

PERSPECTIVE *With* JEFF SARTI



“Those who have knowledge, don't predict.
Those who predict, don't have knowledge.”
— Lao Tzu

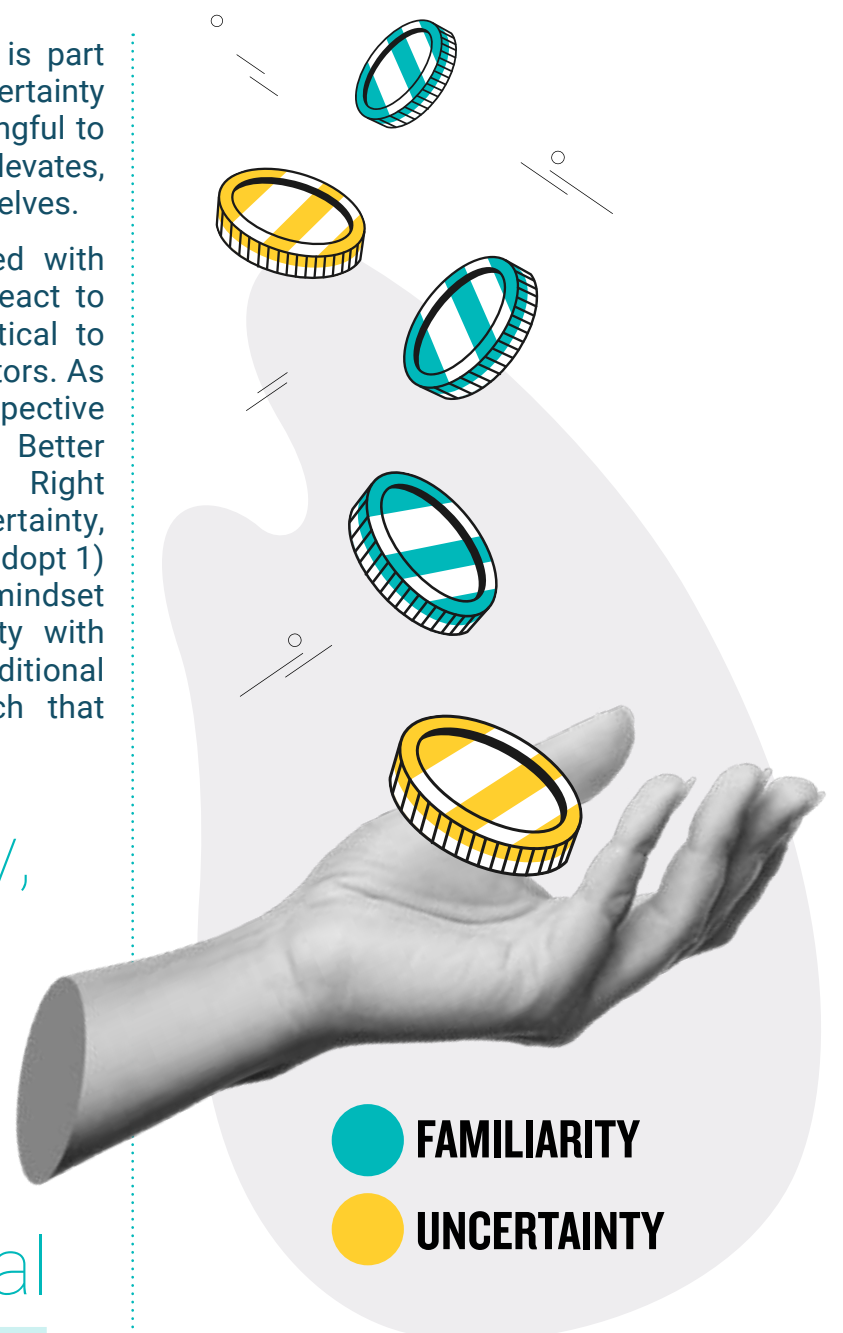
One of the primary goals of this *Perspective* newsletter is to challenge conventional thinking when it comes to sound, long-term investing. In the previous installment, I challenged our natural disposition towards familiarity and how its emotional lure can often instill a false sense of confidence and guide us down a flawed investment path.

What is the flip side of familiarity? Uncertainty. While we seek out what is familiar, we often avoid what feels uncertain. On one hand, when uncertainty is benign and unthreatening, we may be drawn to it because the unknown adds spice to our daily lives. For instance, when you are watching a movie, you don't want to know in advance how

the movie ends. The unknown is part of the fun. However, when uncertainty threatens things that are meaningful to us, that's when our heart rate elevates, and we scramble to protect ourselves.

The world of investing is filled with uncertainty. And it's how we react to this uncertainty that is so critical to our long-term success as investors. As I've described in previous *Perspective* letters, our formula for the Better Investor = Right Mindset + Right Strategy. When faced with uncertainty, investors can either choose to adopt 1) a more common (and easier) mindset of trying to reduce uncertainty with predictions or 2) an untraditional and more thoughtful approach that embraces uncertainty. ■

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Common Approach

It's completely understandable that most investors feel unsettled when faced with uncertainty, as it can feel overwhelming to be faced with an unpredictable future where the economy or stock market can move in a variety of different directions outside of our control. When I meet someone new and they learn about what I do for a living, the most common question I get is, "How are stocks going to do over the next year?" After all, I am the "expert" who can reduce their anxiety by bringing certainty and answers to the mix.

Yet it's exactly this anxious mindset that results in building a flawed investment strategy that aims to regain control in an otherwise unpredictable world. Our whole industry is built on the flawed premise that our purpose as financial advisors is to predict the future and devise an investment strategy that will "win" if our predictions are correct. Here's the harsh truth: no one has a crystal ball or can accurately predict the future on a consistent basis.

Countless studies have borne this out. For example, a recent study by the CXO Advisory Group investigated over 6,000 stock market forecasts over many years from 68 "experts," well-known throughout our industry. The results? Slightly worse than a coin flip, with 47% of forecasts being accurate.

What about our policymakers? Don't even get me started with their track record regarding the future path of the economy. In 1927, shortly before the epic 1929 stock market crash, famed economist John Maynard Keynes confidently claimed, "We will not have any more crashes in our time." How about recent Federal Reserve Chair

Ben Bernanke in 2007, prior to the Great Financial Crisis of 2008: "We do not expect significant spillovers from the subprime housing market to the rest of the economy or to the financial system." Let's not forget our current Fed chair Jerome Powell's claim several years ago that inflation would be "transitory."

If even so-called market experts and policymakers have no ability to predict the future, what is the solution to protect ourselves from the uncertainty that persists? ■



Thoughtful Approach

The thoughtful mindset is actually quite simple: embrace uncertainty. Instead of fighting uncertainty and obsessing over how to "beat" the markets and "time" its unknowable ups and downs, lean into the unknown. Acknowledge that the complexities of our modern world are too numerous to count and trying to outsmart an unpredictable future is a fool's errand.

This may sound a bit nihilistic, but I am not suggesting that we simply put our hands up and relinquish control to the unstable world around us. Instead, I'm suggesting that a thoughtful investment approach can improve the odds of investor success without requiring accurate predictions about the economy or markets. I'm not a surfer (the California Pacific is too cold for me!) but I'll use this surfing analogy to illustrate this approach.

Waves are an appropriate comparison to the stock market and the economy since

they are fluid, unpredictable and potentially violent. Catch the perfect wave and the ride can be exhilarating. But one misstep can result in a harrowing crash. Boom or bust.

Investing is very similar to riding waves. The "common approach" is based on making the right move at the right time. Most investors will try to time the next wave perfectly and outsmart the investing landscape that lies in front of them. Buy stock X because you think it's got great growth prospects and can withstand the waves ahead. Or focus on a certain stock industry that will outperform others at just the right time. But this is truly "coin-flip" investing, where 50/50 odds are the norm.

If you would rather play it safe, many head to shore and wait for the tide to subside. In investing, this is when most move to cash or buy bonds and wait for the perfect time to get back in the water. Two choices:

brave the waves or head to shore. Stocks or bonds. That's it.

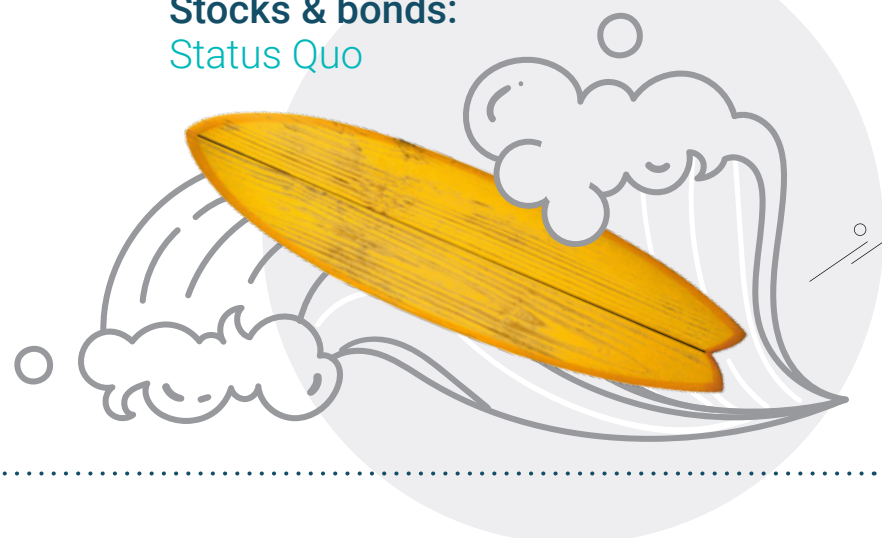
But protecting and growing your nest egg is not a game. The goal is not to perfectly time the next wave for a thrill ride, but to stay in the water and consistently generate returns over years and even decades. But how do you stay calm in the water when uncertainty abounds? You ditch the status quo of the surfboard and craft a vessel that is appropriate for you. A buoyant boat made to be resilient, with built-in contingencies like life rafts and communication systems in case the unforeseen happens. And you might as well make it robust, bigger than the waves themselves.

This is how we build portfolios. We don't simply stick with a surfboard (stocks and bonds) because that's what our industry tells us to do. Nor do we have the audacity to believe that we can time the market perfectly. Instead, we embrace the uncertainty and construct portfolios like resilient vessels, built to withstand waves of all shapes and sizes. No crystal ball required. The key to this approach is our passion (outright obsession!) with diversification. ■

Embrace uncertainty: Diversification



Stocks & bonds: Status Quo



Rethinking Diversification

Diversification is a term that, while broadly used in our industry, is wildly misunderstood. Most have the simplistic view that as long as you own a number of stocks across a handful of different industries, you are properly diversified. But tough times in the market (2008 or 2022 as recent examples) show that when challenging markets rear their ugly heads, most stocks go down together, no matter what industry they are in. Others further "diversify" by incorporating bonds into their portfolio as well. But in an inflationary environment with rising interest rates, bonds do poorly too. A perfect example of this was 2022, with the broad-based bond index down 13%. Stocks and bonds alone simply don't cut it.

When we diversify at Morton, we target asset classes that will behave differently than stocks and bonds in a variety of different environments. A good test of this strategy was in 2022, when many of these other investment types marched to the beat of their own drummer and performed well in an otherwise difficult environment. In my next *Perspective* newsletter, I'll go over examples of these more resilient investments, but the key point is that there are a number of them. True diversification for us is not just sprinkling a couple of investments beyond stocks and bonds into the mix, but incorporating a multitude of investments that are designed to behave differently from one another. We'll be interviewing many managers of

these various investment types at our symposium on October 12 so please RSVP if you haven't already.

At first, acknowledging the uncertainty in the markets can feel unsettling and humbling. Most counter these fears through seeking control and devising strategies where predicting the future is their key to success. We take a very different approach, where we embrace the uncertainty and build an investment strategy with a bigger boat that can withstand rough waters. Whether the seas are calm or unexpected storms arise, our goal is for you to stay in the water and still sleep well at night, knowing that your nest egg is being cared for by your stewards at Morton Wealth. ■

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