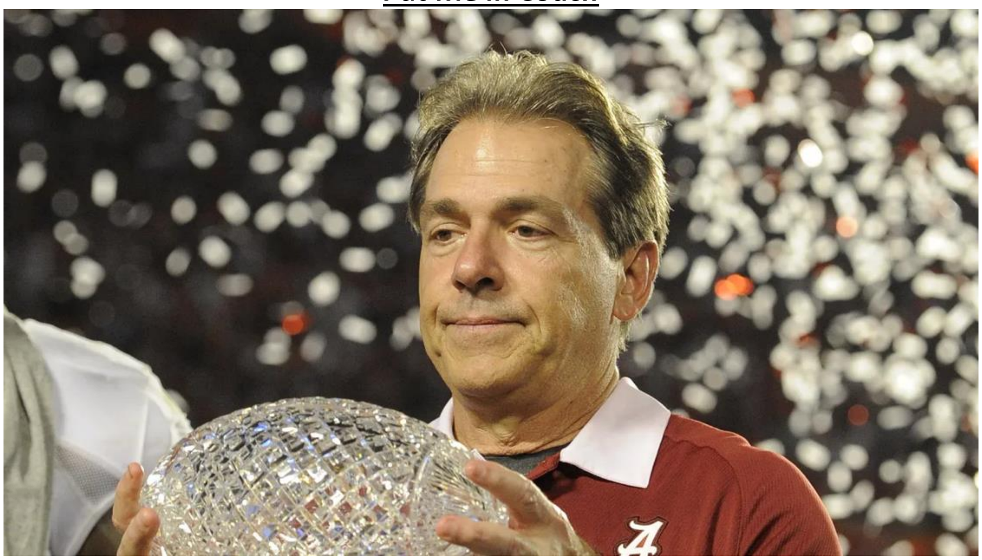
MEDALLION WEALTH MANAGEMENT

Mid-January 2024 Market Commentary

Put Me in Coach



Well, A-beat the drum and hold the phone, the sun came out today
We're born again, there's new grass on the field
A-roundin' third and headed for home, it's a brown-eyed handsome man
Anyone can understand the way I feel

Oh, put me in Coach, I'm ready to play, today
Put me in Coach, I'm ready to play, today
Look at me, I can be Centerfield
-John Fogerty – Centerfield https://www.youtube.com/watch?v=Xq3hEMUeBGQ

It's been an interesting couple of weeks in the sports world. We've seen about 18 job openings (firings) created for college football head coaches, and 8 out of 32 created for NFL head coaches. Jobs that pay about $4M annually in college and $7M annually in the NFL. Of course, the top coaches make in excess of $10M annually.

Within all of that turmoil the story that stood out the most was the retirement of arguably the greatest college football coach of all-time, Alabama's Nick Saban. At the age of 72, after 50 years in coaching, and an amazing seven National titles, Nick Saban called it a day.

Let me be clear, I hate Alabama, but I respect the hell out of what Nick Saban has accomplished. Just look at the photo above, that's as much of a smile as we get after he wins another National title. He's probably thinking, "hurry up, I should be out recruiting." A former Saban assistant, Coach Lane Kiffin once said that Saban's attitude was, ***"You win the trophy, you hold it up, you take a picture, you hand it back, and you go try and win the next one. The "Process" continues."***

One of Nick Saban's first head coaching jobs was at Michigan State University, where he befriended an eccentric psychiatry professor named Dr. Lionel Rosen. As Saban prepared his 4-5 underdog team to travel to Columbus and take on the undefeated, #1 ranked Ohio State Buckeyes, he turned to Dr. Rosen for advice on improving the mindset of his unconfident players. Rosen not only changed their minds; he changed the very way they saw the game of football…and life.

Saban has explained it as follows. Realizing the average football play lasts only seven seconds, Rosen asked the team to think differently: Concentrate not on winning the game itself but on winning those seven seconds. Ignore the scoreboard. The game clock. The opposing sideline. Seven seconds are all that matter. If the Spartans could outplay the Buckeyes for seven seconds more times than not, the unlikely victory would be in their grasp.

Once game day finally arrived, things started badly for the Spartans. Down by 15 points with ten minutes left in the third quarter, Saban remined the team to trust "The Process". As then quarterback Bill Burke remembers, despite the deficit, it felt like "we had an infinite amount of time to come back." Undeterred by their circumstances, and with total faith in "The Process", Burke and his teammates clawed their way back and won in dramatic fashion.

On that day in 1998, "The Process" was born.

Saban and Rosen's unconventional philosophy isn't confined just to the world of sport, it can also be used in our everyday lives. Life is full of struggles and goals that we wish to achieve, and that journey is made up of a multitude of decisions, or plays. Oftentimes the magnitude of the effort required to achieve our goals seems overwhelming, we feel like throwing in the towel before we even get started. But if we break that effort down into only the parts that we can control now, it suddenly becomes less intimidating. Because "The Process" is relaxing. Under its influence, we needn't panic.

Another Saban acronym is **WIN: "What's Important Now".** Saban has redefined the very notion of victory to emphasize not a future outcome, but this moment and this moment alone. The focus is on the present, what can you control now, what little battle can you win now.

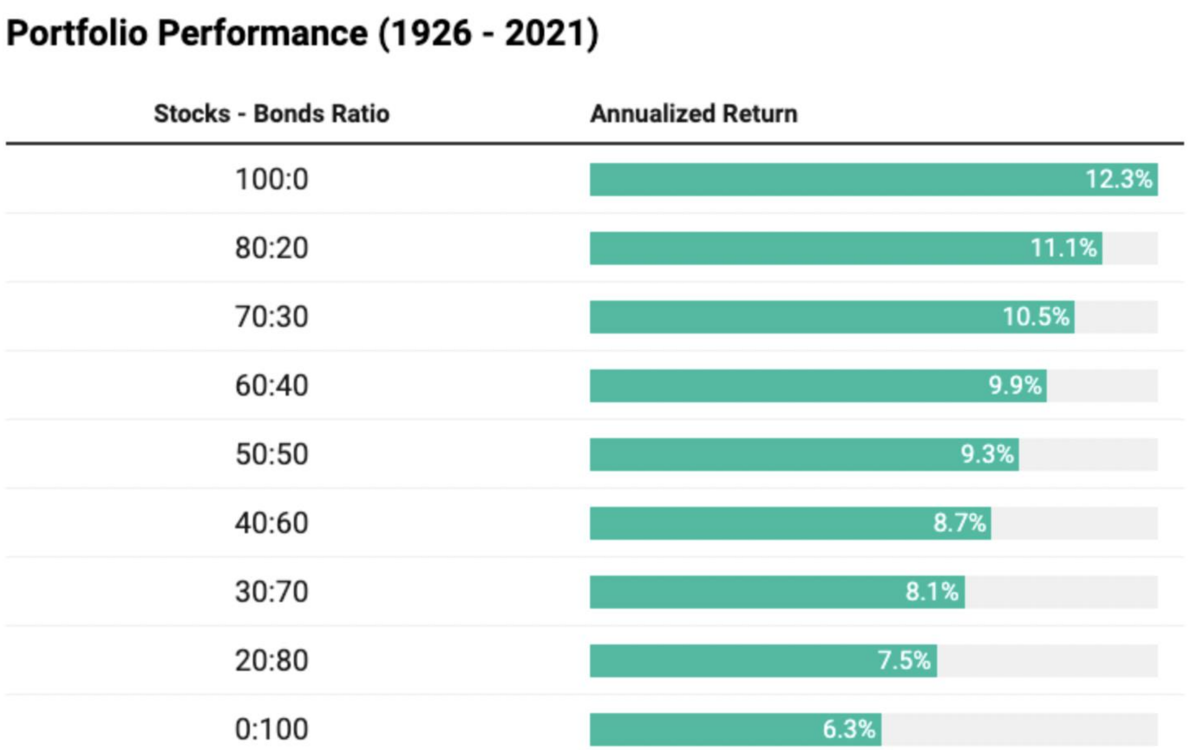
The other interesting thing about "The Process" is that it has no end, there are no milestones. The end of one season/journey is just the first step to the next. You do not dwell on past failures, nor do you rest comfortably on past successes, you simply focus on the present and move forward.

Investing is another endeavor that's perfectly suited to Nick Saban's "Process". We often think of investing in terms of our long-term goals, "I'd like to have $x millions for retirement." Or short-term goals, "I'd like to beat the S&P 500 this year." Instead of these "outcomes" we should be focused on the here and now, what we can control now, our process.

This means; what investment vehicles we should be using, their current attractiveness, and their appropriate allocation. For simplicities sake I'm going to focus on Stocks and Bonds, kind of like Offense and Defense.

A recent study from Vanguard has shown that over the last nearly 100 years stocks have returned about 12.3% annually, while bonds have returned about 6.3% annually. In 2023, stocks returned an impressive 26.2% while bonds returned 5.65%.

Below are the returns for various stock/bond portfolio allocations:

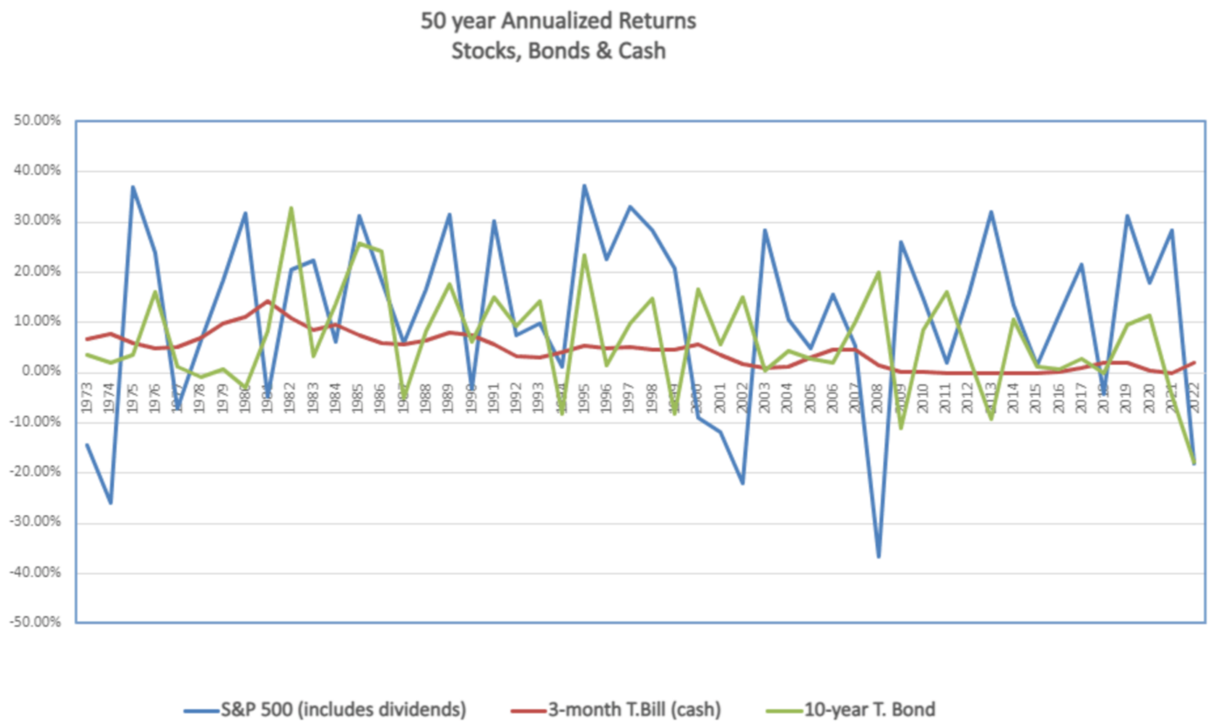


What's pretty obvious from the above graphic is that stocks outperform bonds over the long-run. Which begs the question, "why don't we just put everything in the S&P 500 and call it a day?"

Keeping with our football analogy, that would be like investing entirely in our offense and ignoring the defense. It may work over time, but the volatility wouldn't be for the faint of heart. On a day-to-day or year-to-year basis stock and bond returns can be pretty volatile. Remember:

Asset	2022 Return	2023 Return	Two Year Annualized
S&P 500	**-18.17%**	**26.19%**	**1.62%**
US Aggregate Bonds	**-13.02%**	**5.65%**	**-4.14%**

Before you say, “who cares about volatility, I’m a long-term investor.” Take a look at the next graphic of annual returns.

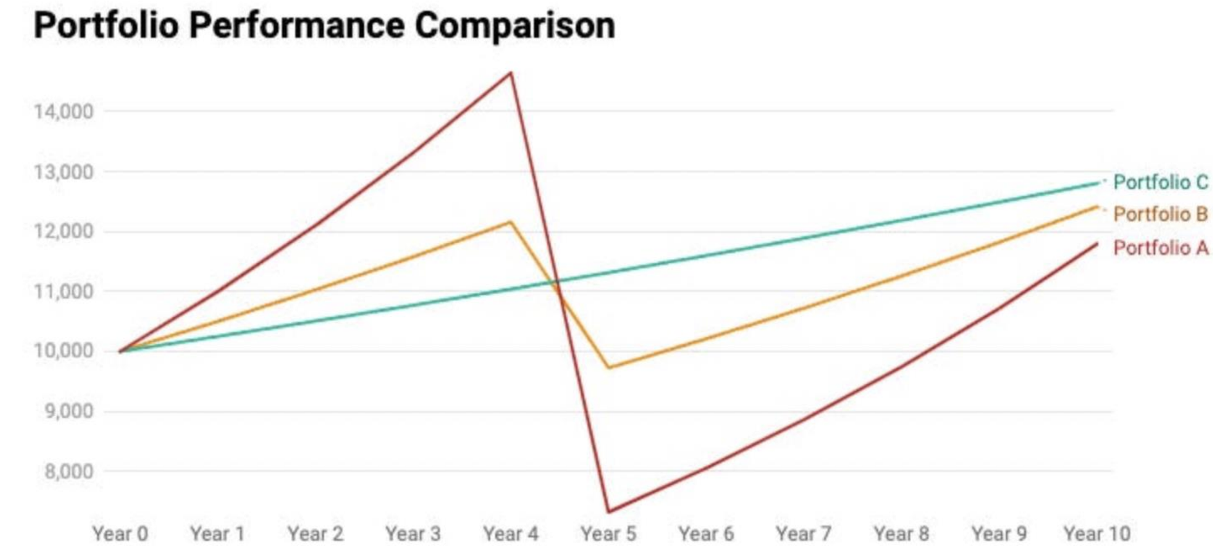


Using Saban’s WIN philosophy (What’s Important Now), we should embrace this volatility and use it to our advantage. In the long-run there are many periods where it makes sense to alter your long-run asset allocation given current circumstances. If the defense is stacking 8 or 9 men in the box, it probably doesn’t make a lot of sense to continue trying to run the ball. Similarly, when bonds were yielding nearly 0%, it was unwise to have a large allocation to fixed income, just like it’s less than wise to overweight stocks after several years of high-teen percentage returns.

Let’s play a little thought exercise. Assume you have the following three portfolio options for the next ten years, which do you choose:

- Portfolio A – Grows at a fairly consistent 10% annually for 10-years, but during that 10-year period it drops 50% once.
- Portfolio B – Grows at a fairly consistent 5% annually for 10-years, and experiences one 20% drawdown.
- Portfolio C – Grows at a consistent 2.5% annually and never has a drawdown.

Our eyes tell us that the 10% annual return has to be superior to the 2.5% annual return, but simple math tells us otherwise. Remember that a 10% loss necessitates an 11% gain to recover, while a 50% loss requires a 100% gain to get back what we lost. This is why conserving your capital is just as important as maximizing your returns. In fact, conserving capital **<u>is</u>** maximizing your returns.



Determining the right asset allocation for you isn't all about mathematics though, it's also about psychology, you have to be able to live with your allocation. There is a great story about Harry Markowitz, the economics professor who won the 1990 Nobel Prize in Economics for his work on evaluating stock market risk and reward.

When asked how he allocates his own retirement account Markowitz replied, ***"I should have computed the historical co-variances of the asset classes and drawn an efficient frontier. Instead, I visualized my grief if the market went way up if I wasn't in it (FOMO) – or if it went way down and I was completely in it. My intention was to minimize my future regret. So, I split my contributions 50/50 between bonds and equities."***

Here's another exercise you can do to help understand your psychology. Assume we're going to toss a coin for $1 million or nothing. If it's heads you win $1 million, if tails you lose nothing. Great game, you have a 50/50 chance of becoming a millionaire. Not a perfect game though, you still could walk away with nothing.

Guarantees are more fun. How much would I have to guarantee you to walk away from the 50/50 coin toss game, how about $100,000? Would you take $100K to walk away from a 50/50 chance at $1M?

- How about $200K
- How about $300K
- How about $400K
- Or would you stick with the original 50/50 coin toss for $1M

Mathematically the correct answer is the coin toss, because the expected value of a $1M coin toss is $500K. But, realistically even $100K is a pretty nice gift to walk away from the potential of $1M or nothing. The person who turns down the guaranteed $400K for the coin toss has a pretty high risk tolerance, while the one who grabs the $100K is pretty risk adverse. Which are you?

So, what have we learned so far?

- Asset allocation is highly personal, it isn't always driven by mathematics, but is an equal measure of mathematics and your personal psychology.
- We need to account for both downside risk as well as long-term returns.
- Have a process that focuses on the present, what we can control today. What assets are attractive today and which are not.

Take me for example. I'm 64 years old and have been investing for 40 years. I consider myself risk-adverse. Having come from a family with no financial assets, I know what it's like to have nothing and I don't intend to go back there.

For most of my professional career I was an equity fund manager, a stock picker. I love picking stocks and the competitive game of investing, but I don't allow that bias to offense take over my portfolio. I want balance, because for me the pain of losses is much greater than the fear of missing out.

My long-term goal is to generate returns of about 6% annually. Professionally I've mostly invested in dividend paying stocks and high-yield bonds, therefore that is how my portfolio leans. I try to get about a 4% return from income and the remaining 2% from capital appreciation.

My long-term allocation looks like this:

- Stocks – mostly equity-income stocks 70%
- Bonds – a mix of investment grade and below investment grade 25%
- Cash – money market funds 5%

This is my long-term allocation, my game plan. But, like any good coach the game plan has to be adjusted as the game evolves. In today's environment, where interest rates are in the 5% range, and stocks have had a very nice run, my current allocation looks something like this:

- Stocks – mostly equity-income 63%
- Bonds – average duration of 3 years 24%
- Cash – money market funds 13%

Investing really isn't that complicated, just like football it's a combination of long-term planning and execution, but most importantly it's about understanding **What's Important Now**, what can you control now. In life, investing and football, good coaches (investment advisors) can help us develop a **Process** to achieve our long-term goals, while helping us adjust our gameplans as changing situations dictate.

You got a beat up glove, a homemade bat
And a brand new pair of shoes
You know I think it's time to give this game a ride
Just to hit the ball and touch 'em all, a moment in the sun
It's a-gone and you can tell that one goodbye

As always, be careful out there,

Chris Wiles, CFA

Where trust is Earned