2013: A Hippocratic View

January 2014

I will follow that system of regimen which, according to my ability and judgment, I consider for the benefit of my patients, and abstain from whatever is deleterious and mischievous. - Hippocrates

We spend an awful lot of our time and energy inside our chosen duty and obligation of providing our clients with comprehensive services within a framework that we have chosen to call financial integration. Many call this concept "financial planning," or "wealth management." We like to expose the idea of integration so our clients understand our perspective or, "where we're coming from."

Among the most important elements of integration is the idea of diversification – both in terms of the whole gamut of our clients' financial lives, and within the confines of the investment portfolios under our care. In the year just ended (2013), investment diversification would not have been necessary had we chosen total exposure to one certain asset class. The best actual return on portfolios would have come from putting all our eggs in the basket of U.S. equities (stocks). It didn't really matter much whether these American-made stock/equity exposures were large companies or small companies; value or growth oriented; dividend paying or not. The U.S. equity markets were simply up, and up big for the year.

The portfolios under our care are intentionally (and appropriately) diversified. Cash, near-cash, bonds (as Hippocrates sort of said, "first do no harm."); U.S. equities; foreign equities – both in the economically developed as well as developing world; oriented toward diverse sectors, income orientations, real estate (even some timber), utilities, satellite strategies, and so on and so on.

Our client portfolios had a great year, but diversification, tactical positioning, and risk-management generally acted as something of a drag on returns. History and common sense suggest that 2013 was an "outlier" and risk management tools benefit investors over longer time periods. We'll stay with our regimen.

Why this drag on returns for 2013? Simply, the key risks of 2013 were not realized: all eyes were on Washington as investors and the media obsessed over the fiscal cliff, sequester, tapering, shutdown and the debt ceiling. 2014 may be a year when the economy and markets are more independent of policymakers as economic growth accelerates.

We know that, depending on the time period examined, average equity returns over time have been somewhere between 5% - 10%. So, for the U.S. equity markets the 2013 returns were well above long-term averages. Interestingly, in the last 86 years (back to the depression) annual returns have only been in the 5% - 10% range in 8 of those years. We must stay diversified and take comfort in our state and status as long-term investors.

What about bonds? After 13 years of annual gains, and almost "straight-up" since the early 1980's, the broad bond market, measured on a total return basis, fell about 2% in 2013 (Barclays Capital Aggregate Bond Index). Interest rates increased a little and bond prices move inversely to interest rates. Our "do no harm" mantra for the bond side of our portfolios generated small, but positive returns in 2013 – due to diversification of issuer class and extremely short average maturities.

2014 looks like fun:

- Much work in the academic community is coming to our practical world in the nature of investment products and portfolio management tools. We are doing our reading and analysis and will be implementing modest changes throughout the coming year and following.
- We have collected five years of portfolio data and will be enhancing our portfolio reporting as the year goes on.
- We have told you that we intend to make some structural changes on the *business* side of TD Capital and that initiative is moving forward. Note – we do not plan changes to the portfolio management or client care side of our work.
- We will maintain concentration on our integration work and enjoy the comfort of long-term investing. And, as always, we will remain focused on the controllable factors of appropriate portfolio management:
    - Diversification
    - Provision of appropriate cash-flow
    - Tax efficiency
    - Sensitivity to the long-term effects of portfolio costs and expenses
    - Attention to client-service.

We hope your holidays were warm and safe.

Happy New Year!

God Bless,

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