THOUGHTS FOR THE WEEK

THE HERMETICALLY SEALED BOX

July 28, 2023

Designing and building an investment portfolio is simple right? We can choose from myriad investable advisor driven portfolio models (human or robo), create and test hypothetical portfolios with on-line tools and place trades, check balances, or make changes on our smartphone. While standing in line.

But simple doesn't mean easy and for most investors, deciding on the right mix of assets, building a portfolio, riding the inevitable market ups and downs, and deciding when (or whether) to make course corrections is challenging, despite having the tools at your fingertips. With that in mind, we thought we'd share a fun thought experiment we run when thinking about long-term portfolio construction.

Portfolio In a Box

Assume that Congress passes a law that requires every American citizen to deposit half of their net worth into a box – a hermitically sealed box – that can't be opened for twenty years. Before placing your assets in the box, you can create the allocation you desire. But once the allocated assets go into the box, they stay there. For twenty years. No checking, no changing - what you put in is what you live with, and you see the results in twenty years.

What's In Your Box?

So, what would you put in your box? Would you build a diversified portfolio? Or pick just a handful of assets you think will do well? Maybe real estate, bonds, private equity, cash, Bitcoin, gold, Old Masters paintings, antique Ferrari's, something else?

What could go wrong? High inflation, a financial crisis, war, recession, climate change, AI run amok? Could you guard against these risks as you assemble your box?

Would it be easier or harder to design a portfolio for your box if the period was shortened? What would you put in your box if you could open it in ten years? In five? In one?

As you think about filling your box consider:

> **Inflation** From 1928 through 2022 U.S. inflation averaged just over 3% per year per year. If you want the value of your box to hold purchasing power, you'll need to at least pace along with inflation. To earn a "real return", the return above inflation, you'll need the value to grow. (Source: officialdata.org)
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> **Cash** Cash may feel safe, but over the long run it's anything but. From 1928 through 2022 cash has produced an anemic 0.2% average real return. (Source: A Wealth of Common Sense)

Bonds The real (after inflation) return on bonds from 1928 through 2022 was 1.5%, about a quarter of that of stocks over the same period. (Source: A Wealth of Common Sense)

Stocks The long-term average annual real return (return minus inflation) of U.S. stocks from 1928 through 2022 was 6.5%, almost exactly the same real return that stocks have delivered over the last 30 years, despite the financial crisis, and COVID. As Professor Jeremy Siegel of Wharton points out, the real return of stocks had been remarkably durable over the long run. But we also know that in the short run, stock markets can be scary. You have to survive the short run to earn the long run. (Source: A Wealth of Common Sense)

Real Estate The data is sketchy, but per Robert Shiller, the real (after inflation) annualized return for U.S. real estate from 1928 to 2021 averaged 1.3% (based on price changes only). Other data suggest the real return from real estate approaches that of stocks. (Source: mindfullyinvesting.com)

After running the experiment, you might be left bewildered. "Safe" may seem "unsafe", and vice versa. As we repeat ad nauseum, it all depends on your time horizon. Cash is safe over a short period, not so safe over a long period. Stocks can be extremely risky measured over 1-3 year increments, but not so much when measured over 10 year increments.

Most of us have twenty-year+ time horizons – because of our own life expectancy, joint life expectancy with our life partners, or because we've built multi-generational wealth – and most portfolios do better the less they are meddled with! So, while we're not suggesting that you place your net worth in a hermetically sealed twenty-year box, we do like thinking about portfolios as a set of hermetically sealed boxes, each with its own distinct time horizon. A box of cash that is there when you need it, a box of fixed income assets to provide modest return and added liquidity, and a box of growth assets that can potentially compound at high rates. Matching assets to time horizons can help indemnify your risks, and help give you the peace of mind to ride out inevitable bear markets. Ideally, you're comfortable enough with your "boxes", that you can leave the worrying to us, and pursue the things you love to do.

Enjoy your reading and your weekend,

Mike, Cate, Scott, Willis, Suzy, Oscar and Wes

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Sources:

https://www.google.com/search?rlz=1C1GCEB_enUS871US872&q=Average+inflation+rate+last+100+years&sa=X&ved=2ahUKEwiSzuTRiK2AAxUUlIkEHW1sDJAQ1QJ6BAhCEAE&biw=712&bih=534&dpr=1

The Measure of a Plan U.S. Stock Market Returns – a history from the 1870s to 2022, January 5th, 2023 | Posted in Data & Insights

historical real returns of U.S. real estate - Google Search

Stock, Bond & Cash Returns Over the Past 95 Years - A Wealth of Common Sense

Historical Returns For Stocks, Bonds & Cash Back to 1928 - A Wealth of Common Sense

$150 in 1850 → 2023 | Inflation Calculator (officialdata.org)

FEDERAL RESERVE BANK OF SAN FRANCISCO WORKING PAPER SERIES The Rate of Return on Everything, 1870–2015 Òscar Jordà Federal Reserve Bank of San Francisco University of California, Davis Katharina Knoll Deutsche Bundesbank Dmitry Kuvshinov University of Bonn Moritz Schularick University of Bonn and CEPR Alan M. Taylor University of California, Davis NBER and CEPR December 2017 Working Paper 2017-25 http://www.frbsf.org/economic-research/publications/working-papers/2017/25

Mike Burbank's Awards:
2017-2022 **Barron's Top 1,200 Financial Advisors: State-by-State** (formerly referred to as Barron's Top 1,000 Financial Advisors: State-by-State) Source: Barrons.com (Awarded 2017-2022). Data compiled by Barron's based on 12-month period concluding in Sept of the year prior to the issuance of the award.

2013-2020 **Financial Times 400 Top Financial Advisors**
Source: ft.com. Data compiled by the Financial Times based the following time periods:
Awarded 2013-2020; data 12/31/12 - 6/30/19

2019-2020 & 2022 **Forbes Best-In- State Wealth Advisors**
Source: Forbes.com (Awarded 2019-2020 & 2022). Data compiled by SHOOK Research LLC based 12-month time period concluding in June of year prior to the issuance of the award.
Awards Disclosures

Any type of continuous or periodic investment plan does not assure a profit and does not protect against loss in declining markets. Since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his financial ability to continue his purchases through periods of low-price levels.

S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. An investment cannot be made directly in a market index.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives, and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer.

Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

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