

ADAMS FINANCIAL CONCEPTS NEWSLETTER

Rich Karlgaard, columnist for and producer of Forbes Magazine in the July 25, 2005, issue says this: "Listen up. I've paid for a painful slug of money to learn this, so pay attention. I'm about to share my best piece of investment wisdom: When America's talking stocks, buy real estate; when America's talking real estate, buy stocks."

Barron's, July 25, 2005 quotes Merrill Lynch's David Rosenberg about a housing bubble: "Real estate has accounted for 70% of the rise in household net worth since 2001. Over 40% of private-sector jobs created since 2001 have been housing related. From 1955 to 1995, home prices rose with inflation, or basically 0% in real terms. Since 1996, home values have risen 45% in real terms. End result: a \$5 trillion increase in housing-bubble wealth... National Association of Realtors data show 23% of home sales in the past year were "investor" (read: speculative) based; another 13% were second property..."

It was not that long ago that stocks were touted (falsely, of course) as the investment which were the sure way to wealth. I remember overhearing a conversation between two women in front of me at the grocery store. One was explaining to the other that she was buying stocks using her credit card because paying 18% interest was nothing compared to the money she would make from the stocks she was buying. That was the mentality of the bubble time.

Now, I am hearing similar comments about real estate. I have been told that there may have been a stock market bubble and NASDAQ may have lost almost 80% of its value from the high to the low. But, with real estate, I have been told, property values never lose their value. I am old enough to remember the billboard in 1969 in Seattle that read: "Will the last person leaving Seattle please turn out the lights?" I can remember advertisements for people willing to sell their homes to anyone who would simply take over the payments.

More and more there are articles written on the "real estate bubble." It reminds me of the articles in the late 1990s on the "stock market bubble." There were those, myself included, who warned of a significant drop in the stock market. It seems, now, that the warnings of a bubble burst in real estate are being ignored.

Robert Markham, in his book *Hazardous to Your Wealth, Extraordinary Popular Delusions and the Madness of Mutual Fund Experts*, says this: "The conventional wisdom in the mutual fund world may be conventional, but it's not wisdom. All the fancy charts, arcane terminology, and pseudo-scientific research can't hide one uncomfortable fact: The 'smart money'—the experts—have been turning in crummy results for some time. Followers of conventional wisdom have hit into the investment equivalent of a double play. They've lagged the market when it's gone up, but haven't achieved an offsetting stability on the downside." Simply, most mutual fund and money managers do worse than the market averages. Check your returns and see into which category your investments fall. I think most of my clients at Adams Financial Concepts, and especially those with fee based accounts, even after all fees and expenses have been deducted, will be pleased to see they fall into the top category. It is not an easy task nor do many money managers achieve it.

Why do most money managers and mutual fund managers underperform? Markham addresses a number of conventionally held, widely accepted "core beliefs" that he states are patently false. In the last issue of this newsletter, I summarized Markham's writing on asset allocation. In summary, he stated: "Tactical asset allocation is ultimately disastrous because it perverts the natural order of things. It shifts the focus of a long-term portfolio to the short-term, thus creating a contradiction of purpose that can't help but negatively impact results." (Copies of the newsletter are available upon request. Contact Megan Lockhart at 206-903-1019 or 877-903-1019.)

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Another “core belief” that Markham states is wrongly interpreted is that volatility equates to risk. Markham says: “The conventional wisdom in the investment world says that the more volatile an investment is, the riskier it is. Linking volatility with risk has become so commonplace that we never think to question whether it really is so. But question it we must, for it is the single most damaging investment myth to which you will ever be exposed.

“So. Does volatility equate with risk? Yes, it does. And no, it doesn’t.

“Why the seeming contradiction? Because only when we establish the time frame for an investment can we make a reasonable judgment as to whether volatility adds risk.”

Markham goes on to explain that inflation is the greatest risk an investor faces. A well constructed stock portfolio has a very small risk of each and every stock going to zero. Very small. However, inflation, is nearly always with us. Inflation can eat up part or all of gains in a portfolio, even when the portfolio is showing gains.

What that means can be illustrated by examining two hypothetical portfolios for an investor that is planning to retire in 25 years. This is a long term time horizon. To make it simple, suppose this investor inherits \$100,000 and plans to use that money for retirement. The least volatile portfolio would consist of 90 day T-bills rolled every three months. T-bills paying 3% annually, over the course of 25 years would result in a portfolio value of \$222,130. Alternatively, this investor puts the money into a stock portfolio that has some fairly large up and downs but over the 25 years has an average 9% return. At times, perhaps the portfolio was down 20% or even 25% as we have seen in the past few years. But, if the average is 9% growth per year, at the end of 25 years, this hypothetical portfolio will be worth \$862,310.

That difference between \$222,130 and \$862,310 is really stark. But, when inflation is factored in, assuming 3%, as has been the average over long periods of time, the real after inflation value of the portfolio invested in T-bills is the same \$100,000 in inflation adjusted dollars with which the investor started. There is no real gain in that portfolio.

Markham states: “The really fascinating element here is that over time, the conventionally expected dynamic actually reverses itself. Short term volatile investments are riskier. Long term, stable investments are riskier. This is due to the fact that the greatest risk to long term investors is inflation risk.”

Does more volatility mean more risk? It depends on the time period you, the investor, plan for the investment. If the time period is short, greater volatility does indeed equate to greater risk. If the time period is long, according to Markham, greater volatility equates to less inflation adjusted real risk.

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ABOUT ADAMS FINANCIAL CONCEPTS

Mike Adams established Adams Financial Concepts, LLC primarily for fee-based custom portfolio management. Each and every account is managed to client objectives and goals. Each and every portfolio is specifically designed for the individual client. In addition to all the account statements, confirmations, etc. you would normally receive, you get quarterly performance monitoring so you can compare your account to market guidelines. You will know whether you are making money and how much. You will be able to evaluate how well I manage compared to the market index. You will establish your objectives and policies and will know quarterly whether you are achieving those goals.

Since you will pay a fee rather than commissions, regardless of the number of transactions, there is no difference of interest between your objectives and mine. Both you and I want to see your money do what it should be doing to achieve your long-term investment objectives.

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