JOPPA MILL ADVISORS LTD.

What is the Most Important Thing an Advisor can do for me?

1. Call me with specific “hot” investment recommendations to make money.
2. Keep me abreast of market developments and provide ideas so I can make my own investment decisions (and be “The Guy” that “knows the market as well as Jim Cramer”, host of CNBC’s “Mad Money”.)
3. Assist me with understanding, thinking rationally and controlling what I can control in the financial sphere.
4. Help me develop a plan for managing my money and funding my lifestyle after I move on from full time employment (some people call this “retirement”!)

Makes you stop and think, doesn’t it! Of course we all want #1; after all, what else is he doing all day, watching the market and researching stocks or sectors or something… This was the model Wall Street was built on; an army of brokers pounding the phones,

> *“Hello Mr. Smith. Bob Jones with Morgan Lynch here. Our analysts have identified tremendous opportunity to make some money in [name of IPO or Hot Stock here]. It’s coming public/trading at $12.50 and we see this going to $28.00 over the near term. This is a leader in an industry that’s growing. Demand is very strong. How many shares can I put you down for…?”*

The problem with this is two fold. The “hot tip” may not pan out. Did you expect the broker to call when it’s time to SELL? The other issue is this provides no context – how does this investment fit into your overall portfolio and financial picture?

You may or may not have read that this week, Merrill Lynch has changed its training program for brokers. Among other changes, there will be no more cold-calling! Instead trainees are encouraged to use Linked-In (yes, Social Media!) to develop leads and referrals from Bank of America. No longer playing the “hot stock” game, Merrill is focused on gaining wallet share.

The advent of discount brokerages, led by Charles Schwab in 1975, has fostered confidence with the notion of self directed investments among the current generation investing in the financial markets on their own. The introduction of 401k Plans in 1978 served to reinforce everyone’s interest and participation in the markets. Now, each individual is responsible for his or her OWN retirement income; pensions have gone the way of buggy whips. Employer matches are the <u>only</u> free money I have ever found to exist and the power of compounding has allowed our retirement plan to grow exponentially over the years (some years more so than others!)

Being attuned to global current events; social, political and financial, is crucial to understanding where we are headed. Does the stock market as a whole, or specific industry sectors face tough sledding or a wind at their back. Context is important in investing, just as it is in communicating with others. Intonation can alter the meaning of words, turning a factual statement or question into a snarky jibe. Most commentators are obsessed with narrating intra-day market moves, sounding as though they are somehow privy to the latest moves the "big names" on Wall Street are making. While this all, knowing speculation fills the airwaves and makes for compelling cocktail party conversation, this is hardly the time horizon with which investors are concerned. All of it amounts to little more than angst-provoking noise.

Even the most revered investment theory is subject to the limitations imposed on the marketplace by current events. Historically, the role of fixed income securities (bonds) was to provide modest current income and a degree of stability in one's portfolio to offset the inherent volatility of the stock market. The diversification afforded by allocating assets across several assets is a fundamental tenet of Modern Portfolio Theory [MPT] first published by Harry Markowitz in 1952 and a core component of every business school curricula. MPT is at the heart of every asset allocation model in use today. In the early 1980's, with inflation running at 7%, this historical role of fixed income (bonds) in a portfolio failed to provide investors with the sought-after benefits as bond prices plunged and the yield on the10-year U.S Treasury reached 15.8%[1] Can you imagine the implications if you had retired in the mid-'80s, drawing on your retirement savings at the nadir of the bond market? Yes, mindfulness of the current relevant socio-political influences is important! Set it and forget it 401ks, the premise behind Target Date funds is easy, but certainly not an assurance of a desirable outcome!

Thinking rationally and un-emotionally is an essential element of successful investing. Previous "Grist from the Mill" articles have illustrated the potential risks that stem from our behavioral biases – Fear of Missing Out ("FOMO"), Loss Aversion, Recency bias, Confirmation bias, etc… The critical assumption underlying virtually all economic theory and especially Modern Portfolio Theory is that we are <u>rational</u> actors. Over forty years experience in the market has repeatedly demonstrated to me that this is NOT the case! For a more immediate insight, AMC Entertainment (the movie theater company founded in 1920) has reported net operating losses in 3 of the last five years, a negative Return on Assets and a negative profit margin, yet the stock has gained 900% since June 2020. Rational? Absolutely not! Reddit and Wall Street Bets version of "pump and dump" (recall the movie "<u>Boiler Room</u>"?)

We cannot control the market. We CAN control our spending, saving and how we allocate our assets.

Have you ever set out on a trip without a destination in mind? If you have not traveled the route previously, do you rely on a map, either in paper form or, more likely today, GPS on your phone or in the car? So, why would you embark on one of the most important financial journeys of your life without a plan? Simple. Painfully obvious. How come so few people actually perform this exercise? Life events alter our plans. Circumstances change. How do you respond? If the variables are changing, why do you think they won't have an impact on your financial future –

perhaps at a point when you have fewer choices or a shorter runway to address any short-comings?

What is the most important thing an Advisor can do for me? – ANSWER KEY

Howard Marks, Co-Chairman of Oaktree Capital Management, is considered to be one of the great investment minds of our time among investment professionals. His periodic Memos to Investors are highly anticipated and broadly read (perhaps even more broadly than the famous Warren Buffet's Berkshire Annual Report). In his book, ***The Most Important Thing*,**[2] Howard draws on four decades of observations and insights with the intent to present the building blocks underlying his highly successful investment philosophy in a manner that would benefit the average investor. The inside joke is that there is no single Most Important Thing!

I believe that the essence of Howard's book (broadly summarized below) affords the optimal answer to the question posed at the outset:

- The most challenging and essential aspect of investing is managing risk.
    - **"The possibility of permanent loss is the risk I worry about."**
    - The most important thing is controlling risk. Over an entire investment career, the amount and size of investment losses will most likely have more to do with returns than the magnitude of winners.

- Be aware of what is taking place in the world and where the result may lead.
    - **"We may never know where we're going, but we'd better have a good idea where we are. That is, even if we can't predict the timing and extent of cyclical fluctuations, it's essential that we strive to ascertain where we stand in cyclical terms and act accordingly."**
    - The most important thing is having a sense for where we stand. We need to be aware of the current environment. Is the outlook for the economy positive or negative? Are the capital markets loose or tight? Are risk spreads narrow or wide? Are investors eager to buy, or eager to sell? Are asset prices high or low?

- Understand the limitations of investment theory and market efficiency
    - **"No rule always works. The environment isn't controllable, the circumstances rarely repeat exactly. Psychology plays a major role in markets, and because it's highly variable, cause-and-effect relationships aren't reliable."**
    - You have to think beyond the obvious (first level thinking). The first level thinker sees favorable circumstances and decides to buy. The second level thinker sees that the investment is over hyped and too expensive to provide a margin of safety.

There are many ways in which one can work with an Advisor; however, essential to success is a mindfulness of the current market environment, guarding against potentially adverse behavioral biases and, most of all, managing risk.

My hope and intention is that through your relationship with Joppa Mill Advisors YOU find that you are being well-served by our focus on these Most Important Things as we invest for your future.

[1] https://www.macrotrends.net/2016/10-year-treasury-bond-rate-yield-chart
[2] The Most Important Thing: Uncommon Sense for the Thoughtful Investor (Columbia Business School Publishing), May 2011