Kirkpatrick Wealth Update

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Timing the Market and Chasing Hot Stock Tips can be bad for your Wealth

Kirkpatrick Wealth Management of

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A disturbing trend…

A few investors asked if we should sell all of our US holdings and others asked about investing in speculative stocks.

As a refresher, I thought I should share my investment philosophy: *diversify by geography, sector and asset class, rebalance once per year, keep costs low, be tax effective, stay out of negative territory, grow and compound wealth over the long term and do not let short term events or human emotion erode said plan.*

Clearly investors are concerned about the recent events in the USA and elsewhere. At the core of all of these inquiries rests the idea of timing the market (or a stock). To act on these impulses would suggest that we know something that the market does not know and that we are able to time when to get in (or out) of said market, sector, or stock and then later sell (or buy back) at the right time and make a good profit.

Where were these emails in 2015?

I do find it interesting to note that I did not get emails with requests such as these after 2015 when the Canadian market (the TSX) was down 9%. Now, after 2016 when the TSX is up 21%, is it possible that folks are more confident in their stock picking/timing skills? Perhaps a neighbor has done really well off of a small cap commodities stock or perhaps a co-worker did well with a marijuana or technology stock and all of this talk about easy money being made is giving folks the impression that anyone can make money without taking on much risk? This thinking is inadvisable and can lead one's portfolio down a dangerous path.

Let us take a moment and examine the possible outcome of following this path:
An investor says "hey I want to throw $5k at this great idea/stock I heard about from a friend." Maybe the stock goes up maybe it doesn't. Next year, same thing, another $5k goes into another "great idea". After 10 years of this we no longer have a balanced portfolio. What we end up with is a collection of "great ideas" that did not pan out. The money that was invested has now depleted. Sadly, all of the growth and dividends we could have collected on that money is long gone. Then the investor wonders, "Why is my portfolio doing so poorly compared to the TSX?" and, "Why didn't I just own the TSX?"
As your advisor, I would not allow this to happen.

Let's now analyze the US scenario. The question was: "Should we sell all of our US stocks?" While many may not support the current political environment in the USA, it would be unwise to let these emotions affect the future of our portfolio. What do we think is going to happen to the US? What do we think will happen to some of the greatest companies in the world (Google, Walmart, Coke, Johnson and Johnson)? Where do we think their stock prices will be in ten years? (response: most likely higher) Do we think their dividends will be higher or lower in ten years? (response: most likely higher) Keep in mind that these companies earn revenues internationally and that they just happen to have their head office located in the US.

If the root of the question is about rate of return and how to best diversify, protect and grow your money then consider the following:

Attached is an excerpt from the Berkshire Hathaway annual report, which was written in Feb 2016.
On page 8 Warren Buffet wrote:
"for 240 years it's been a terrible mistake to bet against America, and now is no time to start."
On page 20 he lists all of the US stocks he owns: $112 338 000 worth of US shares which he has no intention of selling. On the contrary, he will add to them as he reinvests their dividends. Also note that he owns more assets in the US. This is a snippet of his stock holdings which he is not actively involved in.

I am in agreement with Warren Buffet. We own reputable companies and I have great confidence that in 10 years they will be making more money and paying more dividends than they currently are today.

Here are a few quotes that are timely for this discussion:

“The four most dangerous words in investing: ‘this time it’s different.’”
- Sir John Templeton

"We continue to make more money when snoring than when active."
-Warren Buffet 1996 Annual Report of Berkshire Hathaway

We will now look at the idea of being proficient at timing the market and picking small cap stock winners.

By pulling money out of the US or buying a speculative stock we are essentially saying that we are able to time the market. When the market or stock has moved favorably in our direction and we’ve made lots of money we would then repeat this simple process year in and year out.

The trouble is that it’s not that simple. On the attached 2016 SPIVA Canada Scorecard on page 8 of 14 we see how active managers performed against their benchmark. We can see that over the past 5 years only 28% of active managers beat the S&P/TSX and that 0% beat the S&P500. Keep in mind these are professionals who spend all of their time and resources trying to outsmart other investors, pick winning stocks, and ultimately beat the market... and yet most of them fail.

In conclusion, attempting to time the market or chase after hot stock tips can be bad for your wealth.

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America's population is growing about .8% per year (.5% from births minus deaths and .3% from net migration). Thus 2% of *overall* growth produces about 1.2% of *per capita* growth. That may not sound impressive. But in a single generation of, say, 25 years, that rate of growth leads to a gain of 34.4% in *real* GDP per capita. (Compounding's effects produce the excess over the percentage that would result by simply multiplying 25 x 1.2%.) In turn, that 34.4% gain will produce a staggering $19,000 increase in *real GDP per capita* for the next generation. Were that to be distributed equally, the gain would be $76,000 annually for a family of four. Today's politicians need not shed tears for tomorrow's children.

Indeed, most of *today's* children are doing well. *All* families in my upper middle-class neighborhood regularly enjoy a living standard better than that achieved by John D. Rockefeller Sr. at the time of my birth. His unparalleled fortune couldn't buy what we now take for granted, whether the field is – to name just a few – transportation, entertainment, communication or medical services. Rockefeller certainly had power and fame; he could not, however, live as well as my neighbors now do.

Though the pie to be shared by the next generation will be *far* larger than today's, how it will be divided will remain fiercely contentious. Just as is now the case, there will be struggles for the increased output of goods and services between those people in their productive years and retirees, between the healthy and the infirm, between the inheritors and the Horatio Algers, between investors and workers and, in particular, between those with talents that are valued highly by the marketplace and the equally decent hard-working Americans who lack the skills the market prizes. Clashes of that sort have forever been with us – and will forever continue. Congress will be the battlefield; money and votes will be the weapons. Lobbying will remain a growth industry.

The good news, however, is that even members of the "losing" sides will almost certainly enjoy – *as they should* – far more goods and services in the future than they have in the past. The quality of their increased bounty will also dramatically improve. Nothing rivals the market system in producing what people want – nor, even more so, in delivering what people don't yet know they want. My parents, when young, could not envision a television set, nor did I, in my 50s, think I needed a personal computer. Both products, once people saw what they could do, quickly revolutionized their lives. I now spend ten hours a week playing bridge online. And, as I write this letter, "search" is invaluable to me. (I'm not ready for Tinder, however.)

For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs. America's social security promises will be honored and perhaps made more generous. And, yes, America's kids will live far better than their parents did.

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Considering this favorable tailwind, Berkshire (and, to be sure, a great many other businesses) will almost certainly prosper. The managers who succeed Charlie and me will build Berkshire's per-share intrinsic value by following our simple blueprint of: (1) constantly improving the basic earning power of our many subsidiaries; (2) further increasing their earnings through bolt-on acquisitions; (3) benefiting from the growth of our investees; (4) repurchasing Berkshire shares when they are available at a meaningful discount from intrinsic value; and (5) making an occasional large acquisition. Management will also try to maximize results for *you* by rarely, if ever, issuing Berkshire shares.

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding because we are part of a control group and account for it on the "equity" method.

			12/31/15	
*Shares***	*Company*	*Percentage of Company Owned*	*Cost**	*Market*
			(in millions)	
151,610,700	American Express Company	15.6	$ 1,287	$ 10,545
46,577,138	AT&T	0.8	1,283	1,603
7,463,157	Charter Communications, Inc.	6.6	1,202	1,367
400,000,000	The Coca-Cola Company	9.3	1,299	17,184
18,513,482	DaVita HealthCare Partners Inc.	8.8	843	1,291
22,164,450	Deere & Company	7.0	1,773	1,690
11,390,582	The Goldman Sachs Group, Inc.	2.7	654	2,053
81,033,450	International Business Machines Corp.	8.4	13,791	11,152
24,669,778	Moody's Corporation	12.6	248	2,475
55,384,926	Phillips 66	10.5	4,357	4,530
52,477,678	The Procter & Gamble Company	1.9	336	4,683 ***
22,169,930	Sanofi	1.7	1,701	1,896
101,859,335	U.S. Bancorp	5.8	3,239	4,346
63,507,544	Wal-Mart Stores, Inc.	2.0	3,593	3,893
500,000,000	Wells Fargo & Company	9.8	12,730	27,180
	Others		10,276	16,450
	Total Common Stocks Carried at Market		$ 58,612	$ 112,338

* This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required under GAAP rules.

** Excludes shares held by pension funds of Berkshire subsidiaries.

*** Held under contract of sale for this amount.

Berkshire has one major equity position that is not included in the table: We can buy 700 million shares of Bank of America at any time prior to September 2021 for $5 billion. At yearend these shares were worth $11.8 billion. We are likely to purchase them just before expiration of our option and, if we wish, we can use our $5 billion of Bank of America 6% preferred to fund the purchase. In the meantime, it is important for you to realize that Bank of America is, in effect, our fourth largest equity investment – and one we value highly.

REPORTS

Report 1: Percent of Active Funds Outperforming Index

This report shows the percentage of funds that have outperformed their comparable benchmarks over one-, three-, and five-year periods. The comparison starts with the funds in a category at the beginning of the period. At the end of the period, the report shows what percentage of funds have survived and outperformed their benchmark. The fund's category at the end of the period is not considered because the category at the beginning of the holding period is of interest.

Most reports that purport to show the percent of active funds outperforming an index work with the funds in a category at the end of the period and then compare their historical returns to the benchmark. The SPIVA Canada Scorecard corrects for this survivorship bias by starting with the funds at the beginning of the period.

Report 1: Percentage of Funds Outperforming the Index

FUND CATEGORY	COMPARISON INDEX	ONE-YEAR (%)	THREE-YEAR (%)	FIVE-YEAR (%)
Canadian Equity	S&P/TSX Composite	26.42	23.08	28.77
	S&P/TSX Capped Composite	26.42	23.08	28.77
Canadian Small-/Mid-Cap Equity	S&P/TSX Completion	31.43	57.14	48.57
Canadian Dividend & Income Equity	S&P/TSX Canadian Dividend Aristocrats	37.84	34.21	13.21
U.S. Equity	S&P 500 (CAD)	6.17	1.20	0.00
International Equity	S&P EPAC LargeMidCap (CAD)	42.50	28.57	13.64
Global Equity	S&P Developed LargeMidCap (CAD)	29.82	11.20	6.82
Canadian Focused Equity	50% S&P/TSX Composite + 25% S&P 500 (CAD) + 25% S&P EPAC LargeMidCap	19.40	4.23	7.69

Source: S&P Dow Jones Indices LLC, Fundata. Data as of June 30, 2016. CIFSC categorizations are used. Financial information provided by Fundata Canada Inc. Table is provided for illustrative purposes. Past performance is no guarantee of future results. Benchmarks used are total return indices.