Financial Alternatives
integrated wealth management

Jim Freeman, CFP® / Chris Jaccard, CFP®, CFA **July 2018**

Market Performance 2018

We saw several asset classes reverse their performance from the first to second quarter of this year. US stocks and REITs went from small losses in Q1 to gains; while, Emerging Markets gave up gains and extended losses this past quarter. See our Market Review Newsletters for detailed returns for stock and bond markets around the world.

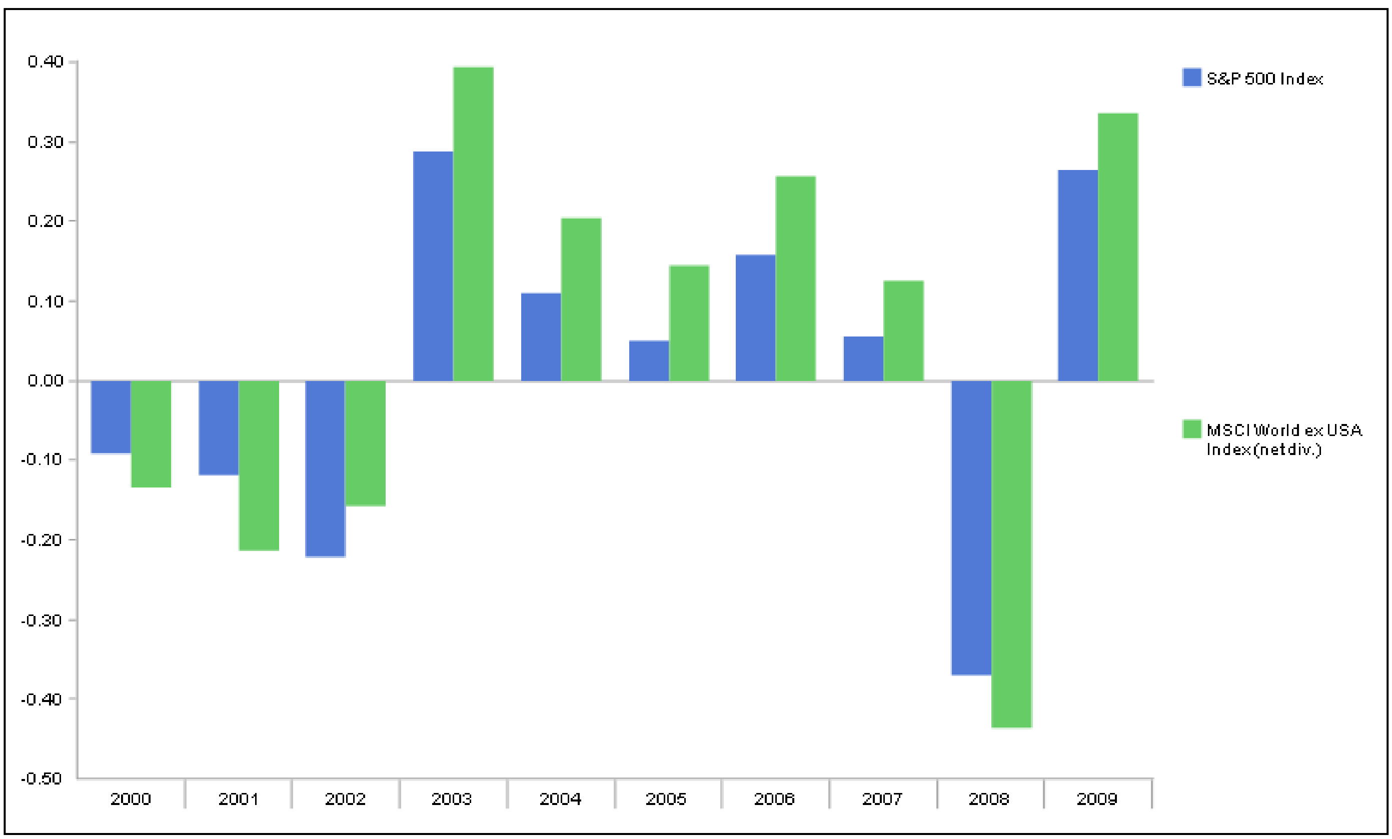
Global Diversification

Last year, International Developed and Emerging Stocks outperformed the US Large Stocks. While much of that trend continued into the first few months of this year, it reversed itself in the second quarter. It can be hard to invest globally when US markets outperform - as they have since the financial crisis - but we believe global diversification is an important part of successful investing.

When you look at the bar chart below, you can see that US Large Stocks (S&P 500) and International Stocks (MSCI World ex USA) moved in the same direction over the period from 2000 to 2009. However, the magnitude of

Executive Summary

- Last year International Developed Stocks and International Emerging Stocks outperformed US Large Stocks.
- Year-to-date US Stocks are outperforming International Stocks.
- For the 10 year period from 2000–2009 the S&P 500 lost -9.10%. International investments logged significant gains during this period.
- Maintaining a globally diversified portfolio can help to smooth out the returns of a portfolio concentrated in US stocks.
- It is next to impossible to successfully time moves between US and international investments in an effort to always be in the highest returning markets.
- It is better to remain globally diversified and disciplined in rebalancing your portfolio back to its predetermined allocation.
- Vanguard is forecasting lower returns over the next 10 years.



Source: S&P Dow Jones, MSCI 2018

the changes was different from year to year.

This 10-year period is a dramatic example of why it makes sense to diversify globally. During this time, the S&P 500 Index lost a total of 9.10% (that is a long, long time to invest with a loss!). In contrast, the MSCI World ex USA NR Index gained a total of 17.47%.

Now see below how a selection of investments performed from 2000 through 2009.

Fund	10-Yr Return
Vanguard S&P 500 (VFIAX)	-9.18%
Vanguard Total Int'l (VGTSX)	25.38%
DFA International Value (DFIVX)	90.67%
DFA Emerging Market (DFEMX)	147.78%

Having international stocks in one's portfolio helped to cushion a very difficult period for US Stocks. Another chart below shows that it is not unusual for international stocks to outperform US stocks and vice versa for multiple years and in some cases over more than a decade.

It would be attractive to be able to swap investments between international stocks and US stocks when one is outperforming the other, but doing this consistently over time is all but impossible. By maintaining an allocation to both US and international stocks, we seek to smooth out rough periods and potentially enhance total returns. Holding a globally diversified portfolio and maintaining discipline by rebalancing back to a target allocation, forces investors to buy low and sell high which is the opposite of what their emotions would have them do when markets underperform or outperform.

	MSCI EAFE	S&P 500
1970-1989	16.3%	11.6%
1990-2001	2.7%	12.9%
2002-2007	14.8%	6.1%
2008-2017	2.4%	8.5%
1970-2017	9.6%	10.5%

Source: Ben Carlson

The hardest time to hold international stocks is when US markets outperform them for several years like they did during the tech boom from 1995-1999. The feeling is exacerbated when you have friends or associates who have all of their stock investments in the US and are touting their returns. This can cause you to wonder why you have these international investments holding back your performance. Yet during periods like 2000–2009, you would greatly appreciate the blended risk and reward of global diversification.

Vanguard's Real Return Forecast

Vanguard recently summarized their 10 year outlook for US stocks and bonds in a piece entitled, "Where's the global economy heading?" In short, they expect returns to be "very muted" in the range of 3% to 5% before inflation, with real returns (after inflation) in the 1% to 3% range.

According to Vanguard, the period following the financial crisis - where policymakers deliberately stimulated markets - is over. Central bank efforts pushed up the prices of risky assets to try to encourage firms and households to spend money. Vanguard believes we are moving into a period where this will begin to reverse itself, and lower future returns will result from the unwinding of these stimulative policies.

We feel it is important to share this information to help you prepare you for what could be a period of lower market returns over the next 5 to 10 years. It will be important to remain disciplined and patient if this forecast materializes.

Summary

Global diversification enhances portfolio returns during times when US markets are underperforming, and weakens returns when US markets are outperforming. By sticking to a disciplined strategy of global diversification, investors can smooth out their portfolio returns over longer time horizons. It is best not to try to time which markets are going to outperform and instead be disciplined in rebalancing back to a predetermined portfolio allocation.

Vanguard is forecasting lower returns for stocks and bonds over the next 10 years. We feel it is important to consider this forecast as a real possibility and plan accordingly.

Please call us if you'd like to discuss your investments or any other aspect of your financial life in greater detail. We hope you are enjoying your summer.

Past performance is no guarantee of future results. All content in this newsletter is intended as general information, not specific advice. Performance data listed is for illustrative purposes only. Portfolios are personalized and often consider many variables, including investment objectives, age, time horizon, risk tolerance, and tax variables. Information contained herein has been obtained from sources believed reliable, but not guaranteed.

FA Financial Alternatives
integrated wealth management

7825 Fay Avenue, Suite 210
La Jolla, CA 92037

858 459 8289
www.financialalternatives.com