FALL 2017

THE JENTNER REPORT

Wealth Management Strategies from Jentner Wealth Management

INSIDE THIS ISSUE

Warren Buffett's Million-Dollar Bet

There has been much debate over the years as to whether high-cost hedge funds can outperform low-cost index funds. Another way of stating the argument is: Which investment philosophy will better reward investors—active or passive?

In 2008, Warren Buffett issued a challenge to the hedge-fund industry. In his view, the hedge-fund industry charged exorbitant fees that couldn't be justified by their performance. So Mr. Buffett bet that an S&P 500 index fund would provide a better 10-year cumulative return than hedge funds after fees, costs, and expenses. Ted Seides, co-founder of Protégé Partners LLC, accepted the challenge, and the two parties placed a $1,000,000 bet. They agreed that in the end, $1,000,000 would be contributed to a charity selected by the winner.

Mr. Seides' Protégé's hedge fund is a fund-of-funds, meaning it delivers the average return of the five best hedge funds as selected by Protégé's managers.

Earlier this year, Mr. Seides conceded defeat ahead of December 31, 2017, the final date of the bet. He admitted the strength of Mr. Buffett's point, stating, "He is correct that hedge-fund fees are high, and his reasoning is convincing. Fees matter in investing, no doubt about it."

However, Mr. Seides continued, "Fees will always matter, but market risk sometimes matters more. My guess is that doubling down on a bet with Warren Buffett for the next ten years would hold greater-than-even odds of victory."

Does active management sometimes beat passive management? Do hedge funds sometimes beat index funds? Sure. The hedge fund beat Mr. Buffett's chosen Vanguard's S&P 500 Admiral fund in 2008, the first year of the bet. But then the S&P 500 index fund beat Protégé's hedge fund each of the next five years. In fact, the hedge fund's lead was so large after the first year that it took four more years for the index fund to finally pull ahead of the hedge fund. This reinforces the fact that active managers will outperform index (passive) investors on occasion. However, their ability to maintain this outperformance remains elusive. In 2015, the hedge fund narrowly beat the index fund, but in 2016, the index fund gained 11.9% compared to Protégé's 0.9%. By the end of 2016, the index...

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JENTNER WEALTH MANAGEMENT

THE PRESIDENT'S WORD

Why Investors Keep Buying Actively Managed Investments

Many sophisticated investors keep trusting active investment management and market timing even though the historical data show that passive management results in better returns.

Bruce Jentner, CFP®, President

Historical evidence indicates that seeking superior long-term investment returns is difficult at best and, for most investors, unattainable. Even though there are some who earn superior returns occasionally over short periods of time, the attempt to repeat this over an extended period results in lower performance.

Those of you who have heard me speak over the years know that I am not a fan of active stock and bond selection, of market timing, or of tactical allocations based on market predictions. What some of you may not know is that for the first half of my career, I employed all of these methods, believing this was in the best interest of my clients.

But once I let historical data reshape my thinking, I concluded that over the long term, active management almost always underperforms passively engineered index and asset-class management. In spite of the overwhelming evidence, why do so many people continue to purchase actively managed investments? Why do people continue to seek economic gurus who can tell them when to be in or out of the market?

According to the research,*

- People of higher financial status generally have higher financial literacy.
- Higher financial literacy helps people become aware of the advantages of passive (index) funds.
- In spite of this, the most sophisticated investors overwhelmingly rely on actively managed funds.
- Yet, the historical performance of actively managed funds selected by the most financially literate investors was, on average, lower than index funds.

What are the conclusions?

- Sophisticated investors appear to be overconfident in their investment abilities.
- The incentive for brokers to sell actively managed funds creates a conflict between brokers and their clients.

Don't take my word for it. Do your own research. Determine what is in your best interest.

* *Financial Literacy and Mutual Fund Investments: Who Buys Actively Managed Funds?* by Sebastian Müller and Martin Weber

Stocks May Be Your Best Inflation Fighters

The stock-market rally continues in spite of much media skepticism. Investors may be tempted to move out of the stock market because they are concerned by the predictions calling for a market correction. Who can blame them?

But this may be a mistake for those planning for retirement. Despite relatively slow economic growth, inflation remains a silent threat. While the current 2% to 3% inflation rate is historically low, it can pose a problem for investors who are hiding in fixed-income investments or cash.

Stocks can be scary to own, but they may be your best inflation fighters. Though stocks fluctuate in value, they have historically beaten inflation. Since World War II, diversified investment portfolios of stocks have earned returns that were 4% to 5% greater than inflation. Although forecasters say those high returns may be over for a while, the consensus is that diversified stock investors are still likely to earn at least 2% to 3% more than inflation.

It may feel painful as you endure fluctuating returns; there will be plenty of periods when stocks lose value and the markets look scary. But investors who buy and sell routinely make timing mistakes, ending up with much lower returns than they would have if they ignored the news and stayed invested.*

Do not let short-term predictions of the stock market derail you from a successful investment experience. Work with a qualified investment professional to design a risk-appropriate, diversified portfolio of stock and bond index funds that you can live with no matter what the daily markets do. Be smart. You owe this to yourself and your family. If you have any comments or questions, please let us know how we can help.

* "Dalbar's Harvey: Individual Investors Brilliant at Mistiming Markets," Moneynews.com by Dan Weil

Can You Handle the Market's Ups and Downs?

Everyone knows the stock market fluctuates. But not everyone is willing to be patient. Are you?

Some really intelligent investment professionals can get you in at the bottom of the market. Some extremely smart investment professionals can get you out at the top. But there are two basic problems:

1. They are never the same people.
2. They never get it right all of the time.

Wouldn't we all like to find someone who can tell us when to get in and when to get out of the stock market? With hundreds of millions of people investing in hundreds of thousands of companies throughout the world with trillions of moving parts, it defies the odds that anyone can consistently predict what the markets will do over the next several years, let alone the next several months.

Warren Buffett, one of the most successful investors during our lifetime, said, "Unless you can watch your stock holdings decline by 50% without becoming panic-stricken, you should not be in the stock market." Why would Warren Buffett say something like this? Because human nature is in conflict with successful investing.

There are two things that cause a stock to move: the expected and the unexpected. Therefore, diversify, and be patient. Thousands of books and magazine articles explain how to get rich quick in the stock market using a variety of strategies and gimmicks. New charts, graphs, and trends are discovered all the time. But the truth is there are no shortcuts, and you will not outsmart the market over the long term.

Some investors have found investing to be a street paved with gold, while others have truly experienced a nightmare on Wall Street. To avoid the nightmare, diversify, be patient, and don't follow the crowd.

History suggests the way to make money in the market is to invest with broad diversification and stay with it. If you are not comfortable with that, don't get in. Get help to determine if you are truly an investor willing to accept the inevitable fluctuations of the markets. If not, it may be best for you to avoid investing and instead save your money using guaranteed bank deposits and insurance-company deposits. Although your long-term returns are likely to be more modest than the market, if you do not have the patience to stay invested throughout market fluctuations, you may be better served using guaranteed accounts.

Daniel J. Bloom, CFP®, NSSA®
Director of Financial Planning

Warren Buffett's Million-Dollar Bet

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...fund had gained $854,000 cumulatively compared to the hedge fund's cumulative gain of $220,000.

Active investment managers are very bright people. They know a lot about the companies they invest in. They have good reasons for making investment decisions based on their prediction of the future. The fact is there are hundreds of thousands of people who are also buying and selling investments based on their beliefs of what might happen. But it is virtually impossible for anyone to consistently get it right. Every time someone believes it is the right time to sell a company stock or bond, someone else is willing to purchase that company stock or bond because they believe it is the right time and price to buy. Who is right?

The paradigm fed to us by the financial media is that we (or someone we hire) must pay attention to daily events in order to earn meaningful returns and avoid permanent loss. It is important to remember why they take this position. They are in the business of attracting subscribers and viewers in order to sell advertisements and commercials to support their business. This does not make them bad people. It is just the reality of their business model. However, their business model does not necessarily support your long-term successful investment experience.

Warren Buffett's opinion is that the financial "elites" have wasted $100 billion or more over the past decade by refusing to settle for low-cost index funds, according to his Berkshire Hathaway shareholder letter from February 2017. And in the final analysis, Mr. Buffett's bet on passive investing paid off. We believe it is likely to pay off for you too.

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Keep Your Digital Info Safe

Our business mission is to help our clients achieve their dreams and goals by protecting and growing their financial resources through prudent financial management. While this requires sound investment management, it also includes prudent steps and habits to protect digital information.

There are a variety of identity-theft protection services available (such as Identity Guard, LifeLock, PrivacyGuard, and IDShield), and we would encourage you to consider subscribing to one. However, each of us must also develop habits to protect our financial resources. Let's review three habits for your consideration:

1. Use a different random password for every online account. You might ask, "How in the world can I remember different, random passwords?" See recommendation #2.

2. Use a password-manager application (like LastPass, 1Password, or Dashlane). These password managers create and store strong, unique, random passwords for each of your online accounts. Then, you access your password manager online using a long, personally relevant, and secure password that you can remember or using a fingerprint-recognition application.

3. Use two-factor authentication whenever available. Some online accounts like Amazon and your bank's website may allow you to use a randomly generated security code on your mobile phone whenever you attempt to log on. This authentication code confirms it is actually you logging in.

These habits may seem a bit cumbersome, but the internet is not going away, so we must adapt. With advantage and convenience come cyber-security risks. Therefore, learn good habits to protect your digital and financial resources.

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