If you want to succeed at your profession, sport or even a hobby, you study, practice and learn what you can from experts. The assumption is that those who work the hardest, practice the most and study the longest will probably be the most successful. But there is one area where the opposite of this is true — investing.

We cannot be competent surgeons with little knowledge of the human body; we cannot be competent lawyers with little knowledge of the law; and we cannot be competent teachers with little knowledge of the subject matter we teach. Yet we can be competent investors with virtually no knowledge of the companies whose securities we buy.

Asset class funds contain hundreds or thousands of stocks, bonds, or other securities. Rare are asset class investors who can name more than a few dozen of the companies that issue these securities. Rarer still are investors who know something about these companies beyond their names.

Surgeons, lawyers, and teachers with no knowledge of their fields cannot hope to earn average incomes. Yet investors with no knowledge of securities have the potential to earn average returns by doing nothing more than investing in global markets. If you want to improve your golf game, practice all you can. But don't think extra practice is going to make you a better investor.

IN THIS ISSUE
P2 Don't Let Your Portfolio Go Out of Style
P3 What is a “Stock Picker’s Market?”
P4 Practice Doesn’t Always Make Perfect

Please Give Us Your Opinion
To help us make this newsletter even more helpful to you, can you take 3 minutes to answer our 3-question survey? www.tinyurl.com/360insights

All survey respondents will be entered into a raffle and 10 of you will receive $25 Amazon gift cards.

Money managers (or fund managers) make bets all the time. They bet on countries, sectors, trends, commodities, economic indices and, of course, individual companies. Problem is, most of them are not very good at it, especially when you factor in fees.

Here's what we know about the challenges of predictive (also known as active) money management.

• It is expensive

The average expense ratio of predictive funds is 1.29% vs. an average of .80% for all market-based (also known as passive) funds.1

• Most money managers can’t consistently outperform

Over the last 5 years (2009 – 2013), only 39% of U.S. stock funds and 29% of International funds outperformed their benchmarks.2 That means most funds were doing worse than simple, unmanaged indices.

• In those rare instances when a manager is successful, it rarely lasts

Over the last five years (through March), only 2 out of 2,860 predictive U.S. stock funds stayed in the top quartile of performance in each of the last 5 years. That’s right 2 funds! The other 99.9% might have enjoyed a good year or two of performance but were unable to produce consistently good performance. And by the way, 852 of those funds (or 30%) merged with other funds or went out of business.3 Even if you are lucky enough to invest with a top-performing money manager, chances are he or she won’t stay at the top for long.

You’d get better results flipping a coin
While we don’t recommend coin flipping, roulette or other games of luck as an investment strategy, pure chance would suggest that at least 3 funds (instead of 2) should have achieved consistent outperformance over the last 5 years. This means most managers are doing worse than chance!

There may be great predictive money managers out there, but the data suggest they are few and far between and they have a very hard time remaining great. In order to give yourself the highest probability of meeting your long-term financial goals, you should work with your financial advisor to create a prudent financial plan instead of gambling on the uncertainties and typically poor track record of predictive managers.

Beating the market is tough, but given the significant long-term growth of markets around the world,4 is it a smart idea to even try? Focus on your goals, stick to your plan, invest in globally-diversified asset classes and let the markets work for you. In other words, be a smart investor, not a speculator.

1 Morningstar Direct
2 S&P Indices Versus Active Funds (SPIVA®) U.S. Scorecard, Year-End 2008
3 Ibid
4 Morningstar Direct
6 “The Return of The Market-Beating Fund Manager: The stage is set for stock pickers to shine.” Morningstar Direct 2014
7 S&P Indices Versus Active Funds (SPIVA®) U.S. Scorecard, Year-End 2013
10 youtube.com/playlist?list=UUX5J2K8OYjixsJyOCmH-FA

Practice Doesn’t Always Make Perfect

by Meir Statman
Glenn Kliman Professor of Finance at Santa Clara University, Member of Loring Ward’s Investment Committee

What is a Stock Picker’s Market, continued from page 3

How about provide value for the higher fees being charged? Not according to just about every academic study published.

The appeal of beating the market is certainly understandable — investors want to get the most for their money. But we prefer to shift the focus from trying to beat the market to investing with the market through a long-term systematic approach which is repeatable, regardless of the environment.

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Don’t Let Your Portfolio Go Out of Style

by Sheldon McFarland
Vice President, Portfolio Strategies and Research
Loring Ward

While some clothes never go out of style — think blue jeans and little black dresses — most do (time to throw out those bell bottoms, thank goodness!). Similarly, investment portfolios also can go out of style. But don’t call the fashion police. This has nothing to do with fads or fashion and everything to do with asset allocation and style drift.

And when these two factors cause your portfolio to go out of style, your ability to achieve your long-term goals can be compromised. Here’s why:

Choosing which asset classes to invest in is very personal and will depend largely on your time horizon and your ability to tolerate risk.

As a refresher, asset allocation describes how money is invested across different asset categories — like stocks, bonds and cash — within a portfolio. Assets that look similar are grouped together into asset classes. For example, the stocks of large companies such as Apple, Exxon and Microsoft are grouped together into the Large Cap Stock asset class.

Stocks are usually grouped by size of company (large, mid, and small), style (value, neutral, and growth) or geography (foreign or domestic). Bonds are usually grouped by maturity range (short, intermediate, or long term) or by credit quality (high, medium, or low).

Research has shown that asset allocation is one of the most important investment decisions each of us has to make, and it explains over 90% of the variation in portfolio returns.¹ Now that we’ve laid the foundation with asset allocation, let’s look at one more thing before we talk style…

There are two main schools of thought when it comes to investing:

• Those who believe that you can consistently predict which stocks will do well and which won’t (also called active or predictive investing)
• Those who believe that it’s impossible to consistently predict market or individual stock performance so it’s better to be invested in many types of companies around the world (also called passive, index or asset class investing).

Of course, proponents of both methods believe they offer investors the best solution, but what does the research show?

If you invest in predictive funds, you may face the risk that over time you are no longer invested in what you thought you were. In other words, your asset allocation may change significantly without you doing anything at all. And that means you could be taking on more risk (or less) than planned.

An 11-year study by S&P Dow Jones Indices found that over time, as many predictive managers buy and sell stocks in an attempt to improve performance, their funds’ style classification actually changes — so an investor who thought he was invested in a U.S. large cap value fund could find that in five years he’s actually in a mid-cap fund.

Style Consistency Declines Over Time

<table>
<thead>
<tr>
<th>Year</th>
<th>Consistency</th>
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<tbody>
<tr>
<td>One Year</td>
<td>89%</td>
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<tr>
<td>Three Years</td>
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Source: S&P Indices Versus Active Funds (SPIVA®), U.S. Scorecard Year-End 2013

The chart shows how style consistency declines dramatically over time. While after one year, 89% of funds are holding true to their original classification, after five years, little more than half of the predictive funds employed the same investment style.

For investors who are counting on their portfolio for retirement, this means that their optimal asset allocation would not be the same after five years. And a change in style can change your risk exposure and potential returns substantially.

There is another popular idea that predictive managers will perform well during periods of low correlations, when individual companies are lagging behind the S&P 500, with similar trends in other asset classes, during a time when correlations between companies have been extremely low.

Individual Stock Volatility

There is an additional claim that predictive managers will perform well during periods of low correlations, when individual companies tend to move very differently from each other — what is sometimes referred to as a “stock picker’s market.” This should allow the more skilled managers to pick out those winners and reap significant benefits when compared to a simple index.

Will The Time Ever Be Right?

Do predictive funds perform better during bear markets and recessions? We haven’t seen it. Will they excel during periods of low stock correlation? Certainly hasn’t materialized.

What is a “Stock Picker’s Market?”

by Matthew Carvalho, CFA®, CFP®
Director of Investment Research
Loring Ward

We’ve often heard the claim that predictive managers will outperform the market in certain periods, especially downturns. (Note: By predictive managers we mean managers who attempt to beat the market by market timing and stock picking.)

It sounds like a great idea: savvy, experienced professional managers steer clear of the worst of market downturns by moving to cash, or sticking with only the highest-quality companies. What investor wouldn’t want to sign up for that deal?

Alas, it rarely works in practice.

Consider the severe market downturn in 2008. Out of the 684 predictive U.S. large cap stock funds benchmarked to the S&P 500 index, only 280 (or 41%) were able to outperform the S&P 500 during that crisis.²

In other words, 59% of the funds that are designed to outperform the market in downturns (or bull markets, for that matter) actually underperformed the index return. In aggregate in 2008, predictive funds underperformed the S&P 500 Index by an average of 1.67%.³

Reflecting on the bear market of 2008 Standard and Poor’s May 2009 Indices Versus Active Funds Study concluded that “the belief that bear markets favor [predictive] management is a myth.”⁴

But what if instead of looking at all 684 funds we just looked at the “winners” — or those who outperformed the S&P in the five years prior to 2008? You would think that more than 41% of those “winning” funds would beat the S&P in 2008, right? Wrong. Of the 401 funds that outperformed from 2003-2007, only 34% (137 managers) underperformed.

Previous Winners Don’t Maintain Performance

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Further, when we looked at these 137 high performing managers to see how they fared more recently, only 21 of them (15%) were able to outperform during the bull market from 2009 through the end of June 2014. In other words, 85% of the top performers from 2003-2008 underperformed from 2009-2013.⁵

Fees are often overlooked, but they can have a big impact on an investor’s returns. A study of monthly returns of 1,511 mutual funds from 1990 to 2010 found that, on average, those predictive funds were not able to provide any value over their fees during recessions.⁶

See “What is a Stock Picker’s Market” continued on page 4
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Source: S&P Indices Versus Active Funds (SPHVA®), U.S. Scorecard-Year-End 2013

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For investors who are counting on their portfolio for retirement, this means that their optimal asset allocation would not be the same after five years. And a change in style can change your risk exposure and potential returns substantially.

There is good news though. Index and asset class funds are part of an investment approach that is more concerned with maintaining style integrity and asset allocation (and keeping costs low) than trying to beat the market.

Fashions will come and go, but your portfolio should never go out of style.

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From The Wall Street Journal in 2010: “[It has been] a tough few years for stock-picking mutual fund managers trying to beat the market,” but they assure you that’s about to change because the correlation between individual companies has fallen.

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4 “Modern Fool’s Gold Alphas in Recession,” by Dr. Shaun A. Pfeiffer and Dr. Harold R. Eversky. The Journal of Investing, Fall 2012, Volume 21, Number 3
7 Morningstar Direct
8 Ibid
9 Wolfram Research, Inc. (Wolfram) is an investment adviser registered with the Securities and Exchange Commission. Securities transactions are offered through its affiliate, Loring Ward Securities Inc., member FINRA/SIPC.
10 R. 14-395 (Exp. 9/16)
11 Morningstar Direct
12 S&P Indices Versus Active Funds (SPIVA)® U.S. Scorecard, Year-End 2013