

Many of you have had the opportunity to meet our Founder and President, John Henry McDonald over the years. He often tells his account of Monday, October 19, 1987, otherwise known as “Black Monday.” After the markets closed and the “experts” finally caught their breath, a television reporter interviewed John Henry for his explanation of what had happened and what the general public should expect going forward. His answer (which is the foundation of the Austin Asset Management Company investment philosophy) was simply “I don’t know.” He reached the realization there are many things we can do as investors to mitigate portfolio risk, but at the end of the day, risk and return are still related.

October was one of the most volatile months the global financial markets have ever seen. The current market conditions are undoubtedly more trying than many of you have experienced in your lifetime. For illustration, since 1990 there was only one period (August 1998) in which the S&P 500 moved at least 14% in one month. In the month of October, the market experienced six separate intra-day moves of that size (-28%, +24%, -17%, +14%, -14%, +15%). As bad as things are here in the US, returns have been as bad (and worse in many cases) for most of the global developed markets. The US actually ranks 5th best among 48 world markets tracked by MSCI over both the last quarter and year-to-date. Additionally, oil prices fell 33% in October, the sharpest one-month decline since the introduction of oil futures in 1983.

We recognize that this uncertainty can be difficult to endure as you see such significant fluctuations from one day to the next. The markets are inherently riskier today than they were just months ago. While we continue to believe that prognosticating adds little or no value, it is important to keep proper perspective as we look ahead to what the future might hold. The S&P 500 was down 17% for the month of October and now stands almost 33% below where we started the year. The only two years since 1970 in which the S&P 500 was down more than 20% were 1974 (-26.46%) and 2002 (-22.10%). In both situations the outlook for the markets, and the economy as a whole, were gloomy at best. Nobody could have predicted the S&P 500 would return 37% in 1975 and 29% in 2003. We hold to the belief that risk and return are related. Thus, because there is heightened risk in the markets at this point, there is also a higher expected return for those willing to bear that risk.

Again, we know it is disconcerting to see the erosion of portfolio values. We remain committed to maintaining the strategy outlined in your Investment Policy Statement. This includes being diligent in comparing the current allocation with our targets and rebalancing when appropriate. We believe our unemotional discipline will serve you well in the years to come.

One thing we do have control over is tax efficiency. During this final quarter of the year we are reviewing portfolios in anticipation of mutual fund capital gain distributions. Even though many funds are down substantially for the year, most will still have capital gains distributions to dispense in December. In order to minimize (and in most cases eliminate) your tax liability, we will look for opportunities to harvest losses to offset these distributions. We are fortunate to be able to accomplish this in a way that keeps the portfolio invested throughout the process.

Please do not hesitate to contact us if you have any questions. We would be pleased to meet with you at your convenience to review your portfolio, financial plan, and overall progress towards your goals.

Sincerely,

W. Eric Hehman, CFP®
Chief Executive Officer