

Always Carry Your 'Knife'

How to Survive an Anaconda Attack

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Sometimes our natural reaction to a threat is not the best one. While flight can serve us well in certain situations, when it comes to a market correction or even a full-fledged bear market, flight often hurts more than helps investors. The following story explains why.

I heard this great story, which I hope will provide you with some guidance in handling your personal investments.

There exists a Peace Corps Manual which is given to its volunteers. It is kind of a survival guide so wherever a volunteer's tour takes them, there will be tips on how to deal with basic survival. In the book's table of contents you will find sections devoted to: "How to Build an Igloo" and "Where to Find Water." Curiously enough, there is a section devoted to "How to Survive an Anaconda."

Since the largest anaconda on record is 37.4 feet long and weighs more than 500 pounds, if you were to come across one in the Amazon, your reaction is probably similar to mine—run and don't look back!

Many feel the same about the market, but here begins the problem. The market, like the anaconda, is faster than you. The market is efficient, and by the time you realize what is happening in the market, changes have already occurred. If that is the case, what should an investor do?



Let's see how the Peace Corps suggests we survive an anaconda attack.

- 1) Lie flat on the ground. Do not panic. The anaconda will begin to climb all over your body. Be calm!
- 2) After the anaconda has examined you, it will begin to swallow you, beginning with your feet. Be calm!
- 3) The anaconda will suck your feet into its body. Be still! This will take a long time.
- 4) When the anaconda has almost fully swallowed your legs, calmly remove your knife and kill the snake. Once killed, slide yourself out from the snake.

Be sure you have your knife!

Now you ask, what does this have to do with surviving a bear market attack?

- 1) If attacked by a bear market, do not run. The bear market is faster than your money.
- 2) Lie flat on the ground. The bear market will begin to climb all over your money. Be calm!
- 3) After the bear market has examined your money, it will begin to swallow your money. Be calm! This will take a long time.
- 4) When the bear market has almost fully swallowed your money, calmly remove your knife and kill the bear market.

Be sure you have your knife!

So besides being calm (sure), you need a "knife." And in a bear market attack, your strategy is your knife.

Most investors assume they can scatter their investments in various categories and they will be properly diversified. Many do not realize that the various categories represent pieces to a puzzle, and that there is a science to developing a sound strategy.

How investments combine is one of the biggest decisions in investment planning. It is the puzzle, not the pieces, that is crucial. Just because you have two different investments that do well individually and do not correlate, does it make sense to combine them?

What often occurs with investors is **DiWORSE-ification**. Good things help you less than bad things hurt you. By assuming that you can just scatter different types of investments for your allocation, does not assure you that your portfolio will perform well.

| Pieces | Puzzle |
|---------------------------|--------------------------|
| Due diligence | Optimal combinations |
| Recommendations | Manager bias mitigation |
| Attribution | Behavior diversification |
| Manager search and visits | Portfolio creation |

Focus on the puzzle, not just the pieces, and reorganize:

What doesn't work in building a diversified portfolio? Basing decisions just on investment correlation and investment overlap. What does work in building a diversified portfolio? Bias mitigation and behavior diversification. What is involved? Look at scenario attribution.

How often and how much do certain factors contribute to the investment outperforming the benchmark? Some examples are: What region or sector is the fund investing in? What asset classes and sectors are involved? When does currency come into play? When do positive and negative market conditions come into play?

What else can help? How about more asset allocation changes and thinking outside the style box? In addition to alternative investments, utilizing all-cap, opportunistic global and SMID Scan help develop a sound investment strategy.

Lastly, in designing your strategy, do you focus on downside risk, tax awareness, social responsible investing, alpha-driven or income? These factors need to be considered.

The lesson learned is being prepared and having a defined strategy so when the bear market attacks, you will have your "knife."



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