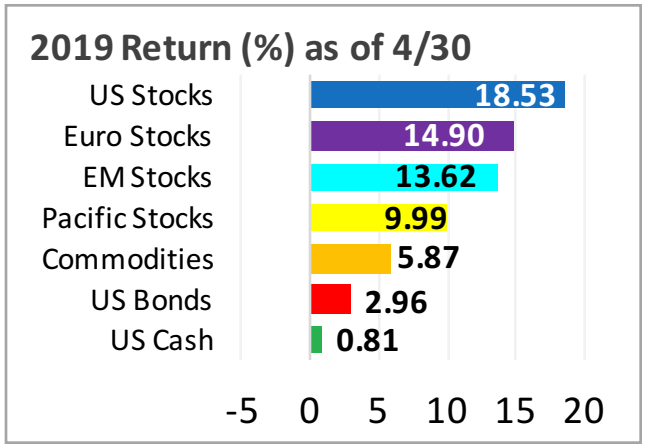
Markets Recap

Stocks around the world kept grinding higher, with US Stocks still in the top spot at 18.53%, and foreign markets hovering between about 10%-15%. Continuing the trend from Q1, all asset classes are in positive territory.



Cape Ann Capital's Crystal Ball

Many investors spend all their intellectual energy trying to predict the unpredictable. It takes an enormous amount of hubris to believe that you can see what millions of others cannot. Though many investors would love to do away with the surprise shocks to the system (eg Brexit, the 2016 election, and most recently US-China trade war fears), these events are ironically the very reason we are all rewarded in the long run for bearing risk.

We do not know next year's return for any of our diversified asset allocation targets, but we (and you) are not completely in the dark. The nearby chart shows the worst and best annual returns over the last 49 years for three portfolios: Risk Level 2 (RL2), comprised of predominantly safe assets (cash and bonds), Risk Level 14 (RL14), comprised of predominantly risky assets (stocks and commodities), and Risk Level 8 (RL8), a balanced mix of both safe and risky assets. The difference between best and worst ranges from –5.8% to +12.0% for RL2 to –40.1% to +35.0% for RL14. Let there be no doubt, the band of uncertainty rises *dramatically* as one moves from RL2 to RL8 to RL14. Why would anyone invest in RL8 or RL14 as opposed to RL2? The answer lies in the long-run returns shown in the third set of bars. It is a good bet, looking forward over a 10 to 20-year time horizon that RL8 will outperform RL2 by an average of about 300 basis points per year and RL14 will outperform RL8 by about 100 basis points per year.

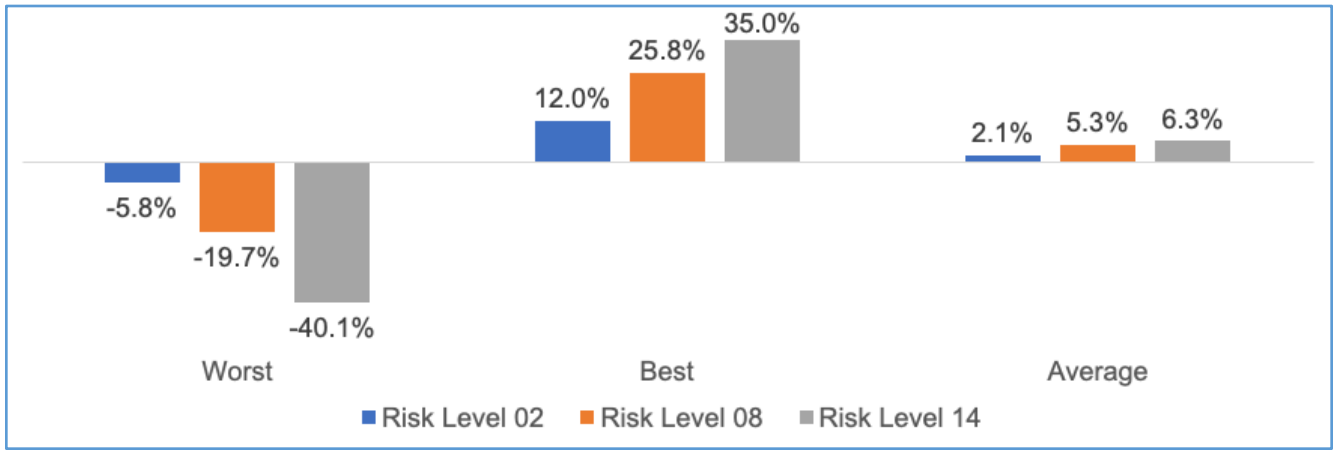


Figure 1: Worst, Best and Average Real Returns

All returns in the table are real returns; i.e. returns in excess of inflation.

So, if you are the type who is inclined to crank up the risk and choose RL14, you would be wise to prepare yourself ahead of time for at least a 40% annual drop at some point in the future. Conversely, for those that want to protect their principal by choosing RL2, it would be prudent to ensure that they can keep their wits about them when they are mostly missing out when stock markets soar upwards of 35% in a year. Luckily investors do not need to choose between extremes. Cape Ann Capital has fourteen total long-term targets, including the three covered here, to align clients with both their financial goals, as well as their temperament.

Dave, Jim & Jeremy

Send feedback to:
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