

LESSON #2: PORTFOILO BUILDING

My Risk Tolerances

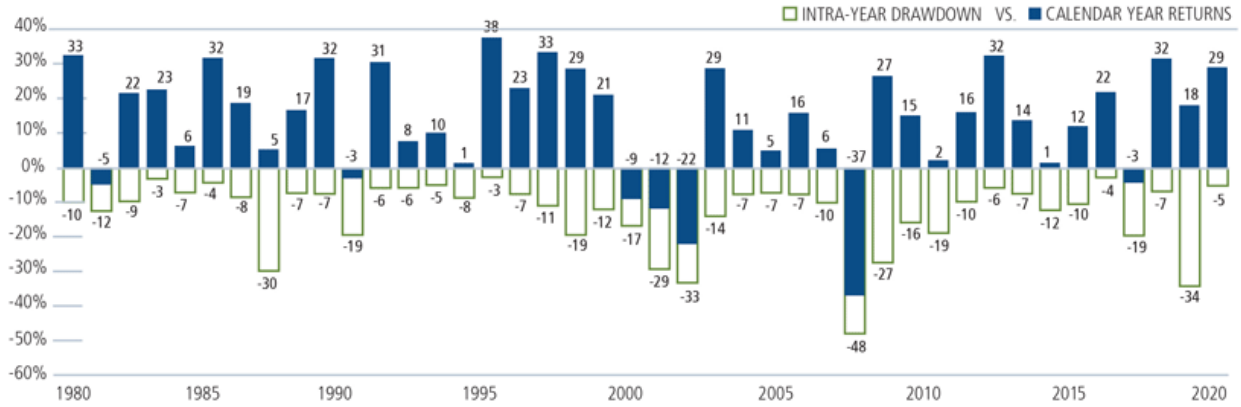
Where do I get my ideas

RISK: parable. father on death bed, gives family business to his son

1. Make good decisions, use your wisdom, make mistakes
2. DO NOT BE AFRAID to make MISTAKES
 - a. If you have never made a mistake, you haven't gained much wisdom
 - b. The very best investors are correct about 70% of the time
 - i. Very good investors are correct 60%+ of the time
 - ii. YOU (I) will NEVER be right 100% of the time
 - iii. Pursue excellence, not perfection
 - iv. Paraphrase John Wooden: Be the best YOU, you can be.
 1. Everyday strive, work to be better at being you
 - c. Average return (with bad years) sp 500 is 11.0%+ since 1950
 - i. Average draw down is 14%
 - ii. Market aver is UP 3 years of every 4
3. We make mistakes of commission and omission
 - a. Sometimes the biggest mistake we make is to NOT take a risk, to not do something
 - b. The first time you did a task, you probably didn't do it well
 - i. Catch a ball, work on the car, cook a steak, etc
 - c. But you did it again, and again and again sometimes succeeding, sometimes making mistakes, until you became competent, good, proficient, etc at it (or you stopped)
4. Learn the difference between the "noise" and a trend change
 - a. www.youtube.com/watch?v=gmMCQz9pG2U
 - b. RISK is the price of admission

S&P 500 MARKET DECLINES IN PERSPECTIVE: EVEN UP MARKETS SEE DRAWDOWNS

AS OF 12/31/2021



Past performance is no guarantee of future results. Source: Morningstar using daily total return data. The S&P 500 Index is generally considered representative of the U.S. stock market.

LESSON #1 homework.

Were you able to do it. Did you figure out YOUR current allocation?



The average return on the SP 500 is about 11.00% per year.

But within the asset categories returns vary year to year

Asset Class Returns

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Ann.
REIT 28.0%	REIT 8.3%	REIT 19.7%	Sm Cap 38.8%	REIT 28.0%	REIT 2.8%	Sm Cap 21.3%	EM 37.8%	Cash 1.8%	Lg Cap 31.5%	Sm Cap 20.0%	REIT 41.3%	Cash 1.6%	Lg Cap 26.3%	Lg Cap 25.0%	Lg Cap 13.9%
Sm Cap 26.9%	HG Bnd 7.8%	EM 18.6%	Lg Cap 32.4%	Lg Cap 13.7%	Lg Cap 1.4%	HY Bnd 17.5%	Int'l 25.6%	HG Bnd 0.0%	REIT 28.7%	EM 18.7%	Lg Cap 28.7%	HY Bnd -11.2%	Int'l 18.9%	Sm Cap 11.5%	Sm Cap 10.3%
EM 19.2%	HY Bnd 4.4%	Int'l Stk 17.9%	Int'l Stk 23.3%	AA 6.9%	HG Bnd 0.6%	Lg Cap 12.0%	Lg Cap 21.8%	HY Bnd -2.3%	Sm Cap 25.5%	Lg Cap 18.4%	Sm Cap 14.8%	HG Bnd -13.0%	Sm Cap 16.9%	HY Bnd 8.2%	REIT 9.4%
HY Bnd 15.2%	Lg Cap 2.1%	Sm Cap 16.4%	AA 11.5%	HG Bnd 6.0%	Cash 0.0%	EM 11.6%	Sm Cap 14.7%	REIT -4.0%	Int'l Stk 22.7%	AA 9.8%	Int'l Stk 11.8%	Int'l Stk -14.0%	HY Bnd 13.5%	EM 8.1%	AA 6.5%
Lg Cap 15.1%	AA 0.3%	Lg Cap 16.0%	HY Bnd 7.4%	Sm Cap 4.9%	Int'l Stk -0.4%	REIT 8.6%	AA 14.6%	Lg Cap -4.4%	AA 18.9%	Int'l Stk 8.3%	AA 10.9%	AA -16.5%	AA 12.8%	AA 7.4%	HY Bnd 6.4%
AA 13.5%	Cash 0.1%	HY Bnd 15.6%	REIT 2.9%	HY Bnd 2.5%	AA -1.3%	AA 7.2%	REIT 8.7%	AA -5.6%	EM 18.9%	HY Bnd 7.5%	HY Bnd 5.4%	Lg Cap -18.1%	REIT 11.4%	Cash 5.3%	Int'l Stk 5.7%
Int'l Stk 8.2%	Sm Cap -4.2%	AA 12.2%	Cash 0.1%	Cash 0.0%	Sm Cap -4.4%	HG Bnd 2.7%	HY Bnd 7.5%	Sm Cap -11.0%	HY Bnd 14.4%	HG Bnd 6.1%	Cash 0.0%	EM -19.7%	EM 10.3%	REIT 4.9%	EM 3.4%
HG Bnd 6.5%	Int'l Stk -11.7%	HG Bnd 4.2%	HG Bnd -2.0%	EM -1.8%	HY Bnd -4.6%	Int'l Stk 1.5%	HG Bnd 3.5%	Int'l Stk -13.4%	HG Bnd 8.7%	Cash 0.6%	HG Bnd -1.5%	Sm Cap -20.4%	HG Bnd 5.5%	Int'l Stk 4.4%	HG Bnd 2.3%
Cash 0.1%	EM -18.2%	Cash 0.1%	EM -2.3%	Int'l Stk -4.5%	EM -14.6%	Cash 0.3%	Cash 0.8%	EM -14.3%	Cash 2.2%	REIT -5.1%	EM -2.2%	REIT -25.0%	Cash 5.1%	HG Bnd 1.3%	Cash 1.2%

Abbr.	Asset Class - Index	Annual	Best	Worst
Lg Cap	Large Cap Stocks - S&P 500 Index	13.88%	32.4%	-18.1%
Sm Cap	Small Cap Stocks - Russell 2000 Index	10.33%	38.8%	-20.4%
Int'l Stk	International Developed Stocks - MSCI EAFE Index	5.74%	25.6%	-14.0%
EM	EM Stocks - MSCI Emerging Markets Index	3.39%	37.8%	-19.7%
REIT	REITs - FTSE NAREIT All Equity Index	9.40%	41.3%	-25.0%
HG Bnd	High Grade Bonds - Bloomberg Barclays U.S. Agg Index	2.28%	8.7%	-13.0%
HY Bnd	High Yield Bonds - ICE BofA US High Yield Index	6.42%	17.5%	-11.2%
Cash	Cash - S&P U.S. Treasury Bill 0-3 Mth Index	1.19%	5.3%	0.0%
AA	Asset Allocation Portfolio*	6.45%	18.9%	-16.5%

Past performance does not guarantee future returns. The historical performance shows changes in market trends across several asset classes over the past fifteen years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/24. *Asset Allocation Portfolio is 15% large cap stocks, 15% international stocks, 10% small cap stocks, 10% emerging market stocks, 10% REITs, 40% high-grade bonds, and annual rebalancing.

Does anyone want to try to rank these categories for 2025?

What if we add in International, commodities, etc

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Emerging Mkt Stocks 71.5%	REIT 26.6%	Cdn Bonds 7.2%	Emerging Mkt Stocks 16.8%	US Small Cap Stocks 35.8%	REIT 29.3%	Cdn Bonds 1.9%	Cdn Stocks 19.3%	Emerging Mkt Stocks 28.7%	Int'l Bonds 1%	US Large Cap Stocks 28.5%	Gold 23.3%	REIT 31.2%	Cash (TBill) -5.2%	US Large Cap Stocks 22.1%	Gold 23.3%
HiYield US Bonds 35.6%	Gold 26.1%	Gold 5.5%	Int'l Dev Stocks 16.5%	US Large Cap Stocks 30.4%	US Large Cap Stocks 12.8%	REIT 1.7%	US Small Cap Stocks 15.9%	Int'l Dev Stocks 23.8%	Cash (TBill) -0.1%	REIT 26.1%	US Small Cap Stocks 17.5%	US Large Cap Stocks 20.2%	Gold -7.2%	US Small Cap Stocks 15.6%	US Large Cap Stocks 21.5%
Cdn Stocks 33.4%	US Small Cap Stocks 26%	REIT 5.5%	US Small Cap Stocks 16.2%	Int'l Dev Stocks 20.3%	Cdn Stocks 9%	US Large Cap Stocks 0.6%	US Large Cap Stocks 9.7%	US Large Cap Stocks 19.3%	Cdn Bonds -0.6%	US Small Cap Stocks 24.5%	US Large Cap Stocks 16.7%	Cdn Stocks 17.5%	Cdn Stocks -11.4%	Int'l Dev Stocks 13.8%	Cdn Stocks 18.9%
US Small Cap Stocks 32.7%	Emerging Mkt Stocks 17.2%	All US Bonds 4.6%	REIT 15.7%	Cdn Stocks 11.7%	Int'l Bonds 8%	Int'l Bonds 0.3%	Emerging Mkt Stocks 9.5%	US Small Cap Stocks 13.8%	All US Bonds -1.9%	Cdn Stocks 20.3%	Emerging Mkt Stocks 13.6%	US Small Cap Stocks 10%	HiYield US Bonds -15%	REIT 9.4%	US Small Cap Stocks 9.8%
REIT 26.3%	Cdn Stocks 14.8%	HiYield US Bonds 4.2%	US Large Cap Stocks 14%	HiYield US Bonds 3.1%	Cdn Bonds 7.2%	All US Bonds -0.3%	HiYield US Bonds 9%	Gold 9.3%	Gold -3.2%	Int'l Dev Stocks 19.3%	Int'l Dev Stocks 8.7%	Int'l Dev Stocks 4.1%	Cdn Bonds -16.9%	Gold 9.1%	Emerging Mkt Stocks 8.2%
Int'l Dev Stocks 24.9%	US Large Cap Stocks 13.4%	Int'l Bonds 0.8%	HiYield US Bonds 12.5%	REIT 0.9%	US Small Cap Stocks 6.7%	Cash (TBill) -0.7%	Gold 6.6%	Cdn Stocks 7.1%	HiYield US Bonds -4.7%	Emerging Mkt Stocks 17.6%	Cdn Bonds 7.5%	HiYield US Bonds -3%	Int'l Bonds -18.7%	HiYield US Bonds 8.1%	HiYield US Bonds 3.4%
US Large Cap Stocks 23.3%	HiYield US Bonds 10.9%	US Large Cap Stocks -0.8%	Gold 6.5%	Int'l Bonds -0.4%	All US Bonds 5.1%	Int'l Dev Stocks -0.9%	REIT 6.3%	HiYield US Bonds 4.9%	US Large Cap Stocks -6.2%	Gold 15.9%	Cdn Stocks 6.2%	Emerging Mkt Stocks -5.8%	All US Bonds -19%	Cdn Stocks 8.1%	Cash (TBill) 2.3%
Gold 20.2%	Int'l Dev Stocks 6.8%	Cash (TBill) -2.9%	Cdn Stocks 6.4%	Cash (TBill) -1.5%	HiYield US Bonds 3.9%	HiYield US Bonds -2%	Int'l Bonds 2.5%	REIT 2.8%	REIT -7.7%	HiYield US Bonds 13.3%	All US Bonds 6.1%	Cash (TBill) -6.5%	Int'l Dev Stocks -20.9%	Int'l Bonds 5.2%	Cdn Bonds 2.2%
Cdn Bonds 4.1%	All US Bonds 5%	US Small Cap Stocks -5.5%	Int'l Bonds 4.5%	Cdn Bonds -2.4%	Emerging Mkt Stocks -0.1%	US Small Cap Stocks -4.3%	All US Bonds 0.5%	All US Bonds 1.4%	Cdn Stocks -10.7%	All US Bonds 6.3%	HiYield US Bonds 3.9%	Cdn Bonds -7.3%	US Small Cap Stocks -23.1%	Emerging Mkt Stocks 5.2%	Int'l Bonds 0.8%
All US Bonds 3.2%	Cdn Bonds 4.2%	Cdn Stocks -10.7%	Cdn Bonds 2.8%	All US Bonds -3.6%	Cash (TBill) -0.7%	Cdn Stocks -9.7%	Int'l Dev Stocks 0.4%	Cdn Bonds 0.6%	US Small Cap Stocks -11%	Int'l Bonds 5.5%	Int'l Bonds 3.1%	All US Bonds -8.3%	Emerging Mkt Stocks -23.2%	Cdn Bonds 2.9%	REIT 0.7%
Int'l Bonds 1.6%	Int'l Bonds 1.7%	Int'l Dev Stocks -15%	All US Bonds 2.4%	Emerging Mkt Stocks -6.4%	Gold -1.2%	Gold -12.3%	Cdn Bonds 0.2%	Int'l Bonds 0.3%	Int'l Dev Stocks -16.1%	Cdn Bonds 4.6%	Cash (TBill) -0.9%	Int'l Bonds -9.2%	US Large Cap Stocks -23.6%	All US Bonds 2.3%	Int'l Dev Stocks 0.1%
Cash (TBill) -2.4%	Cash (TBill) -1.5%	Emerging Mkt Stocks -21%	Cash (TBill) -1.7%	Gold -29%	Int'l Dev Stocks -6.4%	Emerging Mkt Stocks -16%	Cash (TBill) -1.8%	Cash (TBill) -1.3%	Emerging Mkt Stocks -16.2%	Cash (TBill) -0.1%	REIT -6%	Gold -10.3%	REIT -31.1%	Cash (TBill) 1.6%	All US Bonds -1.6%

NO ONE knows what the future will look like, do not expect yourself to be able to do that.

If someone tells you they know, they are lying

HOW would you do this? Or have someone else, do it??????

ROBO Investing?

Subtitle: Scott's rant against Wall Street asset allocation investing models

Robo example, some category is 10% if it moves below 8% computer buys more, if above 12% computer sells some, to stay in range

NO LOGIC, NO THOUGHT, It is all based on past Relationships between asset classes

And though I am a believer in “there is nothing new under the sun” the data they use is only 50 ish years old, and almost exclusively based on one major economic trend, lower interest rates.

Also these programs tend to only reset once a quarter or at most monthly, not when there is a trigger.

They, Robo and most paid “money Managers” are playing: “NOT TO LOSS”

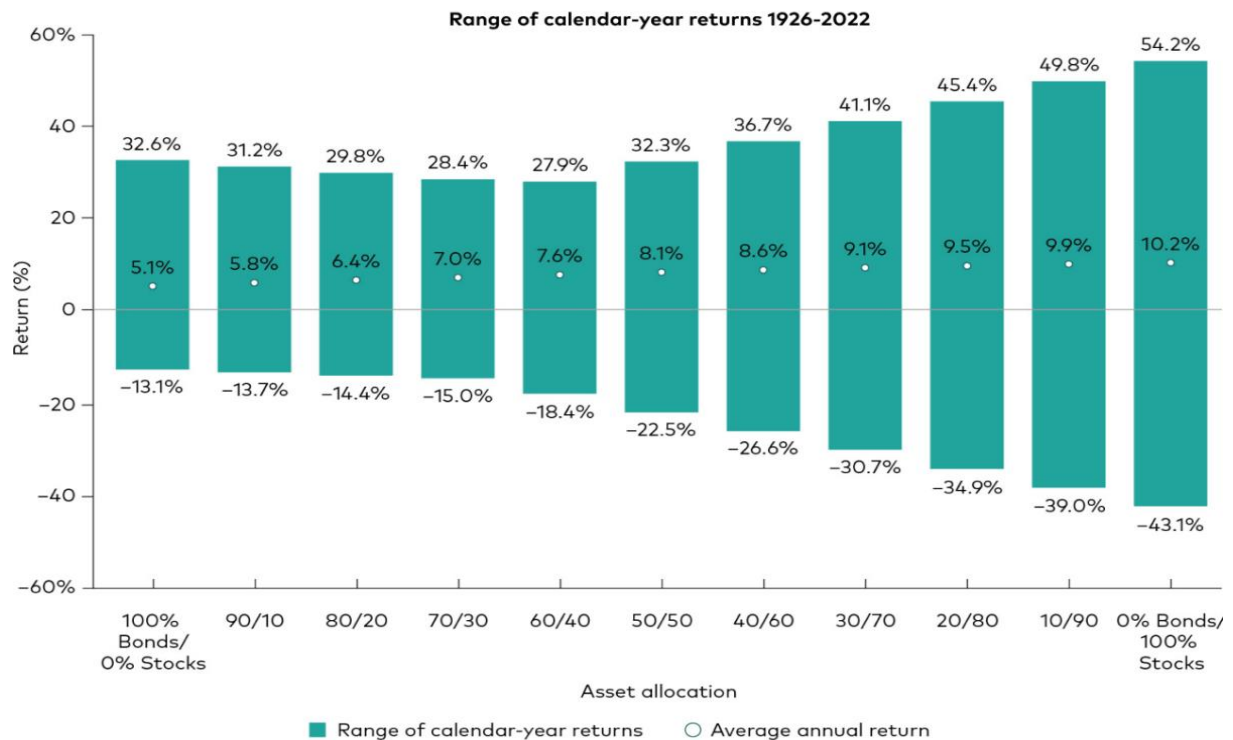
(and thus retain your money, collect the fee)

Are you in this to “not loss” or to “WIN”?

(and I suggest that WINNING is NOT beating the other guy but rather reaching and then surpassing YOUR definition of Financial Freedom.)

1. To thy own self be true
 - a. You do not have to make more than everyone else
 - b. You are not racing anyone, anymore
 - c. At tomorrow bar-b-que/cocktail party you do NOT have to be the person who owns the best investment ever
 - i. And if some one is telling you that you HAVE to get into “XYZ” , remember if there was really \$\$\$ to be made, no one would be shoving it into your pocket (though your “friend” is just letting his/her ego run amok
 - ii. Also remember that if you miss an opportunity in a stock, you do not need to chase after it, there is always another opportunity coming your way

d. Look at the chart



e.

f. Reminder that the average WHICH includes the year/years with losses

g. the famous factor of 72: if your money averages 9.0% return it doubles in value every 8 years

i. so if you retire at age 65 with \$750,000 in investable assets, by age 73 you will have \$1,500,000 and by age 80 close to \$3,000,000

h. Stick to YOUR goals, your asset allocation model

i. Remember that the biggest threat to your success is your EMOTIONS. You are willing to become more aggressive when times are good, returns are high, and you become more fearful when the risk feels highest.. which is just to opposite of what you should be doing

ii. SELL when everyone is buying

iii. BUY when there is blood in the street

iv.

- i. TO manage the risk of the markets successfully you need to create investment ranges
 - i. Example: if your allocation is 50% stocks, you NEVER let it grow past 67%, and never drop it below 33%
 - 1. So if you have a great stock with a great future you hold on to that (mostly) and trim away some of the other stocks that are NOT performing at well
 - a. Caveat: you do not want to let one holding become TOO big
 - ii. Also, they say you should reduce your risk as you age
 - 1. So if your are comfortable with 60% stocks/risk at age 65 by age 70 you should have reduced to 55%
 - a. Caveat: per lesson #1 if you have 2X expenses in after tax cash flow, you can let more growth happen
 - j. WHERE ARE YOU COMFORTABLE
 - k. Right now the “risk free” rate of return is about 4.5%-5%
 - i. 10 Year treasury
 - ii. So you can earn that amount with almost no risk to principle
 - iii. Though if that is all you did you have risk of inflation eating away at your buying power
 - iv.
2. WITHDRAWAL RATES and GROWTH EXPECTATIONS
- a. OR the risk of running out of \$\$\$\$
 - b. When I was taught this stuff, they discussed the “accumulation phase of our financial life and the Distribution phase
 - i. But most of us do NOT want to think that at some point I might run out of money, so we plan, we spend in a way that we hope makes certain there is still money there when we pass
 - ii. Historically a 50/50 allocation makes about 8.00% per year

- iii. They tell us we can withdraw about 4%-5% per year, which leaves 3% potential growth, but if there are taxes, growth is not keeping up with the rate of inflation
- iv. If at age 70 you had \$1 million in liquid assets, and by age 80 it had dropped to \$500,000 how would you feel?
 - 1. If that worries you, you need to either reduce your withdrawal rate or aim for higher growth (add risk)
 - 2. If it doesn't worry you.. party on
 - a. What's the point of having accumulated what you have accumulated if you do not allow yourself to enjoy the fruits of your labor?
- v. IRA RMD
 - 1. Age 73 withdrawing 3.773% of the total balance
 - 2. Age 75 4.06%
 - 3. Age 80 4.95%
 - 4. Age 85 6.25%

3. WHERE DO I FIND INFORMATION/IDEAS

- a. See media at top of this lesson, no one knows what the coming year will look like. If someone is telling you that they know, they are lying and you should FIRE them immediately
- b. The professionals, the people good at what they do will tell you they can NOT predict the future, can not even predict tomorrow
- c. Choose more than one source
 - i. Choose sources that normally disagree
 - 1. A perma-BULL (optimist) and perma-Bear (pessimist)
 - 2. Is the glass $\frac{1}{2}$ full, $\frac{1}{2}$ empty or just $\frac{1}{2}$?
 - ii. Learn to read for what is not being said
- d. Are they providing information, or recommendations
 - i. Do they have a process? Can they articulate it
 - 1. Proprietary?
 - ii. Example I use Seeking Alpha for it's data, I use IBD for its stock picks
- e. Where is the largest percentage of YOUR asset allocation, find someone who specializes in THAT segment
 - i. Example: if your allocation is 70% income and 1% Crypto why pay someone a lot for Crypto updates?
- f. You WILL pay for information and subscriptions
 - i. If you simply handed your assets to a money manager, they would charge 1%-1.5% of the total.
 - ii. So you should be comfortable spending $\frac{1}{3}$ - $\frac{1}{2}$ of that to get ideas, to learn.
 - 1. Eventually as your assets grow (if that is your goal) your percentage will decrease
 - a. If you are primarily fixed income, then what you pay a money manger should be closer to .75% and what you pay $\frac{1}{2}$ of that
- g. If millions of other people are receiving the same advice, that advice becomes less and less valuable

- i. CNBC, Yahoo Finance, Seeking Alpha, Motley Fool all have millions of followers

h. SOME SOURCES

i. FREE

- 1. Your broker, even if you are paying for money management, you should be able to sign up for daily weekly email updates as well as get invited to streaming seminars

ii. NOT FREE

- 1. AAll
- 2. Seeking Alpha
- 3. IBD
- 4. 5 with Fitz

iii. Social media

- 1. @avigilburt Elliot wave trader
- 2. @BraVoCycles Technical Analysis
- 3. @jamesBotdCS_ Schwab trading, charts
- 4. @fitz_keith Keith Fitz-Gerald
- 5. @stockmarketNerd. Brad Freeman fundamental
- 6. @keithMcCullough Hedgeye
- 7. @jake_Wujastyk trader, entry and exit points on his stocks
- 8. @theEconomist magazine
- 9. @quennOfFibs Fibonacci (local)
- 10. @LizAnnSonders Schwab chief investment officer

4. HOMEWORK

- a. Pick two sites for gathering information, stock ideas, and be prepared to discuss why you picked those.
- b. Come to session #3 with two stock ideas for purchase
 - i. Be prepared to discuss why you picked that idea
 - ii. What to upside is, what the down side is
 - iii. Where you got the idea