

This letter is dated August 2007

Long Run & Long-Run

My first marathon experience involved lessons learned much analogous to a rookie investor. The lessons are apropos to the current climate of the financial markets, which is why I share them with you now. Following is an excerpt from the McCauley family newsletter¹, summarizing the marathon experience:

Father Knows Best

Dad, Phil and I had been training hard for months, running up to 45 miles a week. So, when the day of the 26.2 mile Boston Marathon finally rolled around, to say we were pumped up would be an understatement! When the starting gun went off, we were like caged lions let loose. The three of us ran together for the first 2 miles. Dad noted at the second mile marker that we were running at about an 8 minute per mile pace which he warned was too fast. So Dad (the tortoise) slowed down while Phil and I (the hare) raced ahead. Phil and I knocked down the next 12 miles at about an 8½ minute per mile pace without much difficulty. On mile 14, however, my calves began to tighten. I told Phil I was slowing down. Phil was still going strong and kept the pace for a few more miles. On mile 16, my calves went into almost a complete cramp and I was wishing I had heeded the old man's advice! It was at this point that I estimate Dad zipped by me because runners were passing me by the dozens like I was standing still (which I nearly was!). Around mile 20, my quads began to cramp in addition to my calves. I was REALLY wishing I had heeded my father's advice. For about a ½ mile, it was difficult to even walk. I knew I had to keep moving forward. I'd experienced enough leg cramps to know that was my best hope to finish. If I stopped, a complete cramp would most certainly ensue, making walking or even standing unachievable. "I doubt they'd let me lay on the road long enough for the cramps to go

away” I thought to myself. I’m a McCauley though so, needless to say, the thought of quitting never entered my mind. Fortunately, I was able to keep walking which allowed the muscles to eventually loosen up some. I was able to run (albeit not exactly at a blistering pace!) the last 5+ miles and through the finish line. I even met clients for dinner an hour later! I was happy to learn that Dad had finished the race in 3 hours and 48 minutes (about one hour before yours truly!) What a race he ran. He nearly qualified to run in the Boston again next year. We were all very proud of him. I, for one, can certainly appreciate and respect the feat he accomplished!

- Paul, 1998

Life Lessons Learned

Nearly a decade later, I still remind myself of that race and what I learned from it. Two of the lessons, listed below, in my opinion are every bit as important (if not more so) in the context of investing.

Don’t Let Emotions Drive the Decision Making

Dad was a rookie marathoner as well in April of 1998, but was able to avoid making the common first-time marathoner mistake of running too hard in the early stages of the race. In short, he was poised and did not let the emotional charge from the cheering crowds dictate his pace.

Plan Your Work, Work Your Plan

Dad planned out his training schedule several months prior to the race. He stuck to the schedule, tracked his results in great detail, and tweaked the schedule as it made sense based on additional information. Based on his training runs, he mapped out a strategy for race day. Dad set achievable and challenging goals, not just for the race in its entirety but also carefully calculated targets for various stages within the race. Dad had the wisdom to know that being too far ahead of target was an even greater danger than falling too far behind.

Current Economic Conditions

Since mid-July, the stock market has experienced extreme volatility, falling about 8% from its July 19 peak.² Credit market concerns, the slumping housing market and a potential consumer slow down have dominated the headlines. While these concerns are legitimate, we believe it wise to evaluate

the news and estimate its effects on the securities clients own; rather that participate in a knee jerk reaction to sell. In general, we believe most of the negative news has been adequately reflected in stock prices but the good news has been shrugged off.

The recent equity market action could prove to be a buying opportunity for investors willing to look past the near-term volatility. Although credit concerns, the housing market, and a potential consumer slowdown are all risks that should not be ignored, we believe the market will ultimately be supported by a number of factors, including solid corporate balance sheets, relatively attractive market valuations, strong free cash flow generation, rising income levels, low unemployment, and moderating inflation.

Summary

Negative economic news has dominated headlines in recent weeks and the financial markets have dropped as a result. As humans, significant swings in the value of our assets impact us not only financially, but emotionally as well. That's just part of being people. The emotions invoked, however, be it euphoria from ups, depression from downs and all that lies in between, should not drive the decision-making process. We should tune out the crowd noise (whether it be cheering or jeering the financial markets), filter through the embellishments, analyze the data and make carefully thought-out decisions. Like Dad did on Patriot Day 1998.

Our plan is to first understand our clients' personal concerns and financial positions. Secondly, we help clients meet their liquidity and income needs. After steps one and two, we may build an equity portfolio to help the client grow their wealth over the long-term. The sequence of these three steps is important. The upfront work of knowing a client's personal situation helps preclude negative surprises and prepares us for the second step. Helping meet liquidity and income needs prior to structuring the equity portfolio can assist in managing the risk, and hence the stress, inherent with equity investing. Historically, the longer the time period money is invested in the stock market, the greater the odds the stock market will post a gain for the time period the money is invested.³ Having liquidity and income gives the equity piece more time. (Past performance is no guarantee of future results).

Whether it ironic or simply applicable across a broad array of life's endeavors, the principles Dad applied for a successful *long run* are also vital when seeking to achieve success in the financial markets over the *long-run*.

We believe we have a good plan; we always seek ways to tweak it to make it better as additional data becomes available, and despite near term distractions we remain focused on the long-run. Thank you for your trust and confidence. We are honored that you have chosen us to help you on your journey.

Paul D. McCauley
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¹The family newsletter was started by my Aunt Sarah, one of her many contributions to keeping the extended family closer and better informed. Organizing family reunions and researching our genealogy are among her other contributions. If only every family could have an Aunt Sarah!

²The Dow Jones Industrial Average (DJIA) is an index of 30 large capitalization stocks. On July 19 the DJIA closed at 14,000.41, which was an all-time high. On August 14 the DJIA closed at 12,861.47 (8.1% below the July 19 close). The volatility can be exemplified by the fact that of the 20 trading days that followed the peak, the DJIA closed either up or down by more than 100 points on 13 of those days: 8/15 -167, 8/14 -208, 8/9 -387, 8/8 +154, 8/6 +287, 8/3 -281, 8/2 +101, 8/1+151, 7/31 -147, 7/27 -208, 7/26 -312, 7/24 -227, 7/20 -149
Source: Reuters

³Based on hypothetical investments in the S&P 500 made each January 1 for the 50 years from 1957 through 2006, results indicate that the longer investors held the investments the more likely the investor would experience a positive rate of return. Investors that held the investment for 1, 5, and 10 year time had positive rates of return 76%, 89%, and 100% of the time, respectively. This is based on calendar years only. The S&P 500 is a capitalization weighted index of 500 large-capitalization stocks.
Source: American Funds, S&P 500 Composite Index Hypothetical Illustration

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For index, indicator and survey definitions referenced in this report please visit the following: <https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions>

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