



STAARSM Strategies Report

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1998: A Year of Volatility and Disparity

How Could You Have Predicted Fund Performance?

This was the first year since 1990 where larger company stocks went down more than 10% during the year. In fact, on August 31 most large company indexes were down around 20% from their mid-July highs. International emerging markets and small company indexes fared even worse.

As scary as this was, the recovery has been even more spectacular. Since August 31, large stocks are up 22%, small stocks 25% and international emerging markets up over 21%!

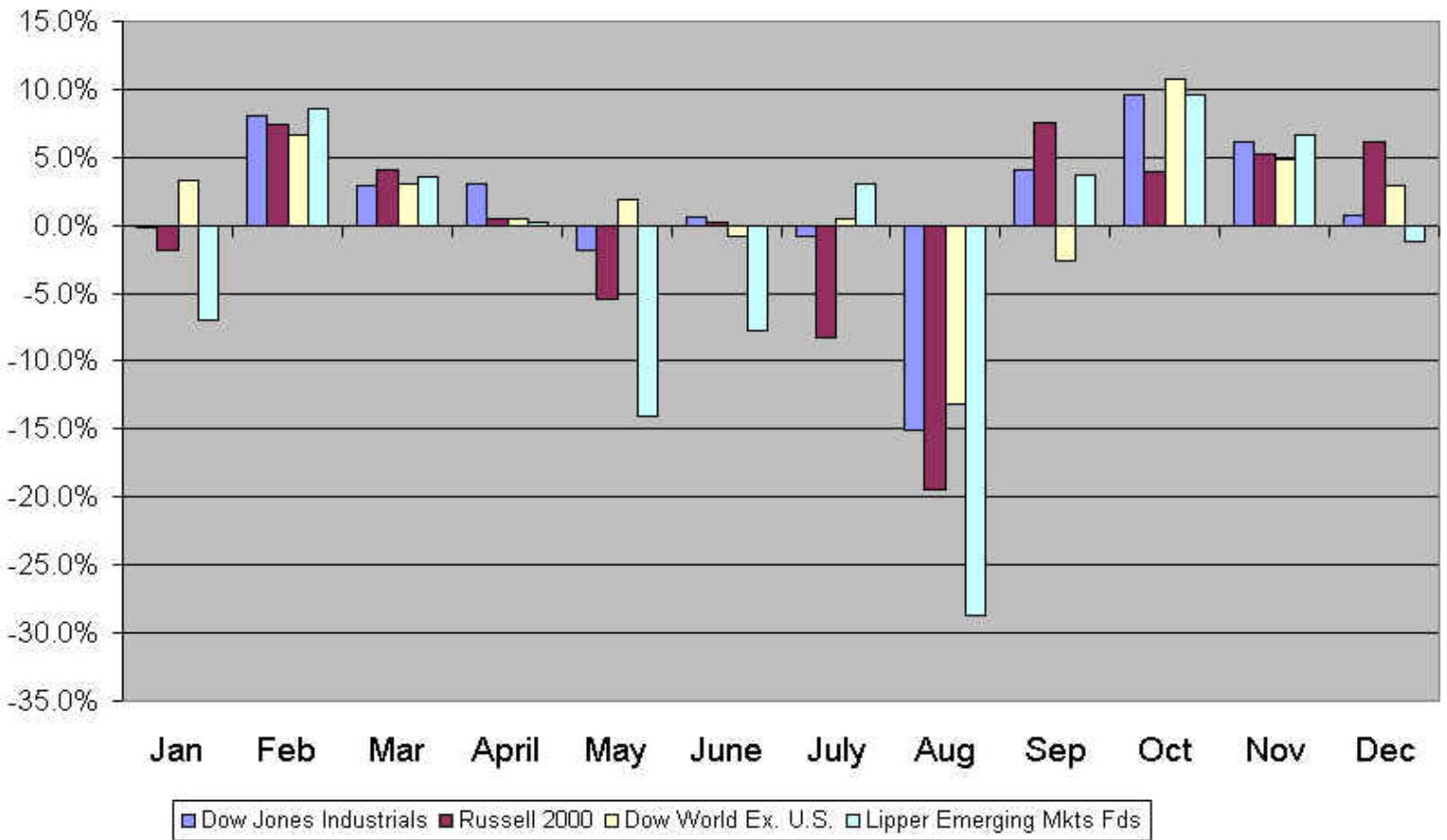
But individual mutual funds were all over the place, even within categories. Funds with similarly good performance over the previous five years experienced radically different performances in 1998.

Consider Chart A. At the beginning of the year, how could we have known that a venerable fund such as the Templeton Foreign Fund would lose 4.9% while Europacific Growth would gain 15.5%? That's over a 20% difference! Both funds had dependable long-term records and had made average returns of 13.9% and 14.9% respectively over the five-year period from 1993 through 1997.

This is a great argument for diversification among managers. Good managers can have bad years. But rarely will a diverse group of good managers all falter in the same year.

CHART A

1998 Monthly Returns



How to Measure Your Own Investment Performance

It is important not to get hung up in comparisons against other investments. In most years, and especially 1998, it will be easy to find someone who did much better than you did... or much worse. You can drive yourself nuts reading too many magazines and rating charts. If you actually followed many financial publications' recommendations, you would probably be changing everything you own every couple months chasing the Holy Grail of "best performance".

It is much saner and realistic to evaluate your holdings by asking questions similar to the following:

1) Did your overall investment portfolio perform within your long-term objectives and risk tolerance?

In other words, if you were a moderately aggressive or aggressive investor who believes in international diversification, including developing markets, you did not do as well as you would have wished. However, that is not a good reason to dump your international investments. History shows that what goes down usually goes up and visas versa. Just look at what happened since August 31.

If you invested in a mix of investments designed to give you a 9%, 10% or greater average return over 10

years, you should have been well aware that the potential for significant losses over any given quarter or year were not only possible, but probable. Such downturns should not surprise us. Nor should they alter our original planning strategies much.

If your investments did not perform outside their volatility expectations, and your long-term performance is close to your objectives, there is probably little need for significant changes. Hang in there.

2) Have you considered the timing of your investment deposits?

Don't compare your investments to whole year returns if you were not in the market the whole year. If you made deposits in the period from mid-February to June, it is very possible to have lost some money. It is doubtful that you made much, unless you bought bonds or held onto cash and made additional purchases in September. And if you pulled out after the downturn, you probably locked in losses.

But just because you were unlucky in timing doesn't mean you should lose sight of your original plan. If you had invested in large company stocks at the peak in 1987 and watched as your portfolio lost more than 1/3 of its value within three months, you would have been tempted to get out of the market, and many poor souls did. However, if you had just kept your stock investments and they made only an average return, you still would have made over 10% per year through 1998.

3) If you were investing for the first time today, would your overall philosophy be radically different?

If you set aside the emotions of the market volatility you experienced this year, chances are you would choose a similar investment approach today. I provide most of my investors with asset allocation charts showing best case, worst case, and reasonable expectation projections. Then we always ask, "Are you comfortable with that?" I didn't promise that there would never be down times. Rather, I told you they are a probability. So when they do happen, do not lose sight of your original objectives and what you said you were willing to risk achieving them.

However, if your life situation has changed, or you have changed your objectives and philosophy, then we should get together soon to make appropriate changes.

Outlook for 1999

I anticipate that 1999 will likely see more volatility. The ingredients for uncertainty abound.

Foreign economic problems are still working their way through the global economy. Politics, concerns about corporate earnings, terrorism and many other real and imagined fears will surface. And then there is good old Y2K. Though it likely will turn out to be something of a paper tiger, it is bound to add to conflicting forces during the year.

But there will be good news, too. Positive events for the Pacific Rim economies are very possible. Low inflation and interest rates should continue. We could continue to avoid a recession. And most of the essential computers could actually work just fine on January 1, 2000.

The following is a short-term market evaluation for the beginning of 1999. No assurance or guarantee of performance parameters is given or implied. While based on historical data and interpreted for current

conditions, they are estimates only. Investments in stocks and bonds involve various risks that should be contemplated before investing.

Intermediate Bonds: Favorable to Neutral -- Reasonable Expectation, 1 Year Return 4.5% to 6% (Best Case Estimate: 8%, Worst Case: 1%) It is likely that short-term interest rates will remain in the 4.5% to 5% range for awhile.

Long-Term Bonds: Neutral -- Reasonable Expectation, 1 Year Return 4% to 7% (Best Case Estimate: 9%, Worst Case: -3%)

Long-term rates also are unlikely to rise precipitously barring a major outbreak of inflation. While they could decrease a bit, it is unlikely they would fall as much as last year. The low for the long-term treasury yield could be around 4.5% and the high around 5.5%. It is more likely to hover in the 4.8%-5.25% range.

Larger Company Stocks: Neutral -- Reasonable Expectation, 1 Year Return 5% to 12% (Best Case Estimate: 19%, Worst Case: -15%)

The large company stock market still is very highly valued, and if earnings fail to grow, it will be hard to sustain stock prices. After four straight years of well above average returns, it is reasonable to wonder if it can happen again.

Smaller Company Stocks: Favorable -- Reasonable Expectation, 1 Year Return 6% to 15% (Best Case Estimate: 30%, Worst Case Estimate: -17%)

While small stocks are generally more volatile, there are seasons when they outperform large companies. We could be entering into such a period, especially if the "January effect" comes this year.

International (Larger Economies): Neutral to Favorable -- Reasonable Expectation, 1 Year Return 5% to 15% (Best Case Estimate: 27%, Worst Case: -15%)

There are still problems abroad, but the upside potential is certainly there. If all goes well, the International sector could have an excellent year. But don't underestimate the risks.

International Emerging Markets: Neutral to Favorable -- Reasonable Expectation, 1 Year Return 7% to 15% (Best Case Estimate: 50%, Worst Case: -35%)

Remember the axiom, "The higher the return desired, the higher the risk you must assume." There is no doubt that the emerging countries present one of the best upside potentials for investors over the next ten years. That potential makes taking the additional risk with a smaller portion of our investments a reasonable action to take.

Do You Know Your "MAGIC NUMBER"?

Are you accumulating investments with the goal of being independent some day? (Notice I did not use the word 'retirement', which denotes the end of work and productivity.) Do you know exactly how much you need to invest monthly to pay for all your future purchases plus provide an inflation-adjusted income in those independence years? Without going into debt?

This is what I call the "Magic Number". Let's say you want to be able to stop working at your current job in twenty years and do other things such as write a book, travel or do missionary work. But before you can do that, you have to put one more child through college, replace the roof on your house, buy two or three more cars and... well, you get the idea.

I have developed a computer program that allows you to plug in all your future major expenditures plus calculate the total amount of capital you will need to have the option to "retire" from your current work and structure your time the way you want. It allows you to set five or six categories of investments having different investment return and varying inflation rate assumptions.

The program then calculates the annual amount you will need to save and invest to pay for all your objectives on your "wish list". Would you like to know your "magic number"? Give me a call.

If You Are In Your Independence Years, Do You Have A Way To Track And Monitor Your Investments, Income And Budget?

If you are already into your "independence" years, I also can provide a planning program that will track and monitor your investments against your objectives. Similar to the "Magic Number" program, it will graph your asset growth progress against a plan that accounts for your planned budget and inflation.

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