July 9, 2015

Dear Client:

So far, 2015 has not been very profitable.

For the first six months of the year, the S&P 500 Stock Index is up just 1.2%.* The Dow Jones Industrial Average is completely flat – no gain at all. It's as bad for bonds, too: The Barclay's Aggregate Bond Index is down 0.1%. Pretty discouraging if you've been watching your account values daily (which you know we discourage!).

You might be annoyed at the lackluster returns of your portfolio. Perhaps merely curious, or even scared. **This letter will explain why the markets have been flat all year, why that might continue for several months more and what you should do about it.**

First, picture yourself at an intersection with a 4-way stop sign. There are cars stopped from every direction, including you at yours. Off to the right you hear a siren and it's getting louder, suggesting an emergency vehicle is approaching. Across the street on the left two small children are playing with a ball – and you sense that the ball, and the kids themselves, are about to enter the street at any moment. On your near left is a person walking with a cane, crossing (slowly) and eventually will be in front of you.

What shall you do?

If you're like most responsible, careful drivers, you'll do…nothing. You'll wait until the scenario becomes clear and distractions and risks dissipate. Wait for the kids' mom to call them back to the yard. Look to see if the ambulance reaches your intersection and wait for that pedestrian to cross the road.

Just wait a little while and you'll soon be able to continue on your way, safe and unperturbed, without being late to your destination.

This is what the financial markets are doing: waiting. The markets realize that there's a lot going on, and we believe that investors are waiting to see what's going to happen next. If Greece's debt default persists, it might reduce Europe's economic growth. If that happens, it might reduce U.S. growth, too. Notice there are two "ifs" in these sentences – far from any certainty.

Puerto Rico might default on its debt too – with potentially far greater implications on millions of American retirees who (often unknowingly) own those bonds. If that happens, states could feel the pressure as their elder residents suffer financially. A couple more "ifs" just surfaced.

China's stock market has fallen more than 25% in recent weeks. If declines continue, these might have ripple effects across the global economy. But the Chinese government reportedly is planning to change rules that could pump trillions of dollars into the global market. Two more "ifs."

And of course, we're in the early stages of a presidential election. At last count, that's 21 more "ifs."

You're getting the picture. **Given these recent and ongoing developments, it's no wonder the markets are flat.** They're sitting at the stop sign, waiting for a clear go-ahead signal.

Instead of being disappointed about the past six months, we have a different perspective: We're thrilled that the markets have been flat. After all, if I were to tell you that Greece and Puerto Rico were about to default and China's stock market has fallen 25%, wouldn't you assume that U.S. prices are also down sharply?

But they're not! They're essentially at the same level they've been for over a year – despite all this scary news!

In our view, this shows how strong the U.S. economy really is. Instead of falling sharply, the markets are content to hold the gains of the past eight years and are simply waiting to see what's next. It's as though a long-distance runner has paused to catch her breath and drink some fluids so she can soon resume her trek.

We would not be surprised if the markets continue their "wait-and-see" mode for several more months. **But at some point – maybe tomorrow, maybe in December, maybe somewhere in-between – the markets will realize, as they always have, that the world is not coming to an end.** That Greece's economy is the size of Connecticut's and not capable of sustaining any disruption beyond its borders, that Puerto Rico's impact on the U.S. economy is near nil, that China is not the mighty economic power (not yet anyway) that some in the media are portraying it to be.

And when the markets realize that, we believe that stock prices will resume rising. And it wouldn't surprise us if that resumption is both fast and at a time when no one expects it.

After all, we've seen this story before. Consider, for example, the year 2004. The S&P 500 started that year at 1120. And that's where it was on February 4, March 18, April 21, May 27, July 7, August 7, October 8 and November 1. Indeed, for the first 42 weeks of 2004, the stock market gained a paltry 1%. Pretty disappointing.

But in the last 10 weeks of 2004, the stock market zoomed, with the S&P 500 jumping 10.7%. In just 10 weeks!

2004 Performance of the S&P 500

This is not the only time the stock market has behaved this way; it has performed similarly in many years. Here are some further examples:

- In 2014, 75% of the yearly gains occurred in the last 11 weeks of the year.
- In 2010, the S&P 500 was down 7% through June 30; by year-end it was up 23%.
- In 2005, after being down 1.3% for nearly nine months, the S&P 500 gained 5.2% in the final nine weeks.
- In 1999, 71% of the gains occurred in the last 12 weeks of the year.
- In 1998, the index gained 29% in 12 weeks, after returning 0% for the first 40 weeks.
- In 1982, the S&P 500 was down 9.5% through July, but finished the year up 31.9%!

Of course past performance is not indicative of future results. And, the current market conditions could continue for a prolonged period of time.

This explains once again why we encourage you to own a portfolio that is extensively diversified, and that you own it on a long-term basis, rebalancing as needed. So, here's what you need to do right now:

1. **Make sure your portfolio is properly diversified**. Don't concentrate your investments in just one or two asset classes, or you run the risk of owning the wrong ones.
2. **Make sure you stay invested for the long-term.** The only way to be certain that you'll capture all of the returns of the markets when they come is to be fully invested in all of them throughout the entire year. This is not the time to lose faith in your portfolio. Rather, now – while prices are flat – is the time to buy.
3. **Don't focus on the current performance of your portfolio**. Some clients have expressed disappointment (there's that word again) that their investments have not risen in value in months (or, perhaps even declined a little). Looking daily at your portfolio value is bound to raise negative emotions. The best way to avoid this emotional roller-coaster is to *not look*. But if you insist on looking, look not only at your portfolio but at market averages, too. You'll see that your portfolio's performance is consistent with the overall markets. This will help you maintain a long-term focus. Remember: Patience is a valuable investment strategy.
4. **Make sure you add to your accounts regularly.** Adding to your investments while prices are down or stagnant helps improve your overall future wealth!
5. **Make sure you manage withdrawals effectively.** This is especially important if you are dependent on income from your portfolio.

Despite short-term uncertainty, we remain confident in the long-term potential of the financial markets and believe your portfolio is properly invested for your situation. You should not expect double-digit returns in the short run; the tortoise is in control these days, not the hare. Greece, Puerto Rico, the election, hack attacks, terrorism and natural disasters will dominate the news, and new developments certainly will affect the markets, as will the unexpected.

As always, we continue to closely monitor the economy, the markets and your investments, and we will continue to be in contact with you as circumstances warrant. And if anything changes in your circumstances, please let us know.

Regards!

Ric Edelman
Chairman and CEO

*All market statistics sourced from Bloomberg.