Upper Left Wealth Management, LLC
Q4 2021
Year in Review

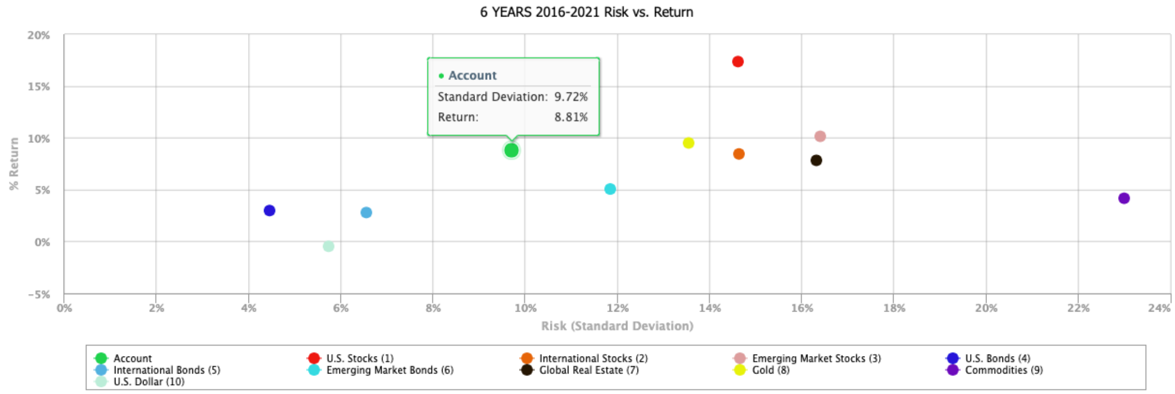
As we do every year, let's look at our portfolio vs. other asset classes. And, like every year, our goal is to be in the upper-left quadrant, with lower risk and higher returns than most assets. Our Core Portfolio is highlighted below.

We're very pleased with how our portfolio did from a risk and return standpoint. But if you're familiar with FOMO, or Fear of Missing Out, you'll understand our feeling because the S&P 500 was up 29% last year. Stunning! Like I've said before, "You would have fired me in 1999." When the S&P is up by such a large amount, solid returns like ours don't always feel so good.

We are in the business of compounding over time while balancing both returns and risk. When *any* asset performs exceptionally, we will likely deliver lower returns in comparison. However, when any asset does exceptionally poorly, we will likely deliver higher returns. Diversified investing aims to even out the highs and lows, creating a smoother path. Diversified investing should deliver FOMO occasionally.

It was a year of haves and have-nots. U.S. stocks, real estate, and commodities all delivered 29%+ returns. On the flip side, emerging market stocks, gold, and all bonds (U.S., developed international, emerging) delivered negative returns. Such large divergences are unusual. But they are what we are built for.

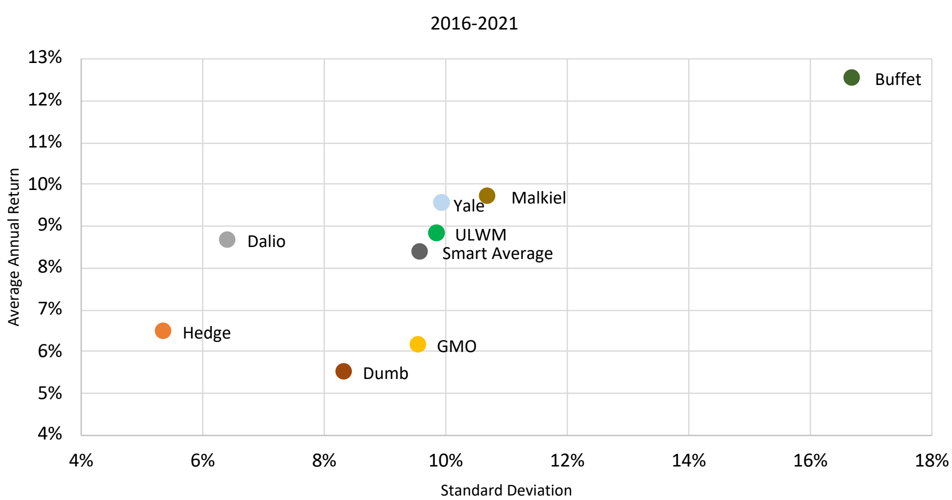
Compare last year's risk/return to a typical 6-year risk/return chart for our portfolios, shown below.



The numbers for the Core portfolio are almost identical for the 6-year period and the 1-year period. A return of 8.83% vs 8.81%, standard deviation of 9.63% vs. 9.72%. All other assets diverged considerably more between the two time periods. The six-year chart is powerful. The Core Portfolio shows lower risk than everything other than the U.S. dollar, U.S. bonds, and developed international bonds and similar or higher returns excepting U.S. stocks (which carried almost 50% more risk!). Let's aim to reproduce this over the next six years.

Looking at long-term results

Let's compare our long-term results with some luminaries in the field. People or organizations which came to mind quickly were Ray Dalio and his All-weather fund, the Yale Endowment, a hedge fund index, a Burton Malkiel portfolio, GMO (Grantham, Mayo, & van Otterloo), a 'dumb' diversified index, and Warren Buffett (although Berkshire is not a globally diversified investment, especially today when a substantial portion of its holdings is Apple). I added "Smart Average" as the average of all the others.



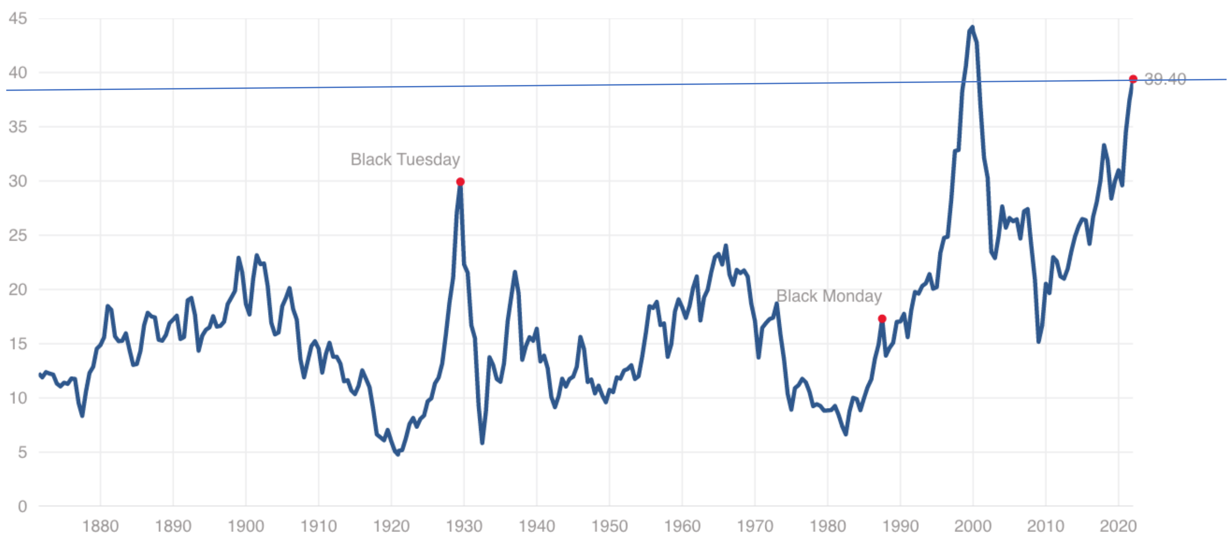
The Dalio portfolio had the best combination of risk and return. Note that the portfolio has a 55% weighting to long-term bonds. Long-term bonds have been a fantastic bet as rates have come down over the last few years. It is hard to envision that continuing going forward. But if you place half your portfolio in one asset class at the right time, things tend to look good.

Berkshire had the highest risk, which is obvious considering its focus on large, consolidated bets. The hedge fund index is likely a function of market neutral funds lowering both the risk and returns, but that is conjecture. I was very pleased to see how our risk/return ratio was far superior to the dumb-diversification strategy. Finally, we are right there with the 'smart average' and the Yale portfolio and in very good company.

That is all I had planned for this quarter. But I re-read last year's annual writeup and could not resist including an update on two sections.

Valuation Matters

The higher the valuation, the more expensive an asset, and the lower our future returns are expected to be. Here is one way to value the S&P 500:



This chart is the Shiller PE of the U.S. stock market. A high number implies an expensive valuation, and vice versa. Looking at this chart, U.S. stocks today are more expensive than any time in history aside from the internet bubble. Further, with 140 years of data, there are no times where purchasing stocks at this valuation proved wise over a medium-term period. U.S. stocks seem expensive, and we remain underweight.

Valuation Matters, and How We Avoided Losing Money on Bonds in 2021

Below is a historical chart of the yield on the 10-year U.S. government bond. When you purchase a bond, the yield is what you expect to earn annually if you hold until maturity. For bonds, a high yield implies a cheaper price, and a low yield implies an expensive price.

Today's yield is around 1.5%. Bonds are more expensive than almost any time in history (the low being around one year ago!). We sold our traditional U.S. bond holdings completely in 2021, due to their high prices. We still own bonds, just not traditional U.S. government bonds, but rather inflation adjusted bonds, floating rate bonds, and international bonds. Rather than own bonds that yield extremely little, we prefer a flat cash position to bonds that will likely drop in price if rates rise.

Looking at our portal and the returns of the benchmarks for 2021, you'll notice that U.S. bonds were down 2.97%, international bonds were down 7.05%, and emerging market bonds were down 7.71%. Our cash position was 'supposed' to be invested in those bonds. We avoided material losses by holding cash. We remain similarly on the bond-sidelines today, aiming to avoid material losses at the risk of missing out on the 1.5% or so yield.

In keeping the cash position for the time being, we've decided:

1. A potential 1.5% yield does not compensate us adequately for the risk of rising rates and declining bond values. In 2021 rates rose a mere 0.6% yet bonds fell 3%.
2. We would rather keep more dry powder available to make purchases of assets at more attractive prices.

Many people are more comfortable being overallocated to expensive assets, rather than having to explain their rationale for doing otherwise. That has never been our game plan. We continue to follow our data-driven approach with the goal of arriving at an upper-left destination.

Randy Kurtz
1/09/2022

Disclaimer:

Risk is defined as standard deviation for the purposes of this letter. 'Diversified' portfolio is defined as equally split between U.S. stocks, international stocks, U.S. bonds, international bonds, real estate, gold, and commodities, rebalanced annually and excluding and fees, taxes, or other costs. This is not a template for how we manage money, but it is a template for how we show the benefits of diversification. This was also the template for the 'dumb portfolio.' Some of the returns from the asset managers mentioned were taken from the website lazyportfolio.com and might not exactly replicate the actual manager performance. The views expressed are the views of Randy Kurtz as of the date on this document and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security and should not be construed as such. Past performance is not indicative of future performance. Individual results will vary, sometimes substantially, from any results discussed here. Any information, statement or opinion set forth herein is general in nature, is not directed to or based on the financial situation or needs of any particular investor, and does not constitute, and should not be construed as, investment advice, a forecast of future events, a guarantee of future results, or a recommendation with respect to any particular security or investment strategy. Any returns presented do not include the effect of fees of any kind or taxes (although the figures mentioned for the Core portfolio is net of advisory fees).
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