BURNS ADVISORY GROUP
private wealth management

2012: Back to Basics
December 2011
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Innovation, taken as a whole, broadens choice and removes barriers to entry. More choice leads to better options that are accessible to an increasing number of people, which is usually positive.

But more access without information can be disastrous. The inventory of new securities available for purchase by anyone with an internet connection grows daily, and yet our collective understanding of the assets or liabilities that underlie them remains constant, and perhaps even decreases given the onslaught of new options.

Most people no longer distinguish between investment and speculation. There was a time not too long ago when an investment referred to a security that offered future cash flows: Interest, dividends, earnings and profits, or income. Back then, speculating was synonymous with gambling.

No more. Today, it seems people are more concerned with how daily headlines from Europe should inform short-term decisions or which precious metal is currently winning an ongoing popularity contest than whether they own assets that will provide value over the long-term.

This is not to suggest everyone is wrong for being distracted. Markets have not achieved levels consistent with their traditional performance, the drumbeat of uncertainty has grown louder, and, most disconcerting of all, returns have been sluggish.

But these are the conditions during which the differences between investors and speculators are clearest. Investors research the securities they consider purchasing, understand the risks they present and maintain a perspective that necessitates long-term ownership of true investment assets. It is not always easy to convince others this is the most prudent path.

Right now, the risk people feel most acutely is price volatility, probably because it is also the most visible. Many people are willing to do just about anything – including taking on a range of other risks – to avoid this one. They are turning their backs on the stock market at a time when stocks arguably represent the most attractively valued liquid investment option.

People are unwilling to pay low prices for stocks, but they are eager to increase inflation risk by purchasing bonds that yield less than the rate of inflation. When these low yields prove unsatisfactory, they choose to boost them by increasing exposure to riskier companies via junk bonds, which carry higher default risk. Or they choose to extend the duration of their bond holdings, which not only increases their default risk but also introduces the risk that rising interest rates will eventually erode their returns.

Those willing to accept stock price volatility are going to be rewarded over the long-term. People paying high prices to avoid it will eventually realize their exposure to other less obvious risks.

One final note about Europe. No one can be certain the outcome or timeline of ongoing discussions in search of a comprehensive solution, but market reactions to the various policies floated over the past several months have made one point clear. The market will cast a swift and disapproving vote whenever the proposed fixes attempt to skirt Europe's fundamental issues. This is not a sign the situation is out of control, but rather that markets have the power to regulate government response. That should reassure Europeans and investors.

Markets will effectively force European leaders to find a palatable solution. Their governments will be punished until they make the necessary reforms. This process may not be comfortable but it will ultimately lead to positive change.

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