Monument Group
Wealth Advisors, LLC

July 22, 2014

Dear Clients and Friends,

Readers of our quarterly letters may recall that we recently minted the term “bubblishers” (referring to those that publish market bubble headlines). While the term hasn’t caught on with the public or the offenders, the bubble articles are still being generated. Two common themes in the latest round of the bubble discussions are the current level of the equity markets and the length of time since a market correction (typically defined as a 10% decrease in the equity market in a relatively short period). The case is being built for the bursting of a bubble. What do we think?

We reviewed data (along with applying practical experience) to support our belief that bubbles are difficult to detect until after the fact, that market corrections are inevitable albeit generally unpredictable and that an investor’s behavior is one of the most important determinants of long-term investment success. We’ll spare you the details and share the not-so-short summary.

But, first, are we in a bubble?

Generally, bubbles are characterized by unwarranted excitement and exuberance for the bubbling asset or asset class followed by a dramatic drop in the price of the asset. For example, let us point to the late 1990’s dotcom mania and the subsequent bursting of the dotcom bubble. Times are feeling much less than exuberant today than the glory days of Pets.com. Despite the market returns of the last five years, while there may be optimism, we can find neither anecdotal nor empirical evidence of equity market exuberance. Hence, we doubt there is a bubble despite the many headlines that would lead us to believe that we are in the midst of one.

Predicting Bubbles

One would think, with all the research devoted to the market, predicting the bubble and the subsequent burst should be easy. Ideally, we would be able to recognize, profit from and escape the bursting of the bubble. While we can point to a select few folks who have predicted certain bubbles, we have yet to find a person who has consistently spotted the signs and timed them correctly.

801 Main Street Concord, MA 01742 Tel 978.369.7705 Fax 978.287.4208 www.monumentgroupwealth.com

Unpredictable Inevitability of Market Corrections

Simply put, our prediction is that we will see a market correction. Market corrections happen. Yes, despite not having a 10% market drop since the 2011 debt ceiling debacle, markets will correct at some point. We have seen drops of 10% or more in 19 of the last 34 years and remarkably returns were positive in 12 of those 19 years. Unfortunately, neither we, nor anyone, can reliably predict when the market corrections will occur. We recommend focusing on investment issues within our control (asset allocation, expenses, tax efficiency, and behavior, to name a few).

Rewards for Good Behavior

The heart of being rewarded for good investment behavior is summed up in the quote by Benjamin Graham, known as the father of value investing, "The investor's chief problem, and even his worst enemy, is likely to be himself." Several studies focusing on investor behavior prove that Mr. Graham was correct in his assertion. Vanguard studied investor returns versus fund returns for the ten year period ending December 31, 2013 and found that investors fared worse by 1% to 2% than the funds in which they invested (other studies over a 20 year period show investors underperforming their funds by 4% to 5%). Unfortunately, history indicates that mutual fund investors generally receive lower returns from the funds in which they invest due to the timing of their cash flows (i.e., decisions to buy high and sell low generally lead to poor results).

Monument's Take

Successful investing often requires a combination of discipline and patience. Avoiding the "soar and plummet" headlines is one key to successful long-term investing. Monument's philosophy is grounded in evidence-based investing. We believe that profitable long-term investing is built on consistent exposure to the market, disciplined rebalancing, careful attention to investment expenses and taxes, and is based on the unique circumstances of each of our clients.

As always, we welcome your suggestions and feedback and value your trust and confidence.

Sincerely,

Byron E. Woodman, Jr.	Lee C. McGowan, CFP®
President	Managing Director

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