Beaumont
CAPITAL MANAGEMENT

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Why Own an Umbrella When it's Sunny Every Day?

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Why would you buy an umbrella when it's been sunny every day? Let's not forget the original use for an umbrella was actually as a sunshade, not for rain, but I digress. Seriously, why would you keep an umbrella in your car, at home or in your golf bag? To state the obvious, it's one thing to get caught in a light shower, but quite another when a squall line or worse moves in. You don't want to get soaked!

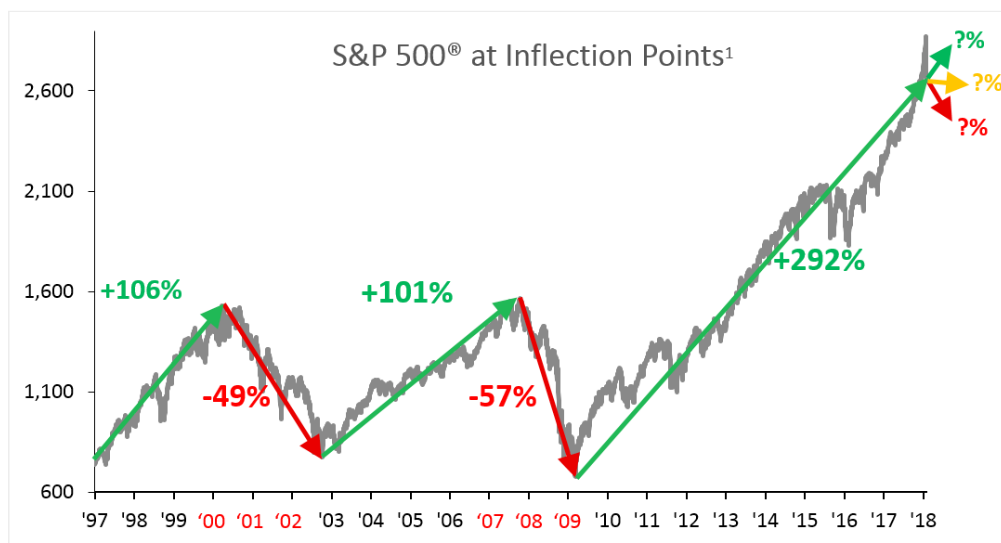
Why do you wear a seatbelt? Why do you wear a life preserver when boating or fishing? Why does a fighter pilot put on a parachute for a routine training mission? We take all of these actions because we are trying to prevent an unforeseen disaster from ruining our future.

Why do you buy insurance? To protect yourself financially if your home, car, income, or other assets were subject to a catastrophic event.

Every day, without thinking about it, we seek to protect ourselves by taking actions or creating a "plan B" in order to avoid or prevent an undesired result. What about your investment portfolio? What actions are you taking to mitigate or prevent a catastrophic bear market from ruining your future financial life?

Ah. You have diversified. Perhaps you have invested some of your portfolio in an annuity or a CD as an anchor to windward. Good, but what about the rest of your portfolio? Do you really mean to have all of it exposed to unlimited loss? What if there was another way?

All of the examples above hopefully describe situations that will never occur or at least do so on an infrequent basis. Yet we take actions to counter them not because they are frequent, but because they are extreme. In the investment world, stocks have historically spent most of their time increasing in value. However, as the chart below shows, there are periods of time when potentially catastrophic losses significantly impact your goals, aspirations and future well-being. What if there was the potential to avoid most of them?



Now let's talk about timing.

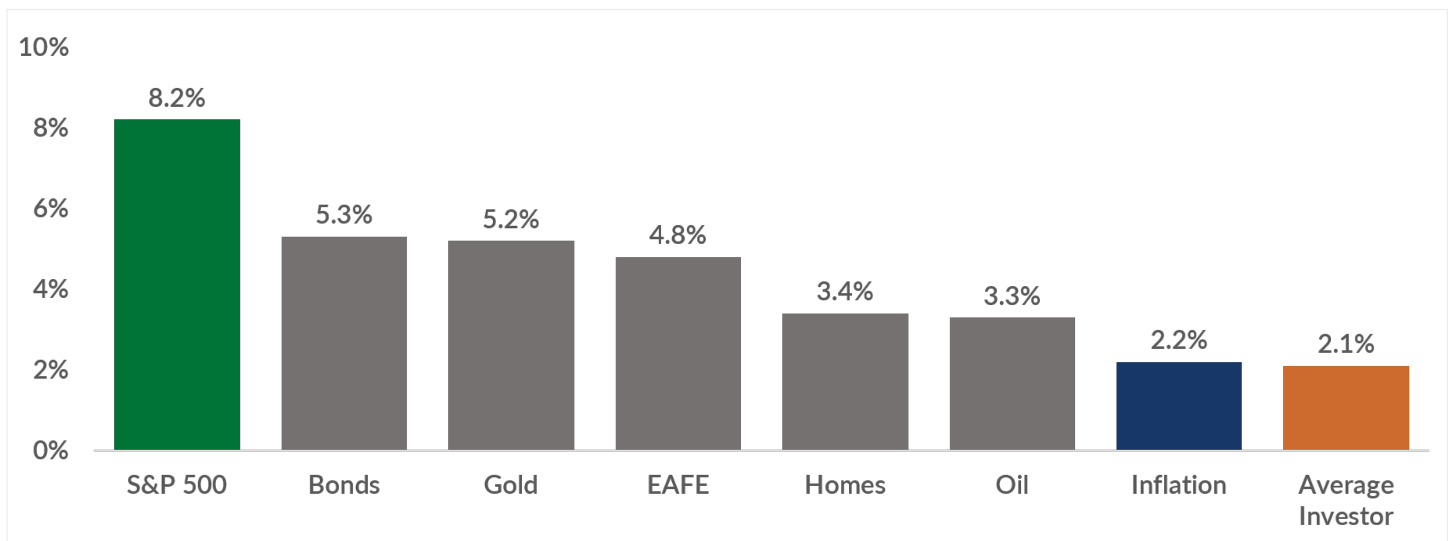
Do you close the barn door after the horse has escaped? Do you buckle your seatbelt after you've hit a pole? Do you insure your home after it has burned down? Of course not! We take all of these actions beforehand in order to protect ourselves from the extreme unforeseen event. So why are you treating your portfolio any differently? Why have you ignored your financial

well-being so completely? Why do you expose the majority of your portfolio to the whims and the risks of the financial markets without even thinking about mitigating large losses?

Welcome to tactical management. First, tactical management is not insurance in any way, shape or form, but the objective is the same: to prevent a large, catastrophic loss from ruining your (financial) life. Like insurance with a deductible, it will not protect you from all loss, but it can, as part of an integrated portfolio, help reduce loss and smooth your overall investment experience. The time to incorporate tactical management is not during or after a bear market, but rather now after we have enjoyed the nine years of growth under the second-longest bull market in the stock market's history. Look at the chart again. What does your intuition say is likely to happen soon? How will you react when the next bear arrives? Be honest, how did you react in 2000-2002 and/or 2007-2009?

Most investors who have not sought any means of protecting their portfolio find themselves not only exposed to the peaks and troughs of the markets movements, but also to their emotional reactions to them. As the DALBAR study below so poignantly outlines, the typical American investor succumbs to their emotions and ends up making one or more poorly timed decisions which have been shown to devastate their investment results over time.

20-Year Annualized Returns by Asset Class[2]



If you would like to see how incorporating a tactical portfolio might help, please click to see a short paper on how to build a portfolio with diversified management styles. There is no magic elixir. No strategy is bulletproof. Yet similar to a seatbelt, parachute or life preserver, a tactical portfolio may not get you out unharmed, but if it works as designed, it will improve the likelihood of achieving your life's aspirations and goals. Why would you ignore a device that can offer such important defensive attributes? Why would you wait to use it until after it's too late?

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[1]Bloomberg. Data as of 2/14/18. The returns shown in the chart are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. The Standard & Poor's (S&P) 500® Index is an unmanaged index that tracks the performance of 500 widely held, large-capitalization U.S. stocks. Indices are not managed and do not incur fees or expenses. "S&P 500®" is a registered trademark of Standard & Poor's, Inc., a division of S&P Global Inc.

[2]DALBAR, Inc. "Quantitative Analysis of Investor Behavior, 2016", www.dalbar.com

Past performance is no guarantee of future results and an investment cannot be made directly in an index. As with all investments, there are associated inherent risks, including loss of principal. Diversification does not ensure a profit or guarantee against a loss.

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