KEEPING UP WITH THE JONESES
(AND THE CLINTONS, AND THE TRUMPS)

Believe it or not, the phrase “Keeping Up with the Joneses” has been around for more than a century. It originated in 1913 as a comic strip in the New York World and various other newspapers. As one would expect, the primary topic of the comic strip was the constant struggle of the McGinis family to “keep up” with their neighbors, the Joneses, who were referred to but never actually shown in the comic.

The phrase continues to have relevance today. Perhaps there’s no better evidence of that fact than typing “keeping up with the” into google and seeing Kardashians come up before Joneses.

Investing in particular lends itself to constant comparison, in some cases causing more harm than good. We compare to ourselves (Do I have more money today than I did yesterday?), to our peers (Did my portfolio outperform my neighbors?), to the market (Did my portfolio outperform the S&P 500?), and to the unknown (Could I somehow have made more than I did?). Comparisons can be helpful to ensure outcomes align with one’s strategy. For example, performance of a group of large-cap stocks should look similar to the S&P 500, but not like emerging market stocks. Comparisons can be dangerous if they lead to constant tinkering and adjusting of portfolios. The annual Dalbar study quantifies this danger, comparing average investor returns (measured by change in assets excluding monthly mutual fund sales, redemptions, and exchanges) to investment returns. In 2015 the average equity mutual fund investor underperformed the S&P 500 by a margin of 3.66%. Over the last 20 years the gap is remarkably similar, with investors underperforming the market by 3.52%. Analysis of the underperformance shows that investor behavior is the number one cause, with fees being the second leading cause. Prudent comparison or benchmarking is valuable; attempting to keep up with the Joneses is not.

Part of the value of an investment advisory relationship with MRA is that we do the comparisons for you. We not only provide performance metrics to our clients over various time periods (so you can compare to yourself), but we provide benchmarking data on the investments we use to frame discussions around performance outcomes. This helps our clients understand why their portfolio performed the way it did. It also relieves our clients of the burden of decision making because we will determine if a change needs to be made.
based on the facts and circumstances of the investment, as opposed to an emotional decision. Our reporting is tangible evidence that we are “minding the store” and ensuring that portfolios are constructed in alignment with clients’ objectives. We don’t have to keep up with the Joneses, but we should know how we are doing relative to the Joneses and be comfortable with why we are better or worse at a given moment.

However, we may not effectively communicate the competitive culture of MRA, and how committed we are to evaluating ourselves and our investment decisions. Our investment department intensely scrutinizes portfolios on a near daily basis to ensure investments continue to meet expectations and there are no surprises lurking in the shadows. In addition, we continue to develop a network of colleagues and partners who manage billions of dollars around the world. We compare ourselves not to determine if we are better or worse than everyone else, but to learn if others are solving problems or improving outcomes in ways we haven’t thought of yet. We are confident that our investment approach is of the highest quality, but fully admit that we can always learn from our peers and competitors.

To that extent, one of the more recent headlines over the past few weeks has been the performance of the $35 billion Harvard Endowment. For the fiscal year July 1, 2015 - June 30, 2016, the endowment performance was -2.0%, translating to a headline grabbing loss of nearly $2 billion for the year. On the flip side, the slightly smaller Yale Endowment ($25 billion) returned 3.4% over the same time period. Preliminary data from Wilshire Associates estimates that the average return among endowments was -0.73%. These comparisons ignore any differences in asset allocation; however, Yale, Harvard, and most educational endowments have similar asset allocations. They typically have approximately 50% committed to equities, with half or more of that in private equity. They have 10-15% in fixed income, and 35-40% in alternatives. Alternatives can be extremely diverse, but typically include various forms of real estate, commodities, and hedge funds. Most endowments will allow up to 50% illiquidity, and because of their size they often invest directly in those assets, such as buying buildings and land directly or taking an ownership interest in a private company.

When we compare this data to MRA, we can make some interesting observations. First, performance for our clients of a similarly allocated portfolio over the same time period was above Wilshire’s estimate for endowment portfolios, gross of fees. We would be concerned if a similar allocation had wildly different results. Second, we are holding our own without investing in some of the higher performing illiquid options. For example, asset class data from Harvard shows that it had 20% invested in private equity which returned 2.6% for the period. The endowment also had 14.5% invested in private real estate which returned 13.8% for the period. While we don’t have asset class performance for Yale, it has a 31% allocation to private equity, a 12.5% allocation to real estate, and a 22.5% allocation to long/short equity hedge funds. We are not trying to compete with Yale, but we fully understand why we didn’t earn as much as it did, and why we outperformed the Harvard endowment.

We want to reiterate that the objective of these comparisons is not to keep score, but to learn. We are not running around the office shouting “we beat Harvard!” because we know that is not our objective, and one year’s data doesn’t really mean anything. However, the smartest asset managers in the world managing some
of the largest pools of capital face the same problems we do. Equity returns are going to be lower than they have been historically and fixed income offers very little return with potentially increasing risks. Endowments need to generate return to fund their programs the same as we need to generate return to meet our clients’ objectives. Our clients benefit from the fact that we are continuously evaluating ourselves and learning from the wisdom of other asset managers, and we have the courage to implement new and unique ideas that can improve portfolio outcomes.

Regarding the Election...

We intentionally avoided making this commentary about the election, because frankly CNN and Fox News have it covered. However, comparison is a relevant topic when considering the two presidential candidates. Along with many of our peers and colleagues in the industry, we have a difficult time comparing the candidates’ economic plans and the impact they may have on the country. They have changed and will continue to change, and we are not sure either candidate is fully communicating the process required to accomplish his or her objectives. Free college education and renegotiating trade deals cannot simply happen, but will require collaboration and consent among many parts of the government. Unfortunately, the result is that we are left to compare ideas meant to attract votes, and not concrete plans that have been fully vetted. We do want to address one statement from the recent debate, which is that the stock market is in a bubble, and asset values will crater the minute the Fed raises interest rates. First, we do not believe the market is in a bubble. Valuations are not at extreme levels and there are no signs of disruptive risks in the economy. On the contrary, our country continues to experience the weakest economic recovery in post-war history. As we have written previously, we are more concerned that this environment persists for a long time, resulting in a need to reset expectations about returns in stocks and bonds. We do expect the Fed to raise interest rates, and while the actual decision may cause short-term volatility, we don’t expect it to have a material impact on markets. Adjusting the short-term interest rate by 0.25% or 0.50% will affect the cost of borrowing and the interest earned on savings, but does not directly impact the supply of money in the economy, and currently has no impact on longer-term interest rates. Until the Fed becomes concerned that the economy is overheating or inflation is too high, and as a result reduces the supply of money, we believe the change in the short-term interest rate will have little impact on markets.

The fourth quarter will bring about a new President and (probably) a higher federal funds rate. These changes will create uncertainty among investors about the future and likely lead to short-term market volatility, but they are unlikely to have a material impact in the long term. Regardless, we remain confident in the portfolios we have constructed for our clients and the investments that they own, and we take comfort in the fact that our process and outcomes are consistent with the best and brightest of our industry.