PMA PRUDENT MANAGEMENT ASSOCIATES

Partner Talk®

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SWAN Song

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"Sleep is the golden chain that ties health and our bodies together," according to the Elizabethan dramatist and pamphleteer Thomas Dekker. Can there be any doubt of the truth of this aphorism – that good sleep is necessary for good health? Or is there any doubt that worries about money have been the cause of many a sleepless night for millions of people? The investment community understands the relationship between sleep, money and health, and has created its own related acronym – SWAN – to recognize that clients should always be able to "sleep well at night."

The last six months, particularly December 2018, may have disrupted many a good night's sleep. Consider the performance of the S&P 500 on a month-by-month basis and then on a year-to-date basis:

Month	Return	YTD Return
December	-9.03%	-3.48%
January	8.01%	8.01%
February	3.21%	11.48%
March	1.94%	13.65%
April	4.05%	18.25%
May	-6.35%	10.74%

While May was not a pleasant month at down 6.35%, as of May 31st the S&P 500 is still up 10.74% for the year, ahead of the average 10% annual return for the S&P 500 from 1926-2018. What is most important to note, however, is that while the large drop in December of 2018 turned that year from positive to negative, by staying invested one made it all back in January.

Of course this does not tell us anything about what may lie ahead. Despite all of the current headlines about trade wars, tariffs, interest rates and the resulting uncertainty they bring, the economy still appears to be growing, albeit likely at a slower rate than we experienced in 2018. With inflation seemingly under control, the consensus is that a recession is unlikely in the near term. However, none of this guarantees that 2019 will close with the markets having had an up year. With all that said, however, what can PMA do to help its clients sleep better? Most importantly, PMA can help its clients determine what their financial goals are and how to achieve those goals while taking no more risk than required. How do we do this?

First we help a client choose the appropriate risk for the assets invested through PMA. Because stocks are more volatile and thus more risky than bonds, the amount of risk in a portfolio is determined by the asset allocation between equities and fixed income. PMA guides clients in both the analysis of their initial asset allocation decision and the re-evaluation of that decision when circumstances change. Clients should revisit their choices if/when life circumstances change such as age, income, need for regular distributions, etc.

Second, PMA then further controls the risks in its portfolios through a rigorous quantitative and qualitative mutual fund manager selection process and an equally thorough portfolio construction and optimization process that creates balanced, diversified portfolios designed to deliver superior risk-adjusted returns.

Third, PMA will discuss with clients and help formulate appropriate investment guidelines, goals and targets, particularly with respect to the relationship between the risk profile of the portfolio and the projected needs for income from the portfolio.

Several basic principles underlie both the process of manager selection and portfolio construction:

- preservation of asset values, even in adverse market conditions;
- limiting portfolio expense;
- diversification and balance of investments across all sectors of the market;
- broad representation within each market sector.

We believe that prognostication and opinions are of less value than a sober evaluation of the range of possible outcomes given a certain mix of assets and their correlations. This does not mean that we ignore what is going on around us or what financial market experts think. We review our model portfolios at quarterly Investment Committee meetings, or more frequently if market conditions warrant, and monitor the markets, the economy, historical data, volatility, correlations and expected returns as part of our process.

We know that no one can predict the future. Therefore, it follows that no one can predict, with precision, the optimum time to buy and/or sell financial assets. We find little value in the short-term approach of trying to analyze whether or not the “market” is overvalued or undervalued at a particular point in time. We believe that investors should maintain portfolios that are diversified and balanced across all market sectors with broad representation within each market sector.

Preserving value in a down market can have a greater long-term impact than the gains a portfolio may have in an up market. Knowing how to measure risk and how to build properly diversified portfolios, enables an investor to seek the best possible return with the least possible risk. We have strived to do this at PMA for over thirty-six years. Clients who have invested in a portfolio with the appropriate risk tolerances should feel confident in staying the course despite short term market swings and most importantly be able to SWAN.