



**Benefiting from fear**  
*A checklist for long term investors*

Our informal “Chicken Little Index” is soaring – gold is over \$900 per ounce; inflation-driven TIPs have surged in price; staggering write-offs continue; the dollar is pathetically weak; the Fed cuts rates but not much happens, World Equity Indexes (Bloomberg: WEI) are all red and many are in bear market territory (down 20% from peak); VIX, a measure of volatility often dubbed the fear index, has doubled in the last year; and national GDP estimates are falling from hat size to drill bit size or below (Bloomberg: ECMX). Chicken Little may or may not be right this time. Since we can’t be sure one way or another until it is too late to act, how can we adapt our portfolios to reduce the fear factor, and even benefit from the trends currently spooking many investors?

True, you can barely swing a leading economic indicator these days without hitting another bearish signal square in the kisser. But this is no time to panic or waver. In fact, there’s never a time to panic or waver. Periods of fear like this one are great reminders that a portfolio should be structured to withstand rough times – and that some portion of one’s holdings should stand strong even when the S&P or EAFE is retreating in shame.

**Fear can be your friend**

Chicken Little’s irrational fears led him to a needless demise (remember Foxy Loxy, who offered help, then ate Chicken Little and his friends?). This checklist can help investors avoid the perils of fear:

- **Make a list of your fears.** Write them down. Fight the enemy you know, not simply the fears fanned by the 24/7 news cycle. When you identify what really worries you – inflation, recession, terrorism, losing everything, losing anything – you can modify investment strategies accordingly.
- **Match your fears with investments that benefit.** For example, a strategy we utilize to help benefit from inflation is to own bonds that rise with inflation. Or, as a declining dollar generally means appreciation for other currencies, own foreign securities and foreign bonds (BWX). It is possible, and advisable, to own investments that aim to be profitable when your worry level rises. Recognize, for instance, that we’re in the midst of a raging bull market right now – in bonds.
- **Stay in balance.** Rebalancing is especially important in fear-rich markets. By scaling back on outperformers and investing more in recent



underperformers, you systematically buy low and sell high, and avoid excessive positions in any single asset class.

- **Own, don't buy.** Think of your portfolio like a clothes closet in Boston or Fargo. You own shorts for summer, sweaters for fall, slickers for stormy days, and parkas for blizzards, plus boots, umbrellas, sun hats and long underwear. You own all of these things all of the time, because it is impossible to know exactly when you will need them, or how to find them at a bargain when you need them most. Imagine the chaos of buying and selling one's outerwear every time the weather forecast changed – you would continually buy high and sell low, and incur excessive transaction charges. Worse still, you would often find that the forecast is wrong, and buy a light sweater when you really need a heavy waterproof trench. Treat your investments the same way. Own everything – a globally-diverse, anything-ready portfolio all the time.
- **Never forget the Big 3.** As individual investors, we face a constant threat from taxes, domestic inflation, and loss of dollar purchasing power in the global economy. Even if you never travel, you buy Middle East oil, Japanese cars, Chinese consumer goods, Brazilian orange juice and Asian textiles. Every portfolio should include elements that work to protect you against fluctuations in the dollar at home and abroad. Just as important, avoid investments designed primarily for non-tax paying entities.
- **Always seek quality.** We used to call them junk bonds before we called them CDOs, CLOs, CMOs and a lot of other arcane acronyms. This junk yielded 12% in a 4% environment; and then values dropped by half in a heartbeat. Lack of quality and leverage on leverage magnifies volatility, and stokes the fear furnace.
- **Make fewer decisions.** We can do crazy things when we are anxious, hurried, scared or confused. We overreact, ignore information, see trends that aren't there, jump on bandwagons, and lose the strength of our convictions. A better approach is to decision-proof your portfolio – buy and hold a portfolio that does not need changing (beyond rebalancing) in times of fear or angst.
- **Pick the right tools.** Variation and volatility are the active ingredients in fearful markets. Because the volatility of individual securities typically far exceeds that of an index that contains hundreds or thousands of similar securities, we recommend building a portfolio almost entirely of indexes. We strongly believe that indexes – especially low-cost, tax-efficient ETFs – are attractive investment vehicles at any time; but this is especially true in unpredictable and volatile markets.



- **Accept the nature of markets.** Without down, up does not exist. Markets rely on the continual tension between fear and greed, optimism and pessimism, panic and euphoria. This realization should be at the heart of every portfolio, enabling positive possibilities in any political, economic, or market environment.
- **Learn from history.** As Mark Twain said, “history doesn’t repeat itself, but it rhymes.” Since 1930, the U.S. economy has experienced a dozen recessions, with two of those occurring in the last 25 years. And over that same timeframe the broad US stock market has returned approximately 10% annually, with big fluctuations both above and below that level. Our current economy is causing many to worry, but history reminds us that the long run growth in national and international markets overwhelms most short term concerns.

**The OCM advantage:**  
*Using index investments, OCM adheres strictly, methodically, and transparently to the investment disciplines of diversification, asset allocation, risk management, and portfolio optimization.*

And finally, **Be realistic.** Sometimes fear *is* justified. For instance, an investor with a portfolio that can only go up when the U.S. equity market is steaming ahead *should* have fears, and should make changes. Now is an ideal to look in your investment closet and check for protection against rain, sleet and snow. *We can help. OCM would be pleased to take a look at your current portfolio and evaluate its suitability for today’s volatile environment.* We promise to treat you much better than Foxy Loxy would.

John Osbon, Chief Investment Officer  
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