Investment Perspectives
2015 Q1

The Success Equation

How many of you believe that Great Success = Skill + Luck? My belief in this equation was reinforced recently after reading the book, The Success Equation by Michael Mauboussin. While I subscribe to the notion that there is nothing you can do to improve your luck and that your luck is just that, luck. I also believe that you can improve your skill which in turn increases your odds for success. In order to achieve success, you cannot rely on skill or luck alone, you have to have both.

A key to understanding the success equation is to recognize where you are on the luck-skill continuum. Whether or not you can improve your skill depends a great deal on where the activity lies on the scale below. If you can easily identify the cause of a given effect, you're most likely on the skill side of the continuum. If it's hard to tell, you're on the luck side.

Mauboussin points out that there are three lessons to take away from his book;

1. Whenever you see an extreme outlier it is a combination of great skill and luck (good or bad)
2. Reversion to the mean is very powerful in that the best estimate of the next outcome is in many cases the base rate. Skill activity = no reversion; Luck activity = complete reversion
3. Paradox of skill; while absolute skill has never been higher, relative skill has never been narrower which leads more left to luck. For example Ted Williams the last person to hit .400 in major league baseball would hit .380 today. This can lead to what is known as Self-Serving Attribution Bias in which people attribute success to their own skill, even in endeavors that are determined mostly by luck

Bottom line, in order to improve your success equation you must pursue a path of deliberate practice in order to increase your level of skill. Here are some ideas to help further develop your level of skill;

- **Develop aids to guide and improve your skill**; Whether you're managing a sports team, running a business, or investing in stocks, a skillful process will be rooted in three parts: analytical, psychological, and organizational.
    - Develop checklists that ensure you actually perform all the tasks you're supposed to perform. They help to direct and manage your attention during distracting times
    - Checklists should be short - five to nine items and fit on one page; language - simple, exact, and familiar to the users; format - free of distracting colors and graphics; typeface - easy to read

- Processes/Checklists should encourage team members to try to identify, prevent, or solve problems. They are living documents that evolve and should be tested and refined as necessary
- **Have a plan for strategic interactions**; if you are the favorite, simplify the game. If you are the underdog, make it more complicated (think David vs. Goliath). Tradition, a lack of awareness, fear of doing something different and then failing, and switching costs can all be factors as to why people fail to move off a bad strategy.
- **Think carefully about feedback and rewards**; a coach or teacher who designs a curriculum specifically to improve performance provides timely and accurate feedback in order to detect and correct errors. Deliberate practice demands performance that is just outside of your comfort zone so there is a constant sense of being challenged without feeling overwhelmed.

One reason that deliberate practice is so taxing is that it compels you to stay in the cognitive stage, constantly thinking about and improving your results, rather than allowing you to slip into the automatic stage, where performance becomes habitual and fluid. Skill does play a role in success and failure, but it can be overwhelmed by the influence of luck.

Insider Trading

10.9...percentage of student loan debt that is at least 3 months delinquent or is in default as of 6/30/14. Just 2 years earlier, 8.9% of student loan debt was at least 3 months delinquent or was in default (source: Federal Reserve Bank of New York)

45...percentage of US households headed by individuals of "working age" who have not set aside any funds for their future retirement

51...percentage of Americans who have less than 3 months of expenses saved in case of a financial emergency

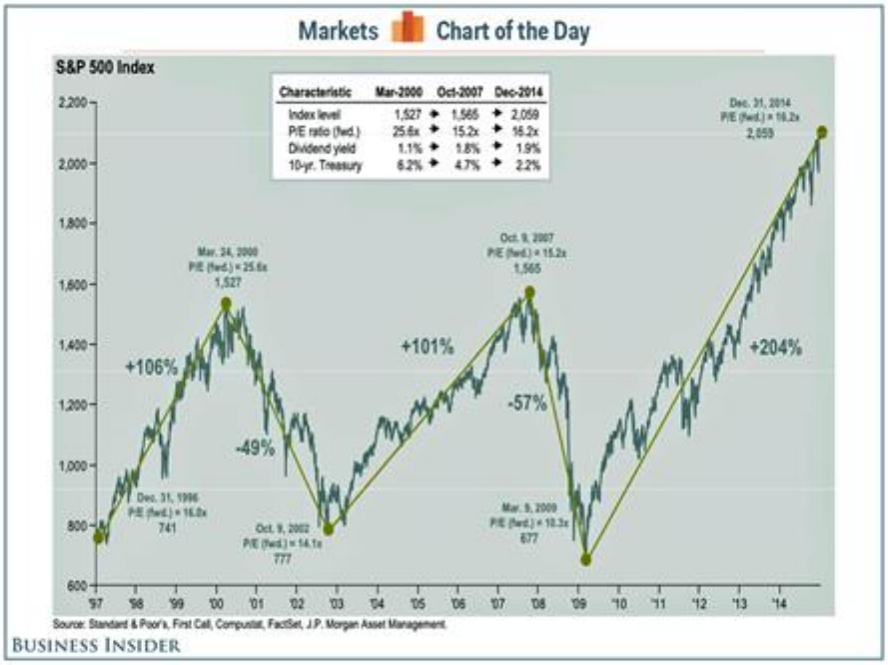
State of the Portfolio

After having a few annual client reviews already this quarter, an interesting discussion point among clients has been the high level of cash that I continue to carry in most client accounts. While 2014 portfolio performance was in the double digits for most of our managed portfolios and our results exceeded their respective benchmarks, the question is why have so much in cash?

What it really boils down to is that I have shifted our allocation from bonds to cash. Meaning, if I was allocating 20% to bonds and 10 % to cash, I am now allocating almost 25% to 30% to cash. While clients are never all in or all out of the equity market, the chart below does keep me up at night. The additional flexibility with higher cash gives me the ability to add more equity assets in a downturn without having to sell assets that I would rather continue to hold.

The chart below shows an almost straight line up from the generational lows set back in March of 2009. Typically we would have seen at least one correction of 10% or more between then and now but we haven't seen a significant pull back such as 10% in years. You can never plan on when such events may occur but you can make choices in order to protect your capital and one of those choices is to carry a larger cash holding.

One point that I would also like to address in this chart is the Price/Earnings ratio. You can see that back at the top in March of 2000 the P/E rate was extremely high at 25.6 but has since dropped down into the mid-15 range between today and the top in October of 2007. This is a result of the increase in corporate profitability that has helped support the rise in asset prices. So while assets prices aren't as expensive in previous market tops the question then becomes, with corporate profits at all-time highs, can this profitability be sustained?



Just like the stock market, many try to predict the future but most are not successful which is why I am hedging to protect my clients' capital while still being invested in the equity markets.

Personalized Investing; Social Security Strategy and 2015 Tax Facts

The Social Security Administration recently sent out email reminders to check your annual Social Security Statement. Typically these statements would be mailed to you every year but the agency did away with that practice for most people a few years ago in order to cut costs. Setting up an on-line account is easy and you get to see more options compared to the previous paper statements that were sent.

I am often asked the critical question of should I take my SS benefits early or wait until full retirement age or beyond? I am of the opinion that most people should wait until they reach their full retirement age or beyond to collect their social security benefits. Only in extreme cases where an individual or couple needs the money as a means to live on do I advise taking benefits early. Typically in these situations it is a result of poor planning or bad decisions that put people in these types of predicaments.

The NY Times penned an article titled The Payoff in Waiting to Collect Social Security. The piece does a great job in highlighting the reasons for delaying benefits.

- If you delay collecting your benefits, which can be claimed anywhere from age 62 to 70, the money you leave on the table each year is basically a payment for a much higher stream of lifetime income. And that money will buy significantly more income, perhaps 50 percent more for a couple, than buying an annuity through a commercial insurer.
- Delaying benefits requires leaving sizable sums of money on the table, which, for many sixty-something’s, could be too difficult — psychologically or financially. Some want to start

collecting what they're owed, while others simply need the money to live on. And individuals who aren't healthy should clearly start collecting benefits as soon as they're eligible.
- But for people who are yearning for more sources of guaranteed income, this strategy — buying more income from Social Security — is especially attractive now when interest rates are low. Commercial insurers cannot compete on price, experts said, and they also have overhead that the federal agency does not.

Since we are still relatively new in the year 2015, I thought that I would share some key tax information for this year when it comes to retirement accounts. Some rates and limits change almost every year as they are adjusted for inflation. Others change in accordance to bills passed by congress.

For an additional listing of tax information and dates, you can access a more in depth list here and below are a few that I think most of you should know about
- Income limits for Roth IRA contribution, single filers: Modified adjusted gross income under $116,000–full Roth contribution; between $116,000 and $131,000–partial Roth contribution; over $131,000–no Roth contribution.
- Income limits for Roth IRA contribution, married couples filing jointly: Modified adjusted gross income under $183,000–full Roth contribution; between $183,000 and $193,000–partial Roth contribution; over $193,000–no Roth contribution.
- Contribution limits for 401(k), 403(b), 457 plan, or self-employed 401(k) (Traditional or Roth): $18,000 under age 50/$24,000 over 50.
- SEP IRA contribution limit: The lesser of 25% of compensation or $53,000.

For questions about IRAs or any retirement vehicle, do not hesitate to reach out to us to find out what option may be best for your own personal situation. Remember at TAMMA, we help to personalize investing for your future.

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