

BEHAVIORAL & FINANCIAL INSIGHTS

Beware of the Wolf in Sheep's Clothing

The Holy Grail in investing would be an investment that provides equity-like returns without the risk or volatility required to achieve such returns. This is what every investor hopes to find. We want a short cut. And Wall Street knows this!

There are investments that claim to provide growth and income while protecting or limiting the downside. As investors, one of our biggest enemies is volatility, so these types of investments are very alluring. They tend to perform satisfactorily in good markets but have repeatedly shown they can fail miserably in bad markets – under the precise conditions we expect them to do well. A few even blow up completely.

February 2018 Example

The LJM Preservation and Growth Fund was marketed exactly as it was named. Preservation *and* growth! Wow, exactly what investors want. The fund's marketing materials stated, "Make Volatility Your Friend". Sounds good, right?

However, in February 2018, we had a volatility spike. Although it was a short-term spike, it was enough to totally tank the fund. Over 90% losses in one month, which led to its demise.¹ If this was the only example, we could chalk it up to being a rarity, an anomaly. Unfortunately, these happen more often than we hear about.

March 2020 Example

More recently, the Allianz Structured Alpha 1000 Fund was marketed as a hedge against a downturn. The lead portfolio manager said the fund will "protect ourselves from catastrophic shocks."² It was led by a very experienced team of financial professionals. The term "alpha" in the world of finance is synonymous with "excess returns," so, when coupled with the promise of protection on the downside, this sounded like a great investment opportunity.

So how did it do during the catastrophic market decline in March this year? It lost 97% of its value and was liquidated shortly thereafter.

Buyer Beware

Wealth preservation and risk management aren't about finding the Holy Grail – it doesn't exist. They are about having the right allocation for *you* and maintaining the faith and discipline to stick with your strategy; to avoid the temptation to react when bouts of fear or greed try to consume us. Long-term wealth management and investment success are the result of having the commitment and discipline to stick with your plan when it is oh so tempting to deviate.

There will always be some shiny investment that appears more attractive than what you own. Investing will always involve a constant tug-of-war between risk versus return and between emotion versus rational thinking. Beware of investments or schemes that sound so good that we are tempted to abandon our well-constructed game plan.

¹ Barrons Feb 10, 2018. "How LJM Preservation and Growth Failed Investors"

² WSJ May 20, 2020. "The Day Coronavirus Nearly Broke the Financial Markets"

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