Passive, In Reality Is Active, Sometimes RADIOactive.

The ?passive? revolution we?re witnessing is to provide a portfolio solution which is based on the demand for the products, regardless of how expensive the products may be. To be clear, I?m an advocate for index *investments* and lower internal portfolio costs. I was one of the first financial professionals at my former employer to use market cap weighted exchange-traded funds in client portfolios to replace mutual funds. My beef is how indexing is perceived by unsuspecting investors as safe and insidiously branded or allowed to be positioned by the buy-and-hold faction, as the ultimate *never-sell* strategy. Not because it?s best for the investor; well, that?s a convenient half-truth. Mostly, it?s optimum for the adviser under pressure who can offer a pretty asset allocation solution in a package and move on to the next notch on the sales belt. The front-line consultant of a publicly-traded big box financial retailer is under never-ending intense pressure to increase margins for shareholders. The performance of the stock price is the priority. I was provided this wisdom, which I have never forgotten, from a former regional manager at Charles Schwab *? ?It?s shareholders first; then follows the rest of us, including clients.? If passive is what clients want, passive is what they shall receive*, but in a manner that can be delivered and scalable by a financial retailer in a CYA/fiduciary manner. It?s time efficient to get cash fully invested in an asset allocation at once; buy full in to the story *that it?s time in the market not timing the market*, regardless of current valuations or expected returns, especially as corrections appear more as distant memory than reality. The asset allocator factory box designers are diligent at work, creating neat, easy-breezy investment packages positioned as products or ?solutions,? thus forging a path perhaps we haven?t walked so passionately before. The demand for these attractive boxes filled with a colorful palate of panacea in the form of passive investments, have made stocks expensive. Market this sausage to a new breed of adviser who perceives passive as safe, has never witnessed a correction or bear market working in the trenches with clients, and serve it up on the finest wrapper Wall Street marketing has to offer, and God help us. Why? ***The investment vs. valuation connection has been severed and the re-connect is going to be marked by turbulence and disappointment*****.** Asset-allocation solutions are being positioned to ?pros? as simple, third-party adjuncts to an overall financial planning experience. The intoxicating promise of ease and low cost which places what you pay in the form of valuations in a clean-up spot, or makes it an afterthought (if that), is incredibly alluring. Buy it up now, let it grow, harvest later. Simple.

> ***Passive investing is not safe***. ***Not by a long shot.*** *To clarify:* Passive is an **investment type**. It is **NOT an investing process** *nor a manner to which RISK is managed*.

The clearest thought I can conjure up about passive investments and bear markets is I have the finest potential to lose money at low internal costs. Never forget ? Once wealth is allocated to stocks, it?s active. On occasion, radioactive. Plain and simple. Index positions must be risk managed. They bear the full risk of markets. The highs and the lows. There?s no *escape-risk-free* card for passive investors or any investors who choose to take on risk.

Surprise! Stocks Are Inherently Volatile.

Wait. What? Yes, last year?s unusual market performance was poison for investor psyche. I describe 2017?s stock market behavior as a shiny-glass ride; a breath of relief, of hope, a drying of the wet blanket on economic growth that occurred during the last presidential administration. Zero volatility (literally), stock indices that closed higher every month (never before occurred in history), was an emotional trap for investors, novice and experienced, who now must deal with the fact that markets experience as a matter of course, intra-year drops of close to 14%. You see, that?s par for the course, price of admission to the stock market. ***If you can?t handle the wiggle room, gracefully face the fact you cannot handle stock investing.*** Whether you hold 10% or 80% in stocks, the investor?s ability to handle the risk ride is about to be revealed: Only you must decide whether stocks are appropriate. Recently, I received a call from a client who admitted he couldn?t handle a 2% decrease in his portfolio value and had decided to invest in CDs instead. I wasn?t going to attempt to convince him otherwise. He took full responsibility for not having the stomach for stocks and was willing to deal with the consequences. I commended him for facing his truth and seeking to adjust accordingly. I have a feeling many will be going through similar a similar financial soul-search as the volatility will at the least, normalize at this juncture. At the worst, increase dramatically. I believe the latter. Here?s why: As the mask of global central bank liquidity is pulled and markets begin to focus on fundamentals again, a new period of price discovery begins. Through this transition, markets will push and pull, gyrate wildly. Similar to how the Fed seeks to figure out ?normal? for interest rates, so will risk assets cross a wood-and-rope walkway swaying above rough waters to gain a handle on how an economy addicted to low rates is going to adjust. Throw a few monster sharks in the water like China under economic distress, effects of tariffs, a stubbornly rising U.S. dollar, and you have the making of a stock market?s vision of Jurassic Park. Those financial pundits who stated so boldly that rising interest don?t matter to the stock market blatantly lied to you. Interest rates always have, always will matter to stocks. Especially now. If you can?t handle wiggle room, you can?t handle stocks. It?s ok to admit it and adjust accordingly.

Odds Are Good Your Adviser Has Never Experienced A Bear Market

I meet and speak with advisers who were in high school during the Great Recession. They confidently share with me that bull markets happen so infrequently that it wouldn?t be a surprise if they disappeared altogether. The financial big-box firms that employ them seek to minimize or rarely discuss the devastating impacts of bears. By the way, 40% of the time since 1871 secular or long-term bear markets have occurred. Secular bulls ? 80 years, 52 years for the bears. Per beliefs of the current and overconfident breed of advisers, bear markets only occur 10-20% of the time. A dangerous tenet. Every dip in the market isn?t a buy. Occasionally, it?s a sell. Stock market corrections defined as 10% down from a previous market high, are not what investors or advisers are accustomed. However, it?s best to understand when you invest in stocks your financial footing is shaky on the stomach of a giant snoring beast and the moves of its chest are enough to knock you off balance at any time. From 1987-2000, one of the greatest bull market periods, the S&P 500 experienced 7 corrections ranging from -8.9% to -19.9%. Two bears roared their heads which took the broad market down 33 and 49% (1987 and 2000, respectively). Now that the stock market is ?normalizing,? in its ebb and flow, investors accumulating assets for long-term goals like retirement, must accept some level of volatility when investing in stocks. That?s the price of admission. Holding cash and high-quality bonds including Treasuries will help quell the ride. If you?re continuing to purchase stocks, some volatility is beneficial as you seek to purchase shares at lower prices. If you?re in retirement and taking distributions from variable assets like stocks, prepare to examine distribution rates every year and adjust accordingly depending on your spending rate vs. how your portfolio has progressed (or not). It?s also best if you?re five years from or in retirement, to reduce stock exposure here based on valuations (currently at 30X for the Shiller P/E). New retirees are best to prepare to reduce risk until stocks are priced attractively.