

February 7, 2018

Re: Letter to the Households I Serve

In just six trading days, the U.S. stock market (S&P 500 Index) lost over 8% before reversing and ending 1.75% in the green yesterday. This experience should serve as a good reminder that “stocks take the stairs up and the elevator down,” which has been easy to forget considering the record low volatility we’ve enjoyed for the last two years. Expect bigger daily moves in both directions going forward.

After a experience like that of the last few days, hopefully we are all reminded of why we take a diversified approach.

The investing environment over the last few months has been one characterized by investors, in fear of missing out (FOMO), chasing returns and ignoring risk. After all, risk has been non-existent for so long many have forgotten what it feels like. When the market hits “air pockets” the latecomers are the first to rush for the exits. Sadly, markets often find a bottom then rebound at that point, which exacerbates those investors’ frustration as they end up buying high, selling lower, and then miss the rebound. This whipsaw effect is what destroys their returns over time and eventually drives them away from stocks altogether.

A profitable trade over the last year has been to short volatility. Some of us, including yours truly, understood that strategy was like picking up pennies in front of a bulldozer. Well sure enough, many of these “short vol” products went bankrupt over the last couple days. Investors in these strategies lost 90%-100%. We’ve already heard some stories about hedge funds and individual investors losing huge sums of money and will surely hear more in the coming weeks.

For most of you, we have prepared / updated your long-term financial projections and financial plans in the last year. You’ll recall that those projections greatly inform the portfolio construction process as my goal is to find the “sweet spot” that maximizes your probability of achieving financial independence in good markets but also through bad bear markets.

Because of this laser focus on helping you achieve your financial goals, which is my primary objective in working with you, I am compelled to manage *risk* as opposed to maximizing returns at all costs. If risk is well-managed, the returns will follow over a full market cycle. Hopefully that approach has been validated in the last week, which is only a preview of what stocks are capable of at the end of the cycle.

The point here is that the approach to constructing your portfolio is informed and methodical. I emphasize this because in the coming months there will be moments where you will be tempted to buy more stocks and other moments when you will be tempted to sell stocks. Just remember your goals and how we came upon your investment strategy in the first place.

Some suggestions on the next page...

Outside the portfolio: Continue knocking out debt and ensuring you have healthy cash reserves. For retired folks that means 1-2 years of expenses in cash reserves. The rationale for paying off debt is you can guarantee yourself the interest savings no matter what the market does. It'll feel a lot better when the market is falling if you've paid down debt.

Within the portfolio: The key will be to remain disciplined throughout. A client shared a great quote with me yesterday morning,

"Yesterday the market didn't get tested – you did."

"You," of course, applies to all of us. If you thought the losses of the last few days proved too great, provoked too much anxiety, caused you to lose sleep, caused you to worry about whether or not you'd be able to fulfill your financial goals, etc... let me know. We can revisit your financial projections, rerun the market stress tests and discuss whether or not a change is warranted.

These suggestions will help you become financially "bulletproof!"

I know I've been communicating a lot lately. One of the biggest complaints clients have about advisors in this industry is that advisors are often inaccessible or unresponsive. So, I'd rather *over-communicate* than *under-communicate*.

I am here. I'm accessible and always responsive to your questions and concerns almost no matter the time of day or night. Whatever the rest of the year brings, I will be here helping you through it.

Disciplined investors are successful investors, but we all need a little help staying the course from time to time. That is part of the value I provide that you can't get on your own. My primary goal is to give you best shot of *becoming* and *remaining* financially independent!

Thank you all for your trust, support, and confidence.

Kindest Regards,

A handwritten signature in blue ink, appearing to read "Ken" followed by a stylized flourish.

Ken