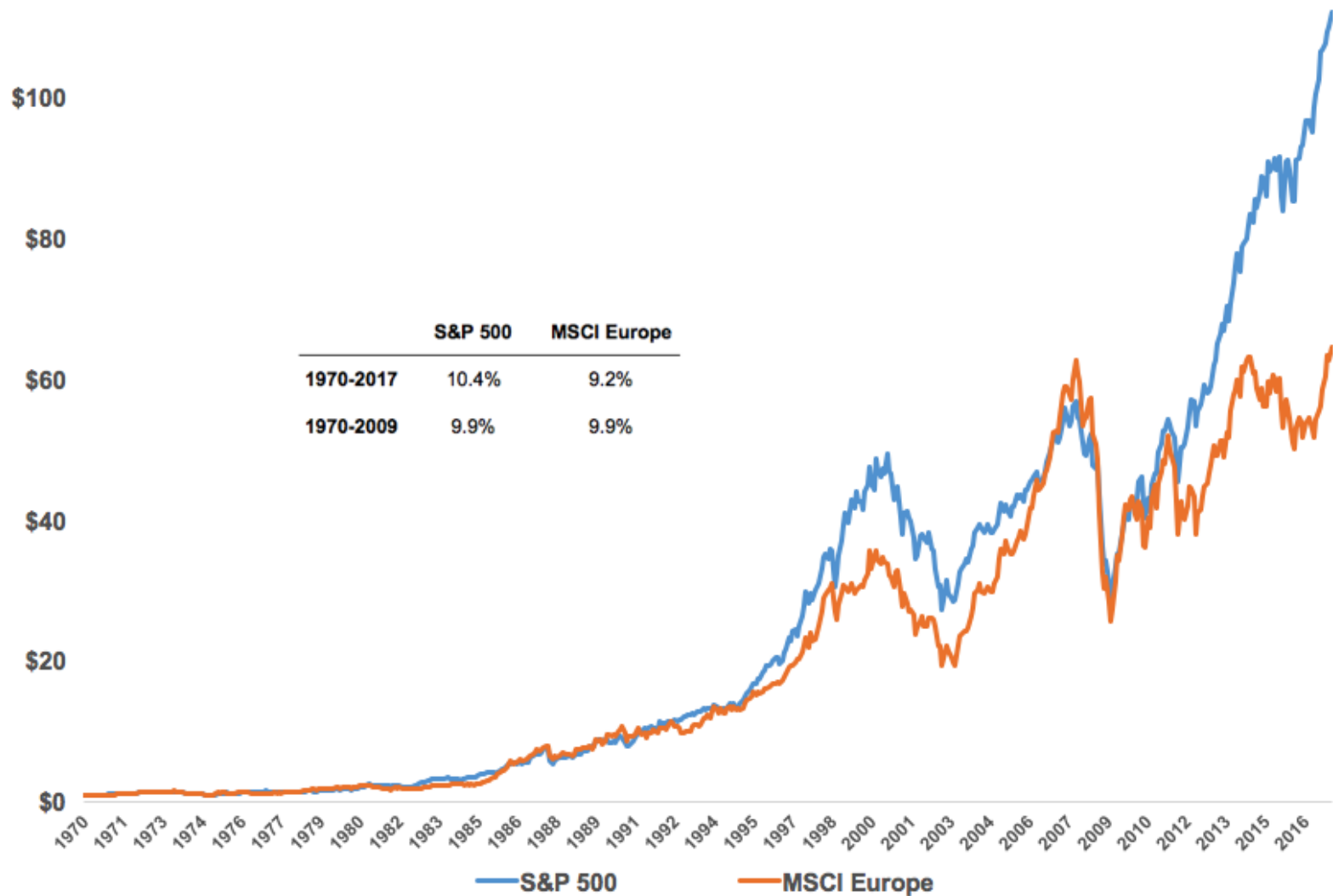
The Lost Decade



Total Returns: 2000-2009



Growth of \$1: U.S. vs. Europe



Diversify Globally

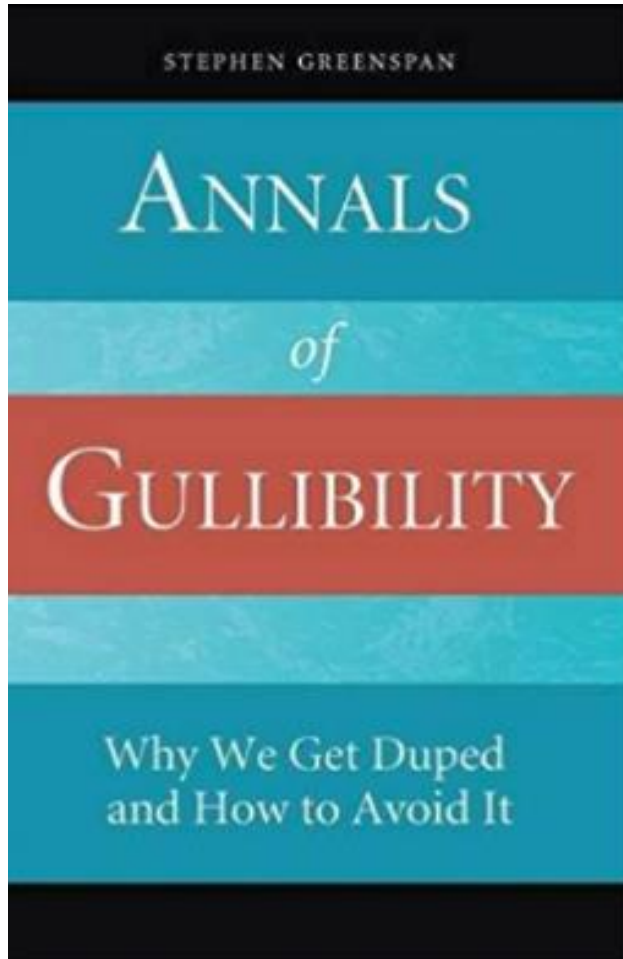
Valuations Through July 2017	United States	Europe	Asia	Emerging Markets
Price-to-Earnings	21.9	19.0	15.9	15.0
Price-to-Book	3.1	1.9	1.4	1.7
Price-to-Sales	2.1	1.3	1.1	1.5
Price-to-Cash Flow	13.5	9.6	7.6	8.3
CAPE Ratio	30.5	17.8	21.9	15.6
Dividend Yield	1.9%	2.7%	2.4%	2.2%
Trailing 10 Year Returns	108.9%	17.3%	27.9%	18.5%

Proxies: SPY, VGK, VPL, VWO



Making Better Decisions

Are You Rational?



Unfortunate Realities of the Investment Business

- A talented sales staff will trump a talented investment staff when attracting \$ from clients
- The products that sound the best are often the worst ones to invest in
- Clients are often in search of unrealistic solutions
- Increased activity does not necessarily lead to better results
- There are no guarantees

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**“I have a diversified retirement plan:
sometimes I wish for money, sometimes
I hope for money, sometimes I pray for money...”**

Everyone Loves a Good Story

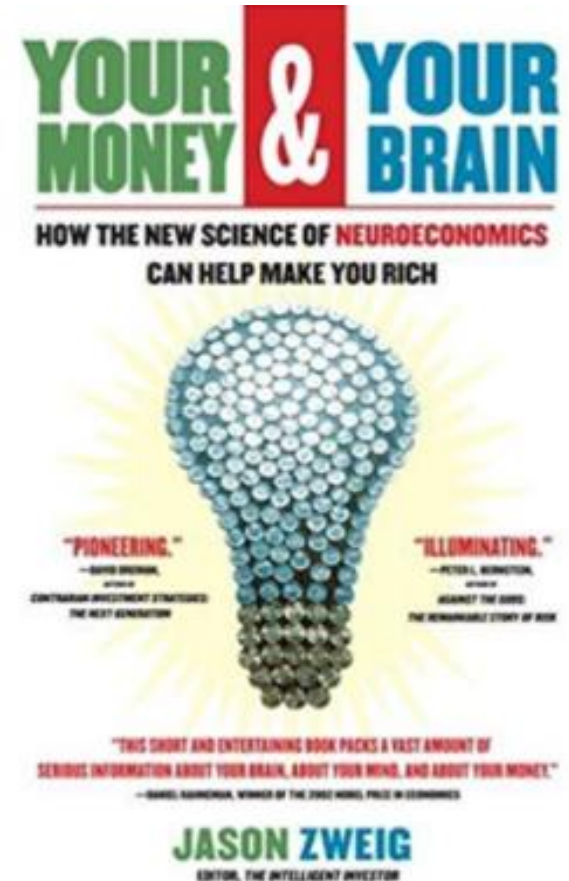


We prefer emotional narratives to accurate data

Stories stick with us not statistics

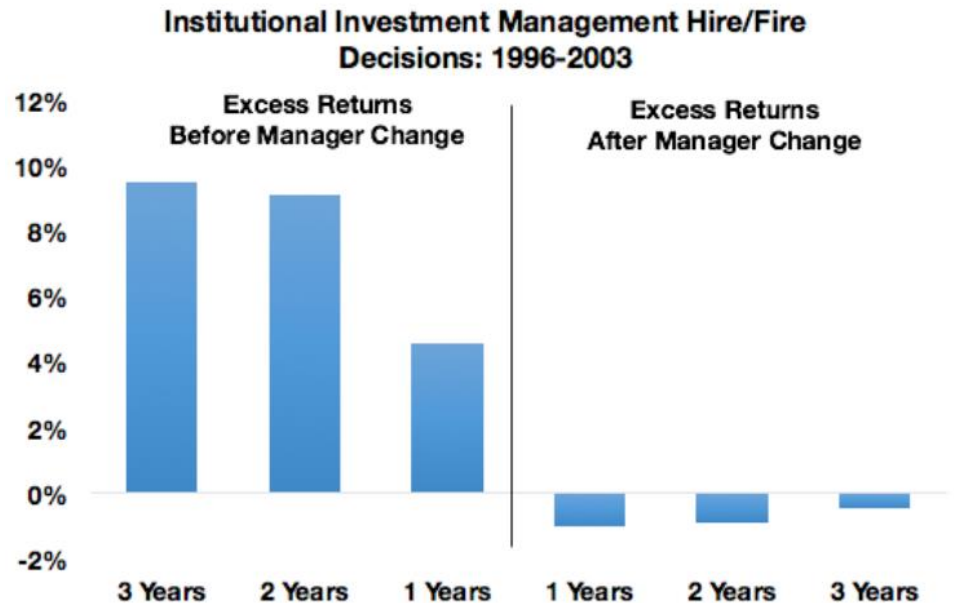
Your Brain on Money

- The brain activity of a person making \$ on their investments is indistinguishable from a person high on cocaine or morphine
- Financial losses are processed in the same area of the brain that responds to mortal danger
- Our brains automatically & unconsciously expect a 3rd repetition after it sees 2 in-a-row
- The anticipation of a gain evokes a much larger response than actually receiving the gain
- The bigger the potential gain the greedier you feel (regardless of how poor the odds might be)



Institutions Chase Performance

Researchers looked at the investment choices from consulting firms that control roughly 90 percent of the U.S. consulting market. They found, **“no evidence that consultants’ recommendations add value to plan sponsors.”** In fact, the average returns were much worse in the funds they recommended than non-recommended funds.



Source: "The Selection and Termination of Investment Management Firms by Plan Sponsors," Amit Goyal, Sunil Wahal (*The Journal of Finance*, Volume 63, Issue 4, printed August 2008). Data: 8,775 hiring decisions by 3,417 plan sponsors delegating \$627 billion in assets; 869 firing decisions by 482 plan sponsors withdrawing \$105 billion in assets. Analysis covers the period 1996 through 2003.

Process > Outcomes

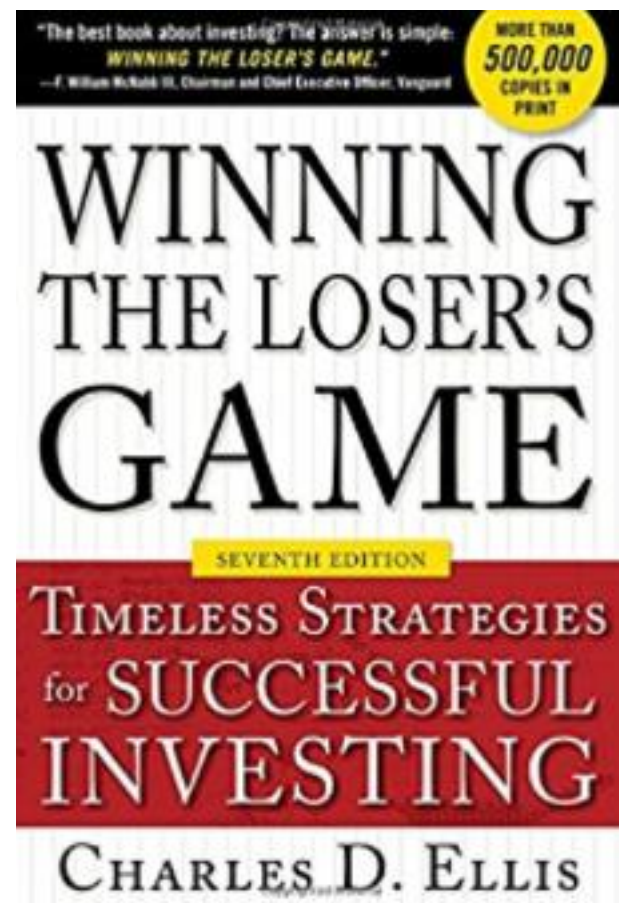
	Good Outcome	Bad Outcome
Good Process	Deserved Success	Bad Break
Bad Process	Dumb Luck	Poetic Justice

Organizational Alpha

- Client education & improved communication efforts
- Behavioral management & modification
- Effective forms of communication
- Setting realistic expectations
- Ensuring alignment of mission & portfolio
- Documenting the investment process
- Saying 'no' over and over again
- Honesty, transparency and the ability to say “we don't know”
- Providing reminders about time horizons & long-term goals

3 Ways to Make Money

- 1. Physically Exhausting:** Work harder than the competition
- 2. Mentally Exhausting:** Be more intelligent than the competition
- 3. Emotionally Exhausting:** Remain more rational than the competition over the long-term



Big Ideas We Believe In

- Investors are compensated for the risks they bear & some risks pay better than others
- While the future is unknowable, the past is a decent guide and you have to always understand the present
- Asset Management has to be tied to goals to work effectively
- Less is more, costs & taxes matter, forecasting is unreliable & performance is mean-reverting
- Client fit is everything
- Behavior will determine client success or failure



Advice That Doesn't Work

“Stay the course”

“Think and act for the long-term”

“Ignore the noise”

“Buy low, sell high”

Clients That Don't Work

- Want all of the upside & none of the downside
- Always want to take part in the latest fad investment
- Pay too much attention to short-term market events
- Care about degree of difficulty & optics
- Are always fighting the last war

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INVESTMENTS AND FINANCIAL PLANNING



**"I retire on Friday and I haven't saved a dime.
Here's your chance to become a legend!"**

Advice That Does Work

- Perform a Pre-Mortem
- Document the Investment Process
- Scenario Analysis
- Checklists
- Consistency & Continuity
- Proactive Communication
- Set Reasonable Expectations Ahead of Time
- Be Humble

Successful Investment Advisors...

Investments and
Financial Planning



"I have a diversified retirement portfolio: 25% down the drain, 40% out the window, 35% gone with the wind."

...manage investors more than investments.

...understand that the long-term is the only time horizon that matters but people don't live life in the long-term.

...obsess about their clients, not their competitors.

...speak in plain English to help their clients understand what's going on with their money.

...help clients focus on those things that they control and ignore everything else.

Questions?



"Any questions?"