

## COMMONSENSE GUIDE TO INVESTING

“Investing is simple, but not easy” – Warren Buffett

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With close to three decades of experience navigating global markets, I have gained insights I wish I had known from the start. My journey began in London and spanned major financial centers worldwide — from Lehman Brothers' trading floors to managing portfolios at Citadel and boutique hedge funds, and now as Deputy Chief Investment Officer at Beacon Pointe Advisors. Each step has deepened my understanding of investing, risk, and wealth creation.

With advanced degrees in finance and economics and experience across both U.S. and European markets, I bring a global perspective to investing. This combination of an academic foundation, cross-border exposure, and real-world application has given me a unique vantage point — and a **set of lessons I now share with the hope of helping others navigate financial markets.**

This guide is designed as a practical resource, covering a spectrum of financial topics — from foundational concepts to advanced strategies. **Feel free to explore the sections that resonate most with your interests.**

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## “Investing Is Simple, But Not Easy”

Although success in investing requires patience and discipline, the core principles themselves are remarkably simple. At its foundation, investing is about putting your money into something — such as stocks, bonds, real estate, or a business — and allowing it to grow over time, earning a return on your initial investment. You do not need to be a financial expert or “beat the market” to be a successful investor. The process, when stripped of unnecessary complexity, is both accessible and logical.

In fact, some of the most effective investment strategies are also the simplest. A buy-and-hold approach, for instance, involves investing in quality assets and keeping them over the long term. Index investing, which involves buying low-cost funds that track the market — like an S&P 500 ETF — offers broad exposure and historically strong performance. One of the best things about investing today is that you do not need a large amount of money to get started.

Time is your most powerful ally. Investing rewards patience more than precision. Thanks to compound interest, even small, consistent contributions can grow significantly over time. For example, investing just \$100 per month at a 10% annual return over 30 years can grow to approximately \$228,000 — all without needing to do anything complex.<sup>1</sup>

### Expected Portfolio Balance Assuming \$100 Per Month Investment

Years	Average Annual Return				
	8%	9%	10%	11%	12%
<b>30</b>	\$150,000	\$184,000	\$228,000	\$283,000	\$353,000
<b>31</b>	\$164,000	\$203,000	\$253,000	\$317,000	\$399,000
<b>32</b>	\$179,000	\$223,000	\$281,000	\$355,000	\$451,000
<b>33</b>	\$195,000	\$246,000	\$312,000	\$397,000	\$509,000
<b>34</b>	\$212,000	\$270,000	\$345,000	\$445,000	\$575,000
<b>35</b>	\$231,000	\$296,000	\$383,000	\$497,000	\$650,000

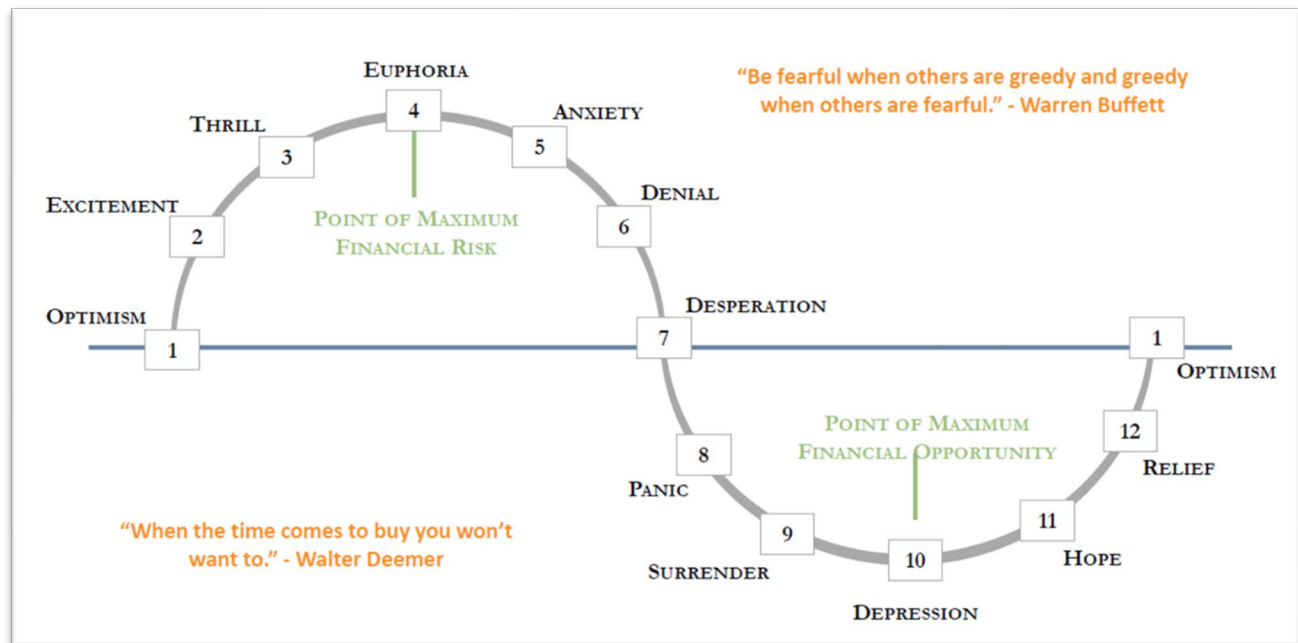
*Rounded to the nearest thousand.*

*Source: Nasdaq, Beacon Pointe. Past performance is no guarantee of future results.*

Perhaps the most overlooked aspect of investing, though, is **emotional discipline**. As Warren Buffett famously said, “Investing is simple, but not easy.” The difficulty lies not in understanding what to do, but in staying committed when emotions threaten to take over. Emotional discipline helps you avoid making impulsive decisions that can sabotage your long-term goals. For example, panic-selling during a market crash might feel like a relief in the moment, but it often locks in losses that would have been recovered with time.

<sup>1</sup> This example is provided for illustrative purposes only and is not intended to reflect an actual scenario.

## The Importance of a Strategy: Emotions of the Market



Source: Beacon Pointe.

Markets naturally rise and fall, and reacting emotionally to these short-term swings can lead to poor timing. Many investors buy when prices are high out of excitement, then sell when prices drop out of fear, which is the exact opposite of a sound investment approach. **Sticking to a long-term plan means staying calm during downturns and resisting the urge to chase hot trends during market booms.** Emotions like fear, greed, and anxiety can cloud judgment, causing investors to abandon strategies, overreact to headlines, or misjudge risks altogether.

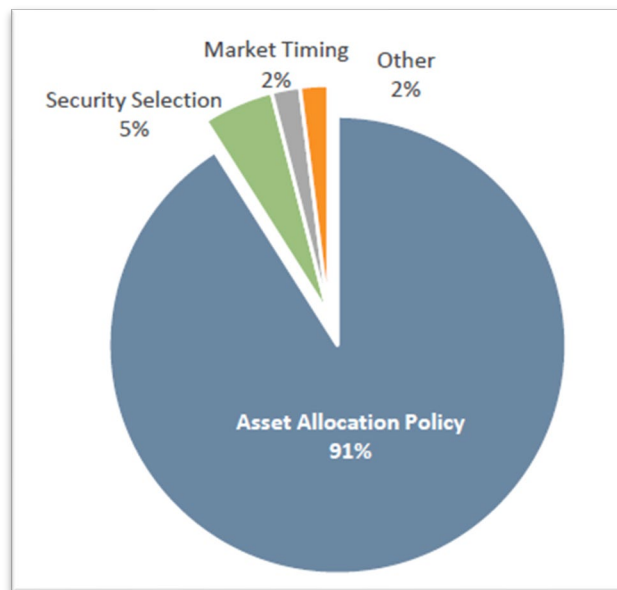
Chasing the latest shiny objects in investing — like trending technologies or hyped sectors — often means buying into assets after much of the upside has already been priced in. This exposes investors to overvaluation risk and sharp corrections if expectations are not met. It can also lead to a reactive, short-term mindset, diverting attention from fundamentals and long-term value. Instead of consistent gains, this strategy often results in buying high and selling low. If a new technology is truly transformative, it will eventually be reflected in the composition of broad-based indexes like the S&P 500. These indexes are designed to adapt and evolve — rising companies gain weight, while declining ones fall away. In other words, patient investors who stick with a diversified index fund can still benefit from innovation, but without the risks of speculative timing or stock picking.

Historically, those who remain disciplined — who stay invested through the highs and lows — tend to perform better than those who frequently jump in and out of the market. Over time, consistency and patience prove far more valuable than attempts to time the market or react to every fluctuation.

## Asset Allocation: The Real Driver Of Returns

Research<sup>i</sup> has shown that more than 90% of the variation in an investor's long-term returns can be attributed to asset allocation — the way you divide your portfolio among different asset classes like stocks, bonds, and cash — rather than the specific securities you pick within those categories. This means that **deciding how much to invest in equities versus bonds or alternative assets plays a far bigger role in your overall performance than choosing individual stocks or timing the market.**

### How Decisions Contribute to a Portfolio's Performance



Source: Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower, *Determinants of Portfolio Performance*, *The Financial Analysts Journal*, July 1986.

Asset allocation helps manage risk and return by balancing growth potential and stability. For example, a portfolio heavy in stocks might offer higher expected returns but comes with greater volatility, while bonds tend to provide more steady income and lower risk. The right mix depends on your goals, time horizon, and risk tolerance.

While security selection and market timing can add some value, they typically have a much smaller impact compared to getting your asset allocation right. This is why many financial advisors focus on helping investors build a diversified asset allocation strategy tailored to their needs. Asset allocation is the foundation of successful investing — making thoughtful decisions about the overall composition of your portfolio is far more important than trying to pick individual winners.

Here is a clear example showing how different asset allocations between bonds (using AGG — the Bloomberg Aggregate Bond Index) and stocks (using the S&P 500 Index) might perform over a 30-year period. Imagine three investors starting with \$10,000 in 1995 and holding their portfolios through 2024 with no additional contributions or withdrawals. Their portfolios are allocated differently between the S&P 500 (equities) and AGG (bonds) and rebalanced annually.

- **Conservative Portfolio: 30% S&P 500 / 70% AGG:** This portfolio prioritizes capital preservation and income. Over 30 years, it would have grown steadily but more slowly, with lower volatility.
- **Balanced Portfolio: 60% S&P 500 / 40% AGG:** A moderate approach balancing growth and risk, this portfolio benefits from stock market upside while mitigating some volatility through bonds.
- **Aggressive Portfolio: 90% S&P 500 / 10% AGG:** This portfolio is heavily weighted in equities, aiming for higher returns with greater volatility.

## Historical Performance

Allocation	CAGR (Annualized Return)	Volatility	Max Drawdown (Peak to Trough Loss)	Ending Value * (from \$10,000)
30% S&P 500 / 70% AGG	6.8%	7.2%	~25%	\$72,000
60% S&P 500 / 40% AGG	8.8%	11.5%	~35%	\$125,000
90% S&P 500 / 10% AGG	10.4%	16.6%	~45%	\$197,000

\* Rounded to the nearest thousand.

Source: Bloomberg, Beacon Pointe. <sup>2</sup>

Higher stock allocations generally deliver stronger long-term returns, yet they also bring greater short-term volatility and deeper drawdowns during market downturns. On the other hand, bonds — such as those tracked by the AGG index — help to dampen this volatility and preserve capital, though they tend to moderate overall portfolio growth. Ultimately, the ideal asset allocation depends on your individual risk tolerance, investment time horizon, and financial objectives, balancing growth potential with the ability to withstand market fluctuations.

<sup>2</sup> The hypothetical historical returns were created with the benefit of hindsight using the percentage allocations indicated above. Any changes to these allocations will impact the hypothetical results, potentially in a material way. Hypothetical performance has many inherent limitations, and no representation is being made that any investor will achieve results similar to those shown. Past performance is not indicative of future results. There is no assurance that the investment objective will be achieved. The value of investments and the income derived from them will fluctuate, and a loss of principal may occur. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index. Indexes do not include expenses, fees, or sales charges, which would lower performance.

## Do Not Get Lost In The Jargon And Overwhelmed By Acronyms

What truly matters is that you understand what you own, at the most basic level. Are you invested in **equities** (stocks), **fixed income** (bonds), **cash or cash equivalents**, or **alternatives**?

Each asset class behaves differently, carries its own risks and rewards, and plays a specific role in your portfolio. Equities offer long-term growth but can be volatile. Fixed income provides income and stability but may lag in returns. Cash offers safety and liquidity but rarely outpaces inflation. Alternatives can add diversification but often come with complexity and illiquidity. Understanding the core nature of each asset class is far more important than getting caught up in product names, tickers, or acronyms. Once you grasp what you actually own — and why — it becomes much easier to build a portfolio that suits your goals, risk tolerance, and time horizon.

People often say they own mutual funds or ETFs, but when you ask them what those funds actually hold, they usually do not know. That is like saying you own a basket without knowing what is inside. Mutual funds and ETFs are just wrappers — vehicles that hold collections of assets like stocks, bonds, or even cash. What really matters is the **underlying allocation**: are you exposed to U.S. tech companies, emerging markets, government bonds, high-yield debt, or something else entirely?

Understanding what is inside your investment is key to knowing your risk exposure, potential returns, and how your portfolio behaves in different market environments. A tech-heavy ETF will respond very differently to interest rate changes or economic shifts than a bond fund. If you do not know what is under the hood, you cannot possibly know how your portfolio will perform — or whether it is aligned with your goals.

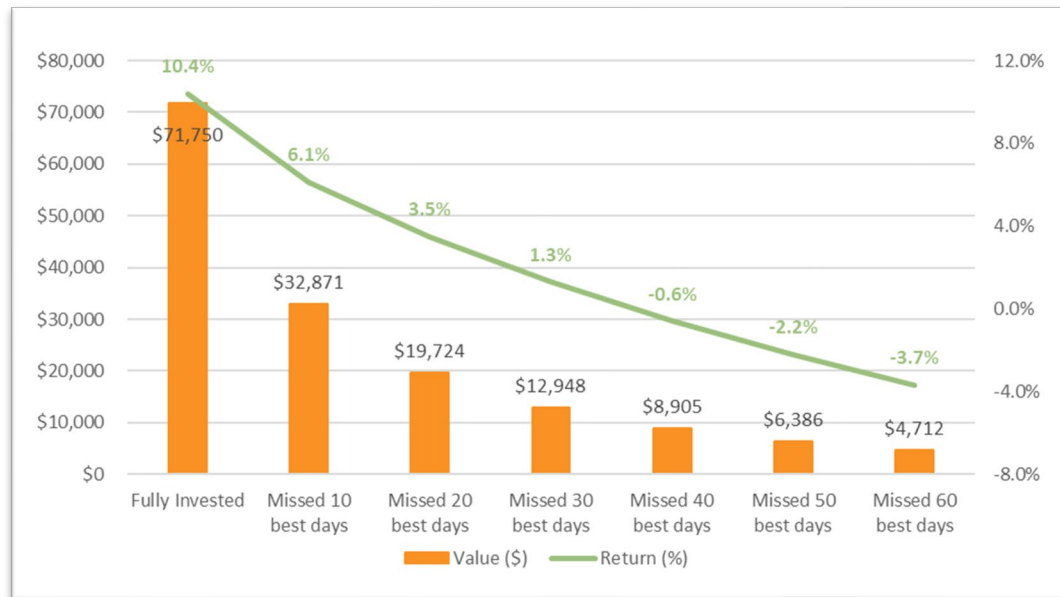
Owning a fund does not automatically mean you are diversified or protected. The real question is: **what securities do you actually own inside that fund — and do they make sense for you?**

## Time in the Market Beats Timing the Market

One of the most important truths in investing is that **nobody can consistently time the market**<sup>ii</sup> — not professional fund managers, not economists, and certainly not everyday investors. Market timing means trying to predict exactly when to buy low and sell high, but this is almost impossible to do with any consistency. Markets are influenced by countless factors — economic data, interest rates, global events, investor sentiment — many of which are unpredictable. Even experts with access to advanced data and research often get it wrong.

The problem with trying to time the market is that missing just a few of the best days can drastically hurt your long-term returns. Historically, some of the biggest market gains have come during very short periods, often right after a major drop when emotions are running high and many people are pulling out. If you are on the sidelines during those key moments, you may miss the recovery, and your portfolio may suffer.

## Impact of Being Out of the Market - Returns of the S&P 500 - Performance of a \$10,000 Investment Between January 3, 2005, and December 31, 2024



Source: J.P. Morgan Asset Management using data from Bloomberg.

That is why the most reliable strategy is to **stay invested**. Time in the market — not timing the market — is what builds real wealth. Staying invested allows you to ride out volatility, benefit from compounding, and capture the long-term growth that markets tend to deliver over time. Markets may go through short-term ups and downs, but historically, they have trended upward over the long run.

Trying to avoid the lows often means you also miss the highs. So instead of guessing when to jump in and out, it is far wiser to have a plan, stick to it, and let your investments work for you over time. Discipline and patience, not prediction, are what lead to lasting success in investing.

## Lump-Sum Investing Or Dollar-Cost Averaging?

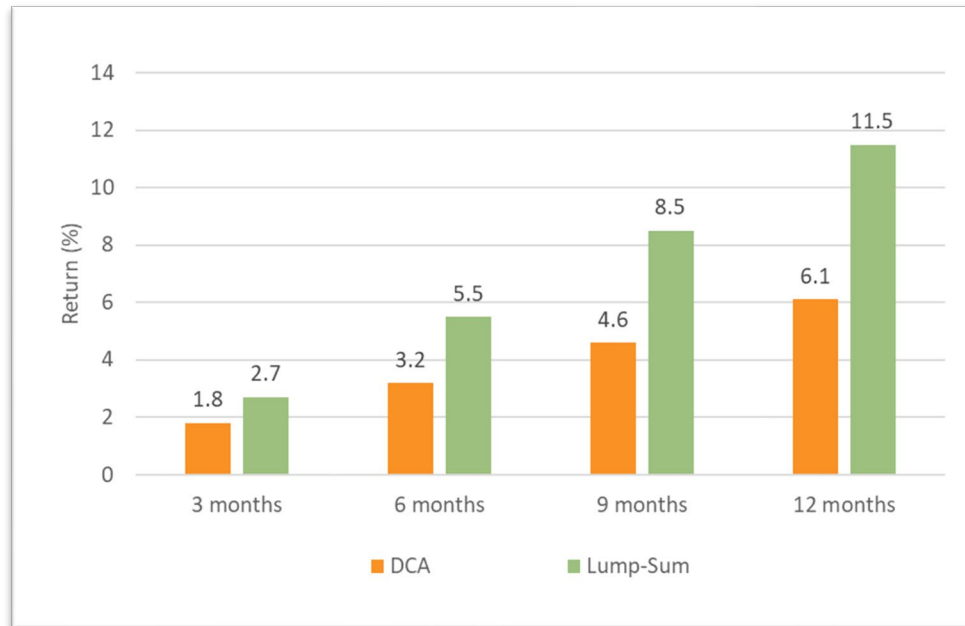
Lump-sum investing—putting all your money into the market at once—is often the better strategy for long-term investors. By being fully invested right away, your money has more time to grow and compound. However, this approach can feel uncomfortable because it requires committing a large amount at once, which raises fears of poor timing and immediate losses. The emotional weight of seeing a sharp drop right after investing can be difficult to handle, especially in volatile markets. While **data consistently shows lump-sum investing tends to outperform over time**, dollar-cost averaging may feel safer for investors who value reduced psychological stress.

Dollar-cost averaging (“DCA”) is an alternative strategy where an investor spreads out their investment by contributing fixed amounts at regular intervals, regardless of market conditions. This disciplined approach reduces the risk of investing a large sum right before a market downturn, and it helps smooth out the impact of short-term volatility by buying more shares when prices are low and fewer when prices are high. While it may sacrifice some potential returns compared to lump-sum investing, **DCA can be a useful strategy for managing emotions and maintaining consistency**.



The chart below compares the average returns of lump-sum investing versus DCA, measured over monthly intervals ranging from three to 12 months, across each consecutive year since 1990.

## Lump-sum vs. Various DCA Strategies



*Source: RBC GAM, Morningstar. S&P/TSX Composite Index (TR). Reflects the average returns of both a lump-sum investment and dollar-cost averaging strategy over 3-, 6-, 9-, and 12-month periods for each consecutive year between date range of January 1, 1990 to October 31, 2024. Returns are based on monthly total returns. An investment cannot be made directly in an index. Graph does not reflect transaction costs, investment management fees, or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results.*

Over long periods, markets have historically trended upward, making early and full investment more effective than spreading it out. While DCA can help reduce short-term risk, it often results in lower returns compared to lump-sum investing. For investors with a long-time horizon and the ability to tolerate short-term market fluctuations, **lump-sum investing is typically the smarter choice.**

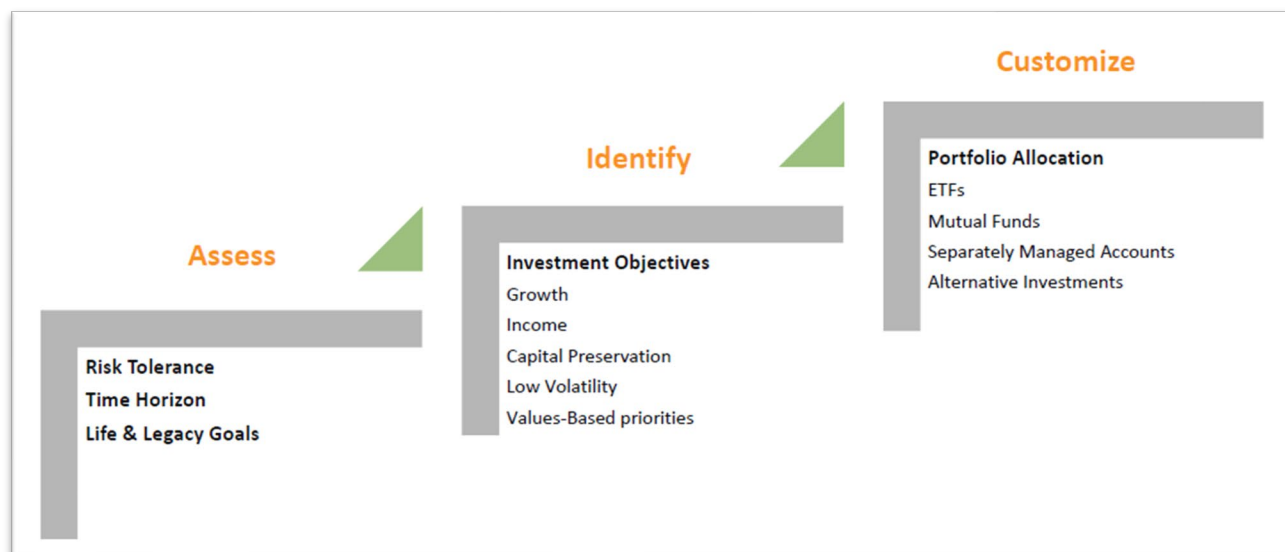
Several reputable studies have analyzed the performance of lump-sum investing compared to DCA, generally finding that lump-sum investing tends to yield higher long-term returns. Vanguard<sup>iii</sup> compared lump-sum investing and DCA across various markets and time frames. Lump-sum investing outperformed DCA in approximately 61.6% to 73.7% of cases, depending on asset allocation and investment horizon. For a 100% equity portfolio, lump-sum investing led to an average ending value 2.2% higher than DCA over a one-year period. Using historical U.S. market data, a Morningstar<sup>iv</sup> study has shown that lump-sum investing outperformed DCA 90% of the time when the DCA period extended over 36 months.

Lump-sum investing tends to outperform dollar-cost averaging in most cases — but it requires emotional discipline. **If you are uncomfortable and it is causing stress or delaying action, DCA is still a solid alternative, as long as it is over a relatively short period.**

## Risk And Liquidity: Finding Your Balance

A key part of successful investing is **taking the right amount of risk**, balancing the potential for growth with your personal comfort and financial needs. This balance depends heavily on two important factors: **how much time you have** before you need to use your money, and your **liquidity needs**, that is, how soon and how easily you might need to access your funds. Everyone has life and legacy goals unique to them. That is why we all need customized investment solutions that are designed to help us achieve our personalized set of objectives.

### Customizing Your Portfolio to Your Objectives



Source: Beacon Pointe.

If you have a **long-time horizon**, such as saving for retirement decades away, you can generally afford to take on more risk. This is because you have time to weather market ups and downs, and potentially recover from temporary losses. With a longer timeframe, riskier investments like equities can offer greater growth potential, helping you build significant wealth over time.

On the other hand, if your financial goals are **short-term** — maybe buying a house in a few years or paying for an upcoming expense — you will want to take less risk. In this case, preserving your capital becomes more important than chasing high returns. Safer investments like bonds, money market funds, or even cash equivalents reduce the chance of losing money when you need it.

**Liquidity needs** also play a crucial role in determining your risk tolerance. If you expect to need cash quickly or without warning, you should keep enough of your portfolio in liquid, low-risk assets that can be accessed easily without losing value. Illiquid investments, like some real estate or private equity, might offer higher returns but cannot be quickly sold without potentially significant losses.

Non-institutional investors often overestimate how much liquidity they truly require, leading them to hold excessive amounts of cash and cash equivalents in their portfolios. This behavior is primarily driven by psychological factors such as loss aversion, availability bias, and fear of future emergencies, rather than actual data on spending patterns. In practice, most households experience significant unexpected expenses far less frequently than they anticipate. Despite this, **many maintain liquidity buffers well beyond the**

**recommended 3–6 months of living expenses.** Research<sup>v</sup> from behavioral finance suggests that this over-allocation to liquid assets is rooted more in emotional comfort than in rational planning. As a result, investors frequently miss out on long-term gains from higher-yielding investments, sacrificing potential compound returns in exchange for a perceived, but often unnecessary, sense of safety. Empirical data from financial institutions also shows that retail investors rarely draw on their cash reserves, further highlighting the gap between perceived and actual liquidity needs.

Ultimately, smart investing means aligning your risk level with your **time horizon and liquidity requirements**. Taking on too much risk when you need access to your money soon can cause stress and force you to sell at a loss. Conversely, being overly cautious when you have time to grow your investments can limit your wealth-building potential. Finding the right balance helps you stay confident and committed to your plan, increasing your chances of reaching your financial goals.

## Managing Risk Starts With Knowledge

Many investors **underachieve** simply because they are **too afraid to take enough risk**. While it is natural to want to avoid losses, being overly cautious can prevent your investments from growing enough to meet your long-term goals. When investors shy away from stocks or other growth-oriented assets because of fear or short-term market swings, they miss out on the higher returns those investments have historically delivered over time.

This fear often leads to holding too much cash or low-yield bonds, which may feel safer but usually cannot keep up with inflation or build meaningful wealth. As a result, portfolios grow slowly or even shrink in real terms, making it harder to achieve important financial goals like retirement, buying a home, or funding education.

Ironically, by trying to avoid risk, investors expose themselves to a different kind of risk — the risk of **not growing their money enough** to outpace inflation and meet future needs. Successful investing requires **balancing risk and reward**, understanding that some level of risk is necessary to earn returns that beat inflation and build wealth.

Overcoming this fear means developing a well-thought-out plan that fits your goals, time horizon, and comfort level, then staying disciplined through market ups and downs. With the right mindset and strategy, taking appropriate risks can become a source of opportunity rather than anxiety — unlocking growth and helping you achieve much more than playing it safe ever could.

One of the most effective ways to manage investment risk is to **truly understand what you own**. Risk is not just a vague concept — it is tied directly to the specific assets in your portfolio, their behavior, and how they respond to different economic conditions. When you know the nature of your investments, you can make informed decisions, avoid unpleasant surprises, and feel more confident during market fluctuations.

Understanding what you own means knowing the business, sector, or asset class behind your investments. For stocks, this includes knowing the company's industry, financial health, competitive position, and growth prospects. For bonds, it means understanding the issuer's creditworthiness, maturity, and interest rate sensitivity. For funds or ETFs, it involves looking at the underlying holdings and their risk characteristics.

When you understand these details, you can better assess how your portfolio might perform in various scenarios — such as a recession, inflation spike, or interest rate change. This insight helps you balance your

holdings to reduce risk concentration and diversify across different types of assets that react differently to economic events.

Moreover, understanding what you own can help you avoid panic during market volatility. Instead of reacting emotionally to price swings, you can remind yourself of the reasons why you chose those investments, why they have value, and how they fit your overall plan.

## **Volatility Is Your Friend**

Equity markets are inherently volatile, with prices fluctuating frequently due to a wide range of factors—from economic data and corporate earnings to geopolitical events and investor sentiment. This volatility is often amplified by the use of leverage and the levels of liquidity within the financial system. Leverage, or borrowing to invest, can magnify both gains and losses. When investors or institutions use borrowed money to buy stocks, small price movements can lead to outsized reactions in the market. If prices drop, leveraged investors may be forced to sell quickly to meet margin calls, creating a cascade of selling pressure that pushes prices down even further.

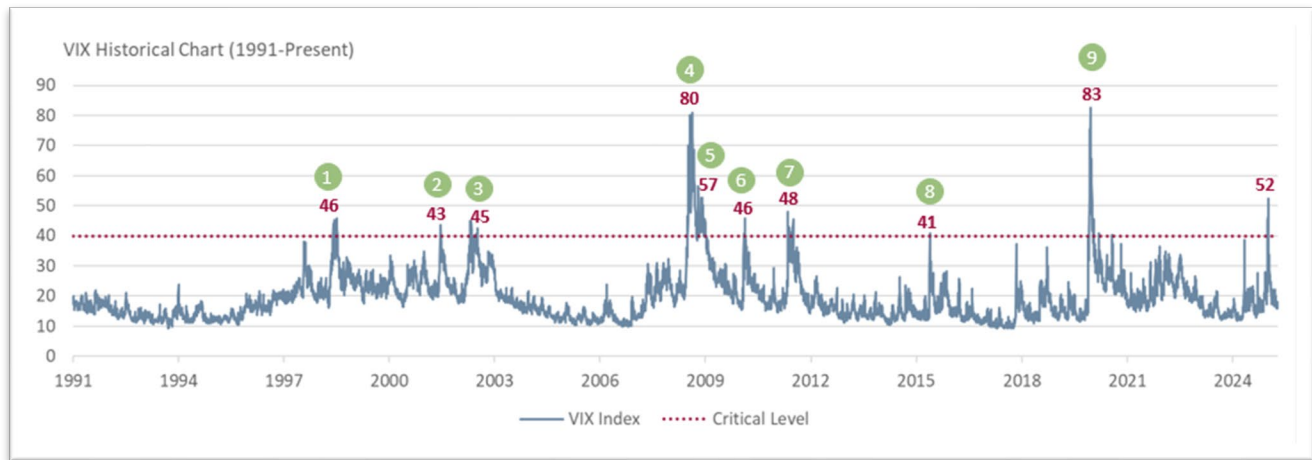
Liquidity — the ease with which assets can be bought or sold without impacting their price — also plays a crucial role. In times of high liquidity, large trades can be executed smoothly with minimal price impact. However, during market stress or uncertainty, liquidity can dry up, making it harder to sell assets without causing significant price declines. This lack of liquidity can exacerbate price swings and contribute to sharp market drops.

Together, leverage and liquidity dynamics create feedback loops that intensify market volatility, turning routine price changes into more dramatic moves that can unsettle investors and the broader financial system.

The VIX, short for the Volatility Index, is a measure of the stock market's expected volatility over the next 30 days. It is often called the "fear gauge" because it tends to spike when investors are worried about market declines. Investors should look at very high VIX readings (panic) as buying opportunities ("be greedy when others are fearful") and very low readings (complacency) as signals to be cautious. When the VIX breaches 40, it usually coincides with major market selloffs (e.g., 2008 financial crisis, 2011 debt ceiling crisis, and the 2020 Covid crash). After the VIX spikes above 40, the S&P 500 tends to perform quite well over the following months and year. Extreme fear often marks capitulation, when panic selling reaches its peak. After maximum fear, markets often stabilize and rebound.

Between April 2 and April 8, 2025, the VIX surged by approximately 31 points to ~52, marking an extreme volatility event at the 99.9th percentile historically. This spike corresponded to stock market turmoil triggered by aggressive new tariffs announced on April 2 ("Liberation Day"). By early – mid June 2025, the VIX had fallen to around 16–17, its lowest level since before the April surge, coinciding with record highs in the S&P 500 and Nasdaq.

## VIX Historical Chart (1991-Present)



Source: Bloomberg, Beacon Pointe. Data as of July 15, 2025.

Volatility often gets a bad reputation, but for long-term investors, it can actually be a powerful ally. That is because **volatility creates opportunities**. When markets swing up and down, they occasionally misprice assets, meaning good investments go on sale. If you stay calm and disciplined during these moments, you can buy quality assets at a discount and position yourself for strong future returns. More importantly, volatility is a sign that markets are functioning properly. Prices move as new information is absorbed, and that movement is what creates opportunity. Without volatility, there would be no chance to outperform, no dips to buy, and no moments of rebalancing to take advantage of market imbalances.

Volatility fuels long-term growth. Stocks reward investors with higher expected returns because they come with short-term risk. That risk is the price you pay for the potential of compounding gains over time. **If markets were stable and predictable, those returns would be much lower.** So rather than fearing volatility, embrace it. It is part of the journey — and if you have a solid plan, a long-term view, and the discipline to stay the course, volatility becomes less of a threat and more of a friend that works in your favor. **To quote Beacon Pointe's CIO Michael Dow, "volatility is the price you pay to build wealth."**

## How has the S&P 500 Performed after the VIX breaches 40

Reference	Event	Start Date	3m	6m	12m	18m	24m	36m
1	Russia defaults on its debt	8/31/1998	22.0%	30.3%	39.8%	45.6%	62.6%	23.0%
2	9/11 terrorist attack	9/17/2001	9.6%	13.1%	-14.6%	-14.9%	2.1%	13.7%
3	Dot Com crash (Enron, Worldcom)	7/22/2002	9.1%	8.1%	22.7%	43.4%	38.6%	58.7%
4	Global Financial Crisis - Lehman collapse	9/29/2008	-20.8%	-25.1%	-1.5%	10.0%	8.4%	9.3%
5	Global Financial Crisis - (700k job losses)	1/7/2009	-9.4%	-1.6%	29.0%	21.0%	46.5%	50.3%
6	Flash Crash	5/7/2010	1.5%	11.5%	23.1%	17.0%	28.5%	56.0%
7	S&P downgrades US credit rating	8/8/2011	14.7%	22.0%	28.1%	40.3%	58.6%	84.2%
8	China slowdown, PBOC devalues Yuan	8/24/2015	11.0%	3.1%	17.5%	29.2%	34.5%	61.5%
9	Covid-19 Pandemic	2/28/2020	3.1%	19.9%	31.3%	56.4%	52.8%	41.0%
	<b>Average</b>		<b>4.5%</b>	<b>9.0%</b>	<b>19.5%</b>	<b>27.6%</b>	<b>37.0%</b>	<b>44.2%</b>
10	Liberation Day "Trump Tariffs"	4/4/2025	24.1%	?	?	?	?	?

Source: Bloomberg, Beacon Pointe, Refinitiv Workspace. Data as of July 15, 2025.

## Risk, Reward, And Capital Structure

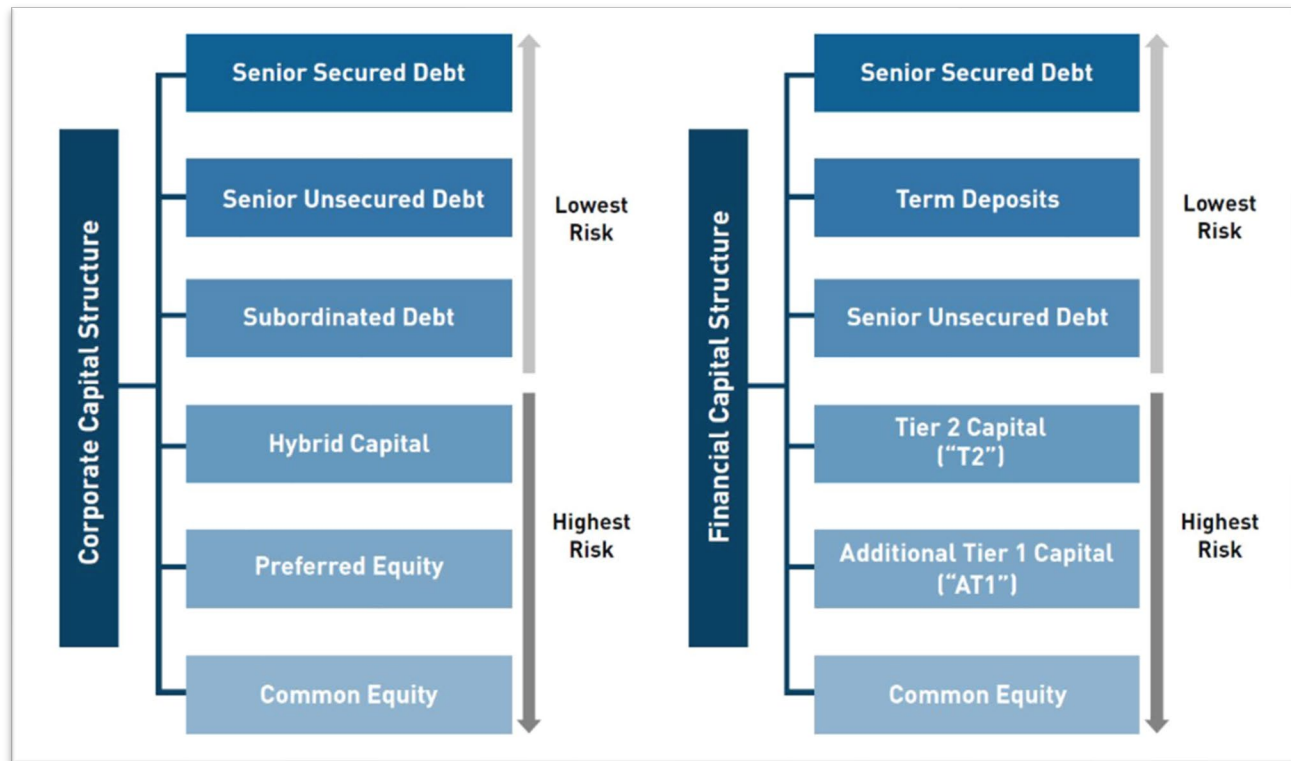
In the world of investing, understanding a company's **capital structure** is essential to grasping how risk and return are distributed among different types of investors. A company finances itself using a combination of debt and equity, and these components are stacked in a hierarchy known as the **capital structure**. This structure determines the order in which investors are paid — whether through interest payments, dividends, or during liquidation in the event of bankruptcy.

At the top of this hierarchy sit **bondholders**, or lenders, who have provided the company with debt. Because their claims are legally prioritized, they are entitled to receive fixed interest payments and are the first to be repaid if the company fails. This relatively secure position means that bondholders take on less risk, but in return, they typically earn lower yields. For example, high-grade corporate bonds might offer annual returns in the range of 3% to 6%. These returns are modest because the risk of losing money is relatively low — barring a major financial collapse, bondholders usually get paid.

Further down the capital structure are **equity holders**, particularly **common shareholders**. These investors are last in line when it comes to receiving payouts. In the event of a company's bankruptcy, they only receive what is left after all debts and obligations have been settled — and often, that means they receive nothing. However, this lower position in the capital stack comes with a significant trade-off: the potential for **much higher returns**. Unlike bondholders, equity investors are not limited to fixed payments. If the company performs well, shareholders benefit from capital appreciation and, in some cases, dividends. Over time, this can translate into returns of 7% to 10% or more annually.

This relationship between position in the capital structure and expected return can be summed up in a simple principle: **the higher you are in the capital structure, the lower the risk and the lower the return; the lower you are, the higher the risk and the higher the potential reward**. In the event of a bankruptcy, holders of securities at the top of the capital structure get repaid first. Bondholders enjoy greater security but accept limited upside. Equity holders, by contrast, take on more risk — especially during downturns — but are rewarded with the possibility of substantial long-term gains.

## Capital Structure Ranking



Source: <https://rpia.ca/market-insights/market-insights/views/2025/03/12/taking-advantage-of-an-issuers-capital-stack>.

In essence, capital structure reflects a fundamental trade-off in investing. Investors seeking safety and stability tend to prefer positions higher up, like bonds. Those willing to accept greater risk in pursuit of higher returns gravitate toward equities, understanding that while they may gain more in the long run, they also face the greatest potential for loss.

## Diversification: The “Only Free Lunch”

Diversification is famously described as the “**only free lunch**” <sup>vi</sup> in investing because it allows you to reduce risk without sacrificing expected returns. By spreading your investments across a variety of assets — such as different stocks, bonds, sectors, and even geographic regions — you avoid putting all your eggs in one basket. This reduces the impact that any single investment’s poor performance can have on your overall portfolio.

The magic of diversification lies in the fact that different assets often do not move in perfect sync. When some investments are down, others may be stable or even up, which smooths out the ups and downs in your portfolio. This lower volatility means you can potentially achieve the same returns with less risk or better returns for the same level of risk.

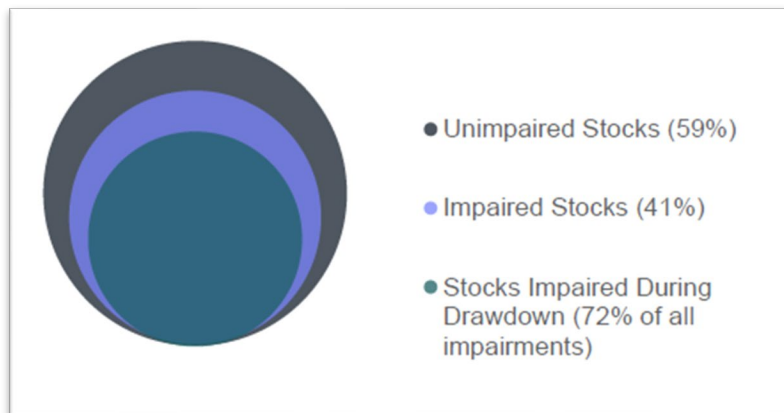
Unlike many other investment strategies that require trade-offs — such as taking on more risk to chase higher returns — diversification provides a **real benefit at no extra cost**. It is “free” because you are not giving up potential gains; instead, you are improving your portfolio’s risk-return profile simply by combining assets wisely. In short, diversification is a foundational principle that helps investors protect their capital, reduce emotional stress during market swings, and improve the likelihood of achieving their financial goals over time.



**Selling a concentrated position is not about giving up on growth; it is about protecting the wealth you have built.** When too much of your portfolio depends on a single stock or company, you are exposed to risks that diversification could easily reduce. No matter how strong a business seems today, markets change, industries evolve, and even great companies can stumble. By holding one name, you are taking on unnecessary risk without being rewarded for it. The market does not pay you extra just for betting big on one stock — it pays you for staying invested and disciplined over time. History is full of once-dominant companies that faltered, wiping out years of paper gains for those who did not diversify. Selling part of a concentrated position allows you to reduce fragility and build a more balanced portfolio — one that can weather setbacks in any one area. And if you still believe in the company, you do not have to walk away completely. You can maintain exposure through broader funds or keep a smaller stake while reducing the risk of a single point of failure.

A study done by Goldman Sachs<sup>vii</sup> shows that **41% of stocks in the Russell 3000 Index have become impaired** — where impairment is defined as a stock that loses more than 75% of its value and does not recover to 50% of its original value. Roughly 72% of these impairments occurred during a market drawdown. The median stock was more than three times as volatile as the Russell 3000 index. A single stock investor would need to have a strong view of stock outperformance to achieve a comparable risk adjusted return. In fact, given that the median stock in the Russell 3000 was 3.3x more volatile than the index, to achieve an equivalent risk adjusted return, an investor would need a 33% one-year return for an individual stock, if we assume a 10% one year return for Russell 3000 index.

## Russell 3000 Impairment Risk Since 2000



*Source: Goldman Sachs Asset Management as of June 30, 2023. Impairment is defined as a stock that loses more than 75% of its value and does not recover to 50% of its original value.*

Ultimately, it is not about timing the top or abandoning conviction. It is about **turning concentrated success into lasting financial security**. The collapse of Lehman Brothers in 2008 is a stark and painful example of why concentration risk — especially in both career and investments — can be devastating. Lehman employees did not just lose their jobs when the firm filed for bankruptcy. Many also lost a significant portion, or even all, of their savings because they had invested heavily in company stock — often through employee stock purchase plans or retirement accounts. In some cases, their entire 401(k)s were tied to Lehman shares.

It is a sobering reminder that **diversification is not just a strategy — it is a form of financial self-defense**. Tying your financial future to a single company, especially one you also depend on for your livelihood, leaves you extremely vulnerable if things go wrong.



## Being Aligned With The Economy: An Indirect Hedge

Investing by aligning with the economy often means choosing broad market indexes that reflect the overall economic landscape, and the **S&P 500** is one of the most popular examples. This index tracks 500 of the largest publicly traded companies in the U.S., spanning a diverse range of industries — from technology and healthcare to finance and consumer goods. Because these companies collectively represent a substantial portion of the US economy, the S&P 500 serves as a reliable barometer of economic growth.

One key feature of the S&P 500 is that it is **market capitalization-weighted, which means the largest companies by market value have the biggest influence on the index's performance.** Market capitalization is calculated by multiplying a company's stock price by the number of its outstanding shares. So, the bigger and more valuable a company is, the more weight it carries in the index.

This weighting method makes sense because larger companies often have a greater impact on the economy and market trends. For example, giants like Apple, Microsoft, and Amazon hold significant weight in the S&P 500 because of their massive market values, reflecting their dominant roles in driving economic growth and innovation. When these companies perform well, they can substantially move the index upward; conversely, their struggles can have a meaningful impact on the index's returns.

Because of this structure, investing in the S&P 500 means your portfolio naturally tilts toward the biggest, most influential companies in the economy. This gives you exposure to industry leaders who are often innovators, trendsetters, and market drivers. Additionally, the index is regularly rebalanced to reflect changes in company valuations and to add or remove companies as they grow or shrink, keeping it aligned with the evolving economic landscape.

**S&P 500** is ideal for **U.S.-bias** investors. **MSCI Country World Index ("ACWI")** is better for **broad global exposure** in one fund or index. While the S&P 500 includes only large-cap U.S. companies, the MSCI ACWI expands this approach globally by including large- and mid-cap stocks from both developed and emerging markets. Despite their geographic differences, the construction of both indexes is structurally similar: they are float-adjusted (excluding shares not available to the public) and rebalanced quarterly. As a result, although the MSCI ACWI is a global index, it still has a heavy U.S. tilt (about 64% of the Index) — since the U.S. market is the largest in the world.

**These indices form the backbone of many investment portfolios,** offering diversified exposure to various segments of the global equity markets. The choice among them depends on specific investment goals, risk tolerance, and market exposure preferences.

When you invest in broad, market-based strategies that are aligned with the overall economy you are naturally positioned to benefit from the system's long-term resilience. Why? Because **in times of crisis or slowdown, the two most powerful economic forces — the Federal Reserve and the government — typically step in to stabilize the system.**

## Top Equity Indices by Assets Tracking Them

Rank	Index	Approx. AUM Tracking	Major ETFs Tracker	Notes
1	S&P 500	\$13–15+ trillion	SPY, VOO, IVV	Widely used U.S. large-cap benchmark
2	MSCI World Index	\$4–6 trillion	URTH, ACWI (partial)	Global developed markets
3	MSCI Emerging Markets	\$2–3 trillion	EEM, IEMG	Emerging markets exposure
4	MSCI ACWI (All Country World Index)	~\$2 trillion+	ACWI	Includes both developed and emerging markets
5	Russell 1000	~\$2 trillion	IWB, VONE	Broader than S&P 500, includes large and mid-cap U.S.
6	Russell 2000	~\$1.5–2 trillion	IWM	Small-cap U.S. companies
7	NASDAQ-100	~\$1.5+ trillion	QQQ	Tech-heavy, non-financial large caps
8	MSCI EAFE	~\$1.5 trillion	EFA, IEFA	Developed Markets ex-US & Canada
9	FTSE Developed Markets	~\$1–1.5 trillion	VEA	Non-U.S. developed markets
10	Euro Stoxx 50	~\$1 trillion	FEZ, EXW1	Eurozone blue chips

*Source: Microsoft Copilot and Beacon Pointe. The securities identified and described do not represent all the securities purchased, sold, or recommended for clients' accounts. The reader should not assume that an investment in the securities identified was or will be profitable.*

Whether it is through monetary policy (like cutting interest rates or buying bonds), or fiscal measures (like stimulus spending or bailouts), these institutions have a vested interest in keeping the economy functioning and markets stable. They do not step in to save individual companies or speculators — but they do act to protect the system as a whole.

**So, when your investments are broadly diversified and aligned with the economy, you are indirectly hedged. You are riding on the same rails that the Federal Reserve and the government are working to keep intact.** That does not eliminate risk, but it provides a level of systemic support that individual bets or niche strategies simply do not benefit from.

## The Income Illusion: Yield Is Not Always What It Seems

When investing, it is tempting to focus on income — like dividends or interest payments — because it feels like a steady cash flow. However, **focusing solely on income can limit your overall wealth growth.** Instead, prioritizing **total return**, which includes both income and capital appreciation, gives you a more complete picture of your investment's true potential.

For example, imagine two stocks: stock A pays a high dividend yield of 5% but its share price stays flat or even declines over time, and stock B pays a modest dividend of 2% but its share price grows significantly, say 8% per year. If you only focus on income, Stock A might seem more attractive. But when you consider total return, Stock B provides a combined return of 10% (2% dividend + 8% price growth), far outperforming Stock A.

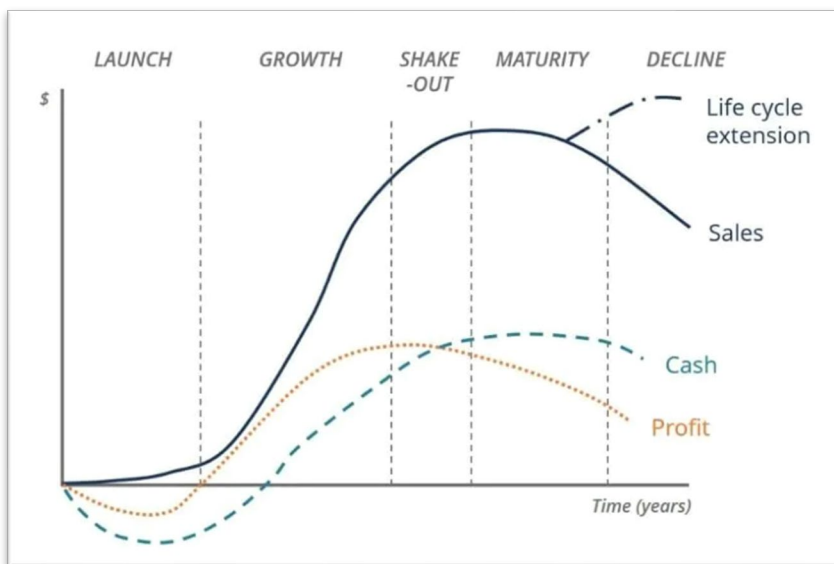
**Over the long term, most of your investment gains typically come from capital appreciation — not income.** For example, over the 20 years ending December 31, 2024, the S&P 500 delivered a 10.3% annualized return, and about 63% of that came from capital appreciation. Focusing too heavily on high-income investments can lead you to miss out on growth opportunities and lower your total returns. Be cautious of investments that advertise high income, as true income should be generated from dividends, interest, or capital gains — not from a return of your own capital, which can erode your investment and misrepresent the fund's actual performance.

## Dividend Stocks Are Not The Holy Grail

Paying dividends is just one of several ways a company can allocate its free cash flow; other options include repurchasing shares, reinvesting in the business, reducing debt, making acquisitions, or building cash reserves. What truly matters is not just generating free cash flow, but using it wisely — whether through dividends, share buybacks, strategic reinvestment, debt reduction, or acquisitions, depending on where the company is in its life cycle.

Dividend-paying equities often underperform growth stocks because companies that are still expanding typically prefer to reinvest their earnings back into the business rather than pay out dividends. These growing companies see greater value in using their cash flow to fund new projects, research and development, acquisitions, or other opportunities that can drive higher future returns.

### Life Cycle of a Company



Source: CFI's FREE Corporate Finance Class.

In contrast, companies that pay high dividends are often more mature and slower-growing. They tend to generate steady cash flow but face fewer opportunities for significant expansion. As a result, they return more capital to shareholders through dividends instead of investing heavily in growth initiatives. This difference reflects the natural lifecycle of companies: younger, high-growth firms reinvest profits to fuel expansion, while mature firms focus on returning income to shareholders.

Because of this, **dividend-focused portfolios may lag those weighted towards growth stocks over the long term, especially in periods of strong economic growth and innovation.**

## Market Signals Speak Louder Than Macro Data

Trying to predict macroeconomic trends is often futile because economies are extraordinarily complex and influenced by countless unpredictable factors — from consumer sentiment to geopolitical shocks. Even central banks and professional economists, despite access to vast data and sophisticated models, frequently miss the mark in their forecasts.

Markets are forward-looking and already price in widely available information. By the time an investor forms a macro thesis, it is likely already reflected in asset prices. Additionally, even if someone correctly predicts the direction of a macro event — such as a recession or rate hike — accurately timing it is extremely difficult. Being early or late can lead to the same poor investment outcome.

Historical evidence shows that expert forecasts are often off the mark. Most analysts missed the 2008 financial crisis, the rapid rebound after the COVID-19 crash, and the speed and magnitude of the 2022 inflation spike. These repeated failures highlight the unreliability of macro predictions as an investment tool. While economic models can offer insights, they often fall short in capturing the unpredictable nature of real-world events.

**Spending time trying to predict the macro distracts private clients from things they can actually control, like diversification, asset allocation, cost management, and long-term discipline.** Over decades, markets are primarily driven by innovation, productivity, and the underlying fundamentals of businesses — not by short-term economic noise.

Perhaps most dangerously, macro forecasting can create a false sense of control. This leads to overconfidence, excessive trading, and ultimately underperformance. In contrast, long-term investors who ignore macro noise and focus on sound principles tend to fare better.

**Making modest shifts between risk-on and risk-off** positioning can be more actionable than trying to predict specific macroeconomic outcomes. While still difficult, it is grounded in **observing market behavior and sentiment**, rather than forecasting complex economic data.

Market signals often speak louder than economic data because they reflect real-time investor behavior and sentiment, rather than lagging or revised statistics. While economic data like GDP or inflation reports are backward-looking and subject to revision, market indicators — such as credit spreads, equity performance, volatility levels, and sector leadership — can provide more immediate insight into how investors are positioned and where risk is building or receding. Numerous widely followed indices track these financial conditions, and they have become important indicators for assessing future economic growth and, by extension, risk-taking.

For example, widening high-yield credit spreads or a spike in the VIX may signal rising market stress well before it shows up in official economic reports. Similarly, when defensive sectors start to outperform cyclical, it often indicates that investors are shifting to a more cautious, risk-off stance.

In practice, markets often move ahead of the economic narrative. By the time the data confirms a slowdown or a recovery, prices may have already adjusted. This is why many investors pay closer attention to what markets are doing than to what economic reports are saying — they believe **the market is the better real-time barometer**.

## Why We Closely Watch The Fed

The Federal Reserve (“Fed”) is the most important entity to watch because it controls U.S. monetary policy, which directly influences interest rates, inflation, and overall economic growth. Its decisions affect borrowing costs for consumers and businesses, impacting spending, investment, and job creation. Since the U.S. dollar is the world’s primary reserve currency, Fed policies also ripple through global markets, shaping investor behavior and capital flows worldwide. In essence, the Fed’s actions set the tone for financial markets and the broader economy, making it a key focus for investors, policymakers, and businesses alike.

In the years leading up to the 2008 Global Financial Crisis (“GFC”), the Fed’s policies played a significant role in creating the conditions for the meltdown. After the 2001 recession, the Fed kept interest rates extremely low for a prolonged period, aiming to stimulate growth. Along with other government policies designed to promote home ownership, this easy monetary policy contributed to excessive borrowing and risky behavior in the housing market. Cheap credit fueled a housing bubble, with many banks and investors taking on high-risk mortgage-backed securities without fully understanding the risks. When housing prices started to fall, the bubble burst, leading to widespread defaults, a credit crunch, and ultimately a global financial crisis. The Fed’s delay in recognizing and responding to these imbalances magnified the damage, showing how central bank missteps can have severe consequences.

In September 2008, the Fed chose not to bail out Lehman Brothers, allowing the investment bank to collapse. This decision was partly driven by concerns about **moral hazard** — the idea that rescuing failing firms might encourage reckless behavior in the future. However, Lehman’s failure shocked markets and severely undermined confidence in the financial system. The sudden collapse triggered widespread **bank runs** and a freeze in credit markets as investors and depositors rushed to pull funds from other vulnerable institutions. The Fed’s decision not to intervene highlighted the delicate balance between preventing moral hazard and maintaining financial stability — a balance that, in Lehman’s case, arguably tipped too far and deepened the GFC. Lesson learned.

Fast forward to 2023, when Silicon Valley Bank (“SVB”) faced a sudden liquidity crisis due to a rapid withdrawal of deposits. Unlike during the GFC, the Fed acted quickly and decisively. It provided emergency liquidity through special lending facilities and coordinated with other regulators to reassure markets and depositors. The Fed’s rapid intervention helped prevent a broader banking panic and stabilized confidence in the financial system. This demonstrated how timely central bank action, combined with improved regulatory frameworks post-GFC, can contain localized crises before they escalate into systemic failures.

The contrasting cases of Lehman Brothers and SVB illustrate that, ultimately, the Fed is the **only game in town** when it comes to maintaining financial stability. Lehman’s collapse showed the devastating consequences when the Fed opts not to intervene, leading to widespread panic and a systemic crisis. In contrast, the swift Fed response to the SVB crisis helped contain the fallout and restore confidence quickly. These episodes underscore that, regardless of the challenges, the Fed’s actions — or inactions — shape the fate of the financial system.

## Equity Valuations, Demystified

When valuing equities, two main factors are crucial: the Fed's influence on interest rates and corporate earnings. The Fed essentially **sets the price of money** through its control of short-term interest rates, such as the federal funds rate. This rate affects borrowing costs across the economy, influencing consumer spending, business investment, and ultimately corporate profits.

In addition to short-term rates, investors look to the **10-year Treasury yield as the "risk-free rate"** when valuing stocks. The 10-year yield reflects long-term expectations for interest rates and inflation, serving as a benchmark for discounting future earnings or cash flows. Because stocks carry more risk than government bonds, investors require a premium (an additional return) above this risk-free rate, which determines the discount rate applied to company earnings.

Higher short-term rates and rising 10-year yields increase the discount rate, lowering the present value of expected future earnings and putting downward pressure on stock prices. Conversely, lower rates reduce the discount rate, making future profits more valuable and supporting higher equity valuations.

**A company creates value when the return it earns on its investments ("ROIC") is greater than the cost it pays to fund those investments ("WACC").** This means the business is generating more profit from its capital than it costs to obtain that capital. If ROIC is consistently higher than WACC, the company is using its resources efficiently and increasing shareholder wealth. On the other hand, if ROIC is less than WACC, the company is destroying value, as it is not earning enough to justify the investment. Therefore, a healthy business should always aim for ROIC to exceed WACC.

Corporate **earnings represent the actual profits companies generate**, and they are the fundamental driver of stock prices over the long term. Strong earnings growth signals that a company is creating value, which attracts investors and drives stock prices higher. Weak or declining earnings, on the other hand, tend to depress valuations.

In essence, the Fed's interest rate policy sets the cost of money, which influences the discount rate used to value earnings, while the earnings themselves represent the economic reality behind stock prices. The interplay between these factors determines how equities are priced and how attractive they are to investors.

The **equity risk premium** is the extra return that investors expect to earn by investing in stocks instead of risk-free assets like government bonds. Since stocks are generally riskier — they can fluctuate widely in value and do not guarantee a fixed return — investors demand additional compensation for taking on this uncertainty.

In practical terms, the equity risk premium is the difference between the expected return on equities and the return on a risk-free investment, often represented by the yield on long-term government bonds (like the 10-year Treasury). For example, if the 10-year Treasury yield is 4% and investors expect stocks to return 7% on average, the equity risk premium would be 3%.

This premium reflects the uncertainty and volatility inherent in stock investing, including risks related to the economy, company performance, market sentiment, and unforeseen events. It is a key concept in finance because it helps explain why stocks tend to offer higher long-term returns compared to safer investments.



The size of the equity risk premium can vary over time based on factors such as economic conditions, investor confidence, and market volatility. When investors perceive greater risk or uncertainty, the equity risk premium tends to rise, meaning they require higher returns to invest in stocks. Conversely, during periods of stability and optimism, the premium may shrink. The equity risk premium is the additional reward investors expect for bearing the risks of owning stocks, and it plays a central role in determining expected equity returns and investment decisions.

## How Bonds Are Priced

**Bond valuation** is the process of determining the fair price of a bond based on the present value of its future cash flows, which include periodic coupon payments and the return of principal at maturity. Two key concepts investors use to understand and evaluate bonds are **duration** and **spread**.

**Duration** measures a bond's sensitivity to changes in interest rates. It estimates how much the price of a bond will change when interest rates move by 1%. The higher the duration, the more sensitive the bond is to interest rate changes. For example, a bond with a duration of 7 years will generally lose about 7% in value if interest rates rise by 1%. Duration helps investors manage interest rate risk by indicating how volatile a bond's price might be.

**Spread** refers to the difference in yield between a bond and a comparable risk-free benchmark, often the yield on U.S. Treasury securities of similar maturity. This spread compensates investors for the additional risks of the bond, such as credit risk (the chance the issuer might default), liquidity risk, or other factors. For example, a corporate bond might yield 4% while a Treasury bond of the same maturity yields 3%; the 1% difference is the spread.

Spreads tend to widen when investors are concerned about economic conditions or creditworthiness, lowering the bond price while increasing its yield. Conversely, spreads narrow when confidence is high, raising bond prices. Ultimately, spreads can be viewed as the compensation paid to investors for taking risks associated with a particular bond or bond index. In summary, **bond valuation depends on discounting future cash flows using appropriate interest rates**, where duration helps understand sensitivity to rate changes, and spreads reflect the extra yield investors require for taking on additional risk beyond the risk-free rate.

## Do You Really Need To Pick Stocks?

For most investors, **owning individual stocks is not necessary** and can often cause uncompensated risk. Individual stocks can be highly volatile, subject to company-specific risks like poor management decisions, regulatory challenges, or sudden market shifts. Even well-known companies can experience sharp declines, and picking the "right" stocks consistently is incredibly difficult — even for professional investors.

Instead, broad-based **index funds** or **ETFs** offer a simpler, safer way to invest in the stock market. These funds hold a diversified basket of stocks, spreading risk across hundreds or even thousands of companies. This diversification reduces the impact of any single company's poor performance on your overall portfolio. Moreover, index funds typically have lower fees and do not require you to spend time researching individual companies.

Owning individual stocks can be **less tax-efficient** because, at some point, you will likely need to sell them to realize gains, rebalance your portfolio, or access cash. When you sell individual stocks that have appreciated

in value, you trigger **capital gains taxes** on the profit you have made. Depending on how long you have held the stock and your tax bracket, these gains can be taxed at rates that reduce your overall returns.

This tax impact can be more significant if you are frequently buying and selling stocks, or if you hold stocks that have large unrealized gains. Managing these gains strategically — through tax-loss harvesting or other techniques — can be complex and time-consuming.

In contrast, investing in diversified funds like index funds or ETFs can offer better tax efficiency. Many funds use strategies to minimize taxable distributions, and by holding a broad basket of securities, you reduce the need to sell individual holdings frequently. Additionally, funds often benefit from lower turnover, meaning fewer taxable events compared to actively trading individual stocks.

One notable advantage of owning individual stocks is the ability to engage in **tax loss harvesting** with greater precision. Tax loss harvesting involves selling securities at a loss to offset capital gains, thereby reducing an investor's overall tax liability. With individual stocks, investors can selectively sell underperforming positions while retaining others, allowing for more targeted tax strategies.

In contrast, while ETFs can also be used for tax loss harvesting, the process is less granular. Selling an ETF typically means exiting a broad basket of securities, which may include both winners and losers. Additionally, due to the "**wash sale rule**," investors must be cautious when repurchasing similar securities within 30 days, which can be more complex with ETFs that track similar indices.

Over the long term, many studies show that passive investing in broad market indexes often outperforms the average active stock picker, especially after accounting for fees and taxes. In short, you do not need to own single stocks to participate in the growth potential of the market. We believe diversified funds provide exposure to the broad market with less risk, lower costs, and less hassle — making them an excellent choice for most investors seeking steady, long-term growth.

## In Liquid Markets, Passive Strategies Often Prevail

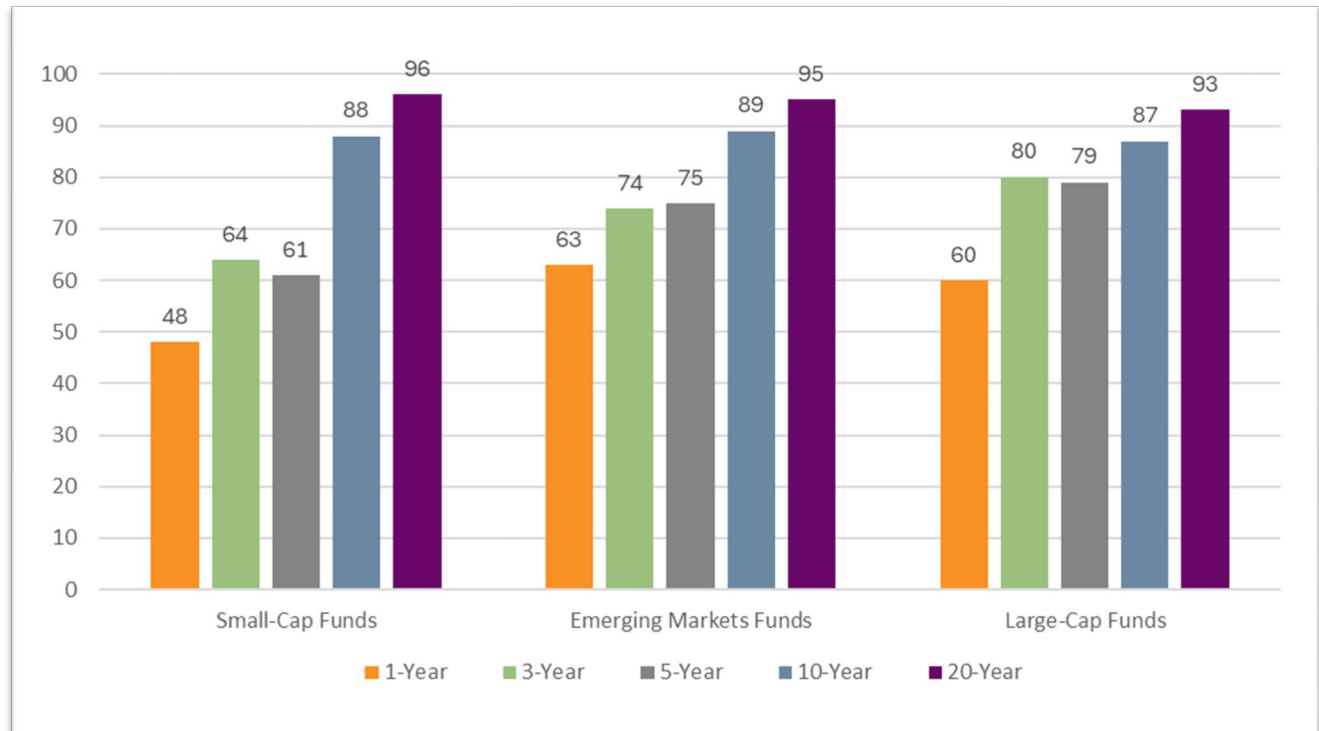
Active managers, who try to beat the market by picking individual stocks or timing trades, often **underperform over the long term** for several key reasons. First, the stock market is highly efficient — meaning that most publicly available information is already reflected in prices. This makes consistently finding undervalued stocks or market timing opportunities extremely difficult, even for skilled professionals.

Second, active management usually involves higher costs than passive investing. These costs include management fees, trading commissions, and taxes generated by frequent buying and selling. Over time, these expenses can significantly erode the returns that active managers deliver to investors.

Third, many active managers struggle with behavioral biases, such as overconfidence or chasing recent winners, which can lead to poor decision-making and inconsistent results. Even top-performing managers often fail to sustain their success year after year. Studies have shown that while some active managers may outperform in short periods, most fail to do so consistently over the long run. As a result, many investors achieve better results by investing in low-cost passive funds that simply track market indexes, capturing broad market returns without the drag of high fees and trading costs.



## Underperformance Rates of Active Managers Increase Over Longer Horizons – Percentage



Source: S&P Dow Jones Indices LLC, CRSP. Data as of December 31, 2023. Past performance is no guarantee of future results. Underperformance rates are reported net of fees.

Active managers, unlike passive funds, require ongoing evaluation and monitoring, much like individual stocks. This is because their performance can vary significantly over time, and not all managers consistently deliver the value they promise. Just as you would not buy a stock and forget about it without checking how the company is performing, you should not invest in an active manager without regularly reviewing their results, strategy, and risk management.

Active managers face the challenge of beating the market, and their ability to do so can fluctuate based on market conditions, skill, and decision-making. Sometimes, a manager who performs well one year may struggle the next. Because of this variability, investors need to “trade” or reassess active managers periodically — deciding whether to stay invested, increase exposure, or exit — based on updated performance data and alignment with investment goals.

Moreover, active managers often charge higher fees, so ensuring that their performance justifies the cost is critical. Just like you might sell a stock that is underperforming or no longer fits your portfolio, it is wise to replace underperforming active managers with better options.

**Investing with active managers is not a “set and forget” strategy. It requires active monitoring and decisions** — much like trading stocks — to ensure your portfolio stays on track.

## U.S. Equities Exceptionalism: Still The World's MVP

For a deeper exploration of the structural and strategic advantages underpinning U.S. equity dominance, see "[\*U.S. Exceptionalism, Mais Bien Sûr\*](#)"<sup>viii</sup> - Beacon Pointe Advisors (2024).

U.S. equities are often considered exceptional for several compelling reasons. First, the United States hosts some of the **world's largest and most innovative companies** — think Apple, Microsoft, Amazon, and Google — that have driven substantial growth and reshaped global industries. This innovative ecosystem, supported by strong intellectual property protections and a dynamic entrepreneurial culture, fuels long-term growth.

Second, the **U.S. financial markets are among the most liquid and transparent globally**, with well-regulated exchanges and high standards of corporate governance and disclosure. This transparency helps investors make informed decisions and contributes to market efficiency.

Third, the **U.S. economy** itself has demonstrated **remarkable resilience and adaptability** over decades, bouncing back from recessions and crises while maintaining steady economic expansion. The diversity of sectors in the U.S. market — from technology and healthcare to finance and consumer goods — provides investors with broad exposure and helps mitigate risks tied to any single industry.

Additionally, U.S. equities have historically offered attractive risk-adjusted returns, benefiting from **strong corporate earnings growth and a culture of shareholder-friendly practices** like share buybacks and dividends.

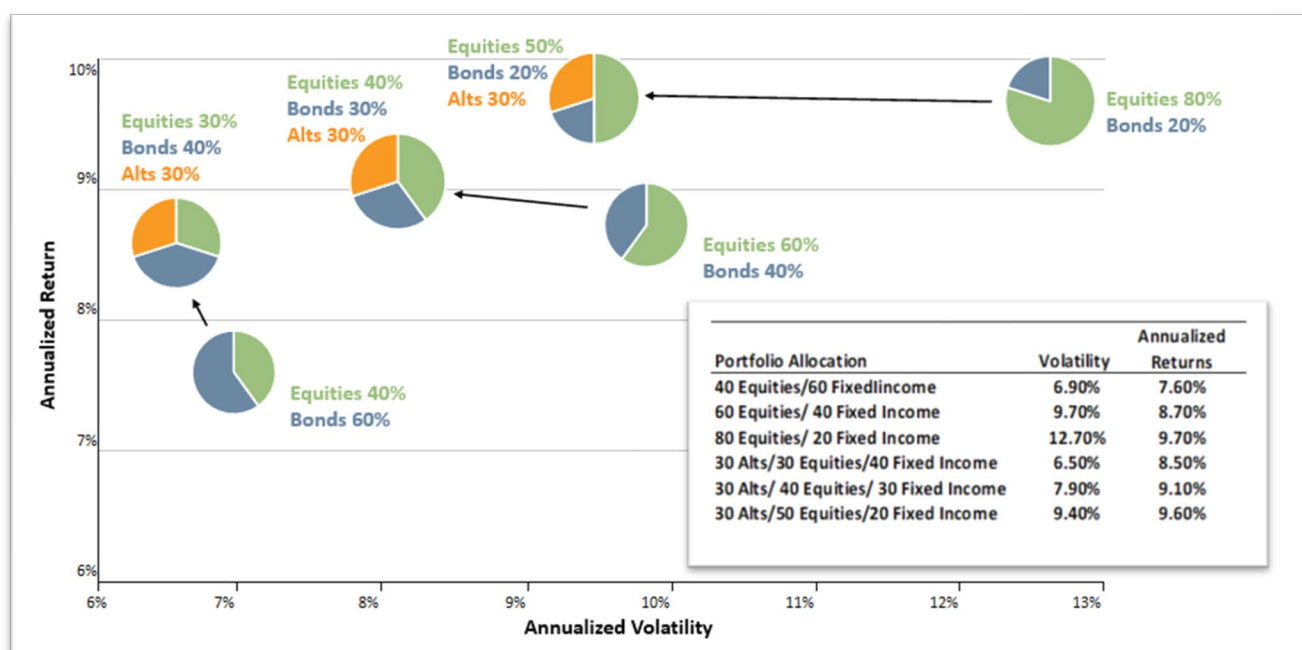
Finally, **the U.S. dollar's status as the world's primary reserve currency** adds an extra layer of stability and appeal to U.S. investments for both domestic and international investors.

Together, these factors make U.S. equities stand out as an exceptional investment opportunity with a strong track record and promising future potential.

## The Case For Alternative Investments

Public equities and fixed income securities, such as stocks and bonds, represent only a small portion of the global investable universe. While they are widely accessible and commonly used, they capture just a fraction of the total opportunities available to investors. The broader universe includes a diverse range of alternative investments<sup>3</sup> — such as private equity, real estate, infrastructure, private credit, hedge funds, and real assets (infrastructure and commodities) — which offer access to markets and assets not typically available through traditional public markets.

### Alternatives and Portfolio Risk/Return, 1989-2024



Source: Bloomberg, Burgiss, HRFI, NCREIF, Standard & Poor's, FactSet, J.P. Morgan Asset Management. Alts include hedge funds, real estate, and private equity, with each receiving an equal weight. Portfolios are rebalanced at the start of the year. Data are based on availability as of November 30, 2024.

Investors often turn to **alternative investments** because these assets offer benefits that traditional stocks and bonds may not provide. One key reason is diversification: alternatives often have low correlation with public markets, meaning they can behave differently during economic cycles. This helps reduce overall portfolio volatility and improve risk-adjusted returns.

Another important reason is the **illiquidity premium**. Many alternative investments are less liquid than stocks or bonds — meaning you cannot easily buy or sell them on short notice. Because investors must commit their capital for longer periods and accept limited ability to exit quickly, they demand higher returns as

<sup>3</sup> Alternative investments, including real estate investments, notes & debentures, hedge funds, and private equity, involve a high degree of risk, can be highly speculative, illiquid, and may result in the loss of principal invested and are not suitable for all investors. Investors should carefully consider the investment objectives, risks, fees, and expenses before investing.

compensation for this illiquidity. This extra expected return above what liquid assets offer is known as the illiquidity premium.

By accepting reduced liquidity, investors gain access to opportunities that may be less efficient, less crowded, or less available to the general public. These can include early-stage companies, specialized real estate projects, or complex strategies that require time to mature. Over time, this illiquidity premium can significantly enhance portfolio returns, especially for investors with a long-term horizon and less immediate cash needs.

Lastly, private alternative investments can realize an additional premium related to the complexity and limited transparency of financial and operational information available – this is known as the asymmetric information or “complexity risk premium” associated with private versus public investments. Private companies are not subject to the disclosure requirements of public companies. This creates a significant information gap between company management and investors, and presents a challenge to investors analyzing the intrinsic value and risk of an investment in a private company. Investors with specialized industry knowledge and strong networks can gain a competitive edge by accessing information and opportunities not available to others.

In summary, alternative investments appeal to investors seeking diversification, potential for higher returns, and the willingness to accept less liquidity in exchange for 1) an **illiquidity premium** — the reward for patiently committing capital to less liquid but potentially more profitable opportunities, and 2) a **“complexity” premium** that accrues to investments in smaller, less transparent private companies. In short – to quote a PIMCO paper – *“while patience is necessary to earn the liquidity risk premium, scale is necessary to earn the complexity risk premium”*<sup>ix</sup>

In alternative investments, **manager selection is absolutely critical** because unlike stocks or bonds, you typically cannot simply invest in a broad market index or benchmark fund. Many alternative asset classes—such as private equity, hedge funds, or real estate funds—are not publicly traded and do not have standardized, widely accepted benchmarks that track their performance. This makes the skill, experience, and strategy of the individual manager or management team the primary driver of investment outcomes.

Since alternative investments often involve complex strategies, illiquid assets, and active decision-making — like picking private companies, structuring deals, or managing properties — the manager’s expertise directly impacts returns, risk management, and the timing of cash flows. A strong manager can identify unique opportunities, navigate challenges, and add value through active involvement, while a weaker manager may struggle to deliver consistent results.

Because there is no “market return” to simply capture in alternatives, **your choice of manager effectively determines whether you succeed or underperform**. This makes due diligence essential: assessing the manager’s track record, investment philosophy, team quality, alignment of interests, and operational capabilities. Investors must be confident that the manager’s approach fits their goals and risk tolerance.

In summary, in the world of alternative investments, where traditional benchmarks do not exist, **the manager you select is your most important decision**. Their skill and discipline are what drive returns and differentiate successful investments from failures. Alternative investments will come with higher fees, but what ultimately matters is the net, risk-adjusted return they deliver.

## Cash: The Comforting Illusion

Cash is often considered the safest place to keep money because it offers immediate liquidity and protection from market volatility. However, this safety is mostly nominal — meaning the face value of your cash remains the same, but its **purchasing power** decreases over time due to inflation. Inflation is the gradual rise in prices of goods and services, which means that the same amount of cash buys less in the future than it does today.

For example, if inflation averages 3% per year, then \$100 today will only have the buying power of about \$74 after 10 years. In other words, keeping money in cash without earning interest that at least matches inflation causes a **real loss of wealth**. This erosion can be significant over longer periods and can quietly undermine your financial goals.

Moreover, during periods of very low or even negative interest rates, cash held in savings accounts or money market funds may generate little to no return, accelerating the loss in purchasing power. Even if you feel secure not losing nominal value, your actual economic power shrinks, which means you are effectively losing money every year you hold excess cash.

In contrast, investments like stocks or bonds have historically outpaced inflation over the long term, helping preserve and grow your real wealth. Thus, while cash is important for liquidity and short-term needs, relying too heavily on it as a store of value can be costly in the long run.

## Do You Really Need Gold And Bitcoin?

**Gold** is traditionally viewed as a **store of value and a hedge against inflation, currency risk, and economic uncertainty**. Because it often moves differently than stocks and bonds, gold can provide diversification benefits. Investors sometimes include gold as a small portion of their portfolio to reduce overall volatility and protect against market turmoil or inflation spikes. It does not generate income but serves as a “safe haven” during times of crisis.

Gold is often considered a better alternative to cash because it helps protect against inflation and currency devaluation. Unlike cash, which can lose purchasing power over time due to rising prices, gold tends to hold its value during periods of economic uncertainty. This makes it a useful store of wealth when inflation is high or when confidence in the currency weakens.

**However, when compared to stocks, Gold generally underperforms over the long term. For instance, over the last 30 years to December 31, 2024, the S&P 500 has achieved an annualized return of 10.9%, as opposed to just 6.6% for Gold.** Stocks represent ownership in companies that generate earnings and grow over time, which drives higher returns. **Gold, by contrast, does not produce income or grow — its value depends mostly on supply and demand, investor sentiment, and macroeconomic factors.**

So, while gold is a safer place than cash during turbulent times, it usually cannot match the growth potential of equities over the long run. That is why institutional investors rarely own gold while many retail investors hold gold as a small part of their portfolio — to balance safety with growth.

For a more detailed view about the potential role of Gold in your asset allocation, I recommend a deep dive into *“The Role of Gold in Today’s Global Multi-Asset Portfolio”* State Street Global Advisors (2019).<sup>x</sup>

**Bitcoin**, on the other hand, is a much newer and more volatile asset. It is often described as “digital gold” because of its limited supply and potential as a store of value, but it also behaves very differently. Bitcoin can offer **high growth potential**, but with significant price swings and regulatory uncertainties.

Bitcoin’s appeal often comes from offering an alternative when local currencies are unstable or inflationary, or when banking systems are unreliable or restricted. In countries with weak or volatile currencies, people may use Bitcoin to preserve value or access financial services they otherwise could not. In contrast, in the U.S., the dollar is the reserve currency, and the banking system is generally trusted and accessible.

Bitcoin is increasingly recognized as an emerging asset class with unique characteristics<sup>xi</sup>. Because it is still relatively new and highly volatile, many investors approach it like a **call option** — a small, strategic bet with the potential for outsized returns, but also significant risk.

Owning a few percent of your portfolio in Bitcoin allows you to participate in its growth potential without exposing your entire wealth to its swings. This limited allocation acts like a low-cost call option: if Bitcoin’s value soars, your portfolio benefits; if it falters, your overall risk remains controlled. In this way, Bitcoin can complement traditional investments, offering diversification and exposure to an innovative digital asset — while keeping risk in check.

For institutional investors, it is hard to own Bitcoin without reliable Long-Term Capital Market Assumptions (“LTCMA”), because institutional and strategic investors need credible forecasts for returns, volatility, and correlations to justify its place in a diversified portfolio.

Bitcoin and Gold may capture headlines, but they are not prerequisites for financial success. **A well-constructed financial plan — that uses a diversified benchmark index for portfolio return assumptions and then uses risk management tools to measure progress towards achieving those goals — remains the most reliable path to achieving your objectives.**

## How Should I Think About Currencies?

When it comes to currencies in your portfolio, the most important one to hold is usually your home currency. **Keeping your investments primarily in your local currency** helps reduce the risk of exchange rate fluctuations affecting your spending power and financial goals. You do not need to own foreign currencies directly. Investing in international stocks or bonds often gives you indirect exposure to other currencies, which can help diversify your portfolio without the complexities of currency trading. Focusing on your home currency and gaining international exposure through global investments is a simple, effective approach for most people.

**If your home currency is the U.S. dollar, the decision is easy because the U.S. dollar is the world’s primary reserve currency.** Holding investments in your home currency — the dollar — makes managing your portfolio and expenses straightforward.

**For investors in other countries, the choice is more complex.** They must weigh the benefits and risks of holding assets in their local currency. Currency fluctuations can have a significant impact on returns and deciding how much exposure to take requires careful consideration of economic conditions, currency stability, and personal goals. In these cases, diversification across currencies and markets becomes even more important to balance growth opportunities with risk management.

The most effective way to manage foreign exchange (“FX”) exposures, as many companies do, is to **match assets and liabilities in each currency**. This approach — known as **natural hedging** — reduces the need for costly financial instruments by aligning inflows and outflows in the same currency, thereby minimizing exchange rate risk.

## Going Short And Options Trading: Leave It To The Pros

To be **long** a security means holding it with the expectation that its price will rise, while to be **short** means selling a borrowed security in anticipation of buying it back later at a lower price. Being short an asset is inherently far more dangerous than being long, and here is why — it comes down to risk and the potential scale of losses. When you are long an asset — whether it is a stock, a bond, or real estate — your maximum loss is limited to what you invested. If you buy a stock for \$100 and it goes to zero, you have lost \$100. Painful, yes, but finite.

But when you are **short** an asset, your risk is **theoretically unlimited**. You are betting that the price will fall, but if it rises — there is no ceiling. That \$100 stock can go to \$200, \$500, \$1,000 ... and you are still on the hook. The losses can grow exponentially, especially in volatile markets or when there is a short squeeze. As the asset rises, you are effectively *increasing* your exposure to loss in both real and psychological terms. Unlike being long — where you can ride out volatility or wait for recovery — being short makes every price increase feel like a time bomb. You are squeezed, pressured, and increasingly offside. This is why shorting is so unforgiving: the further you are from being right, the more severe the punishment. In short, **when you are wrong on a short, you are digging deeper into a hole that grows faster than you can climb out of**. It is a high-stakes game with brutal math.

That is why shorting is best left to professionals — those who have deep research, risk controls, and the financial strength to survive when a trade goes against them. For everyday investors, shorting is not just risky, it is **asymmetric** in the worst possible way: **limited upside, unlimited downside**.

It is one thing to be wrong and lose your investment. It is another to be wrong and lose many times more than you ever planned to risk. Long positions might go south, but they will not take your entire financial life down with them. Shorts can — and have. In investing, **survival is rule number one, and shorting is a game where the odds are stacked against you** unless you really, truly know what you are doing.

An **option** is a financial derivative that gives the buyer the right, but not the obligation, to **buy or sell an underlying asset at a specified price** (the strike price) on or before a specified date. Options trading introduces complexity far beyond buying and selling stocks because it adds new variables: not only do you need to predict the direction of the underlying asset, but also **how far it will move, how fast, and how volatile it will be**. This means traders are effectively betting on **volatility**, not just price — a concept most retail investors do not fully grasp. The pricing of options is influenced by the **Greeks** (like Delta, Gamma, Theta, and Vega), which measure sensitivity to price changes, time decay, and market volatility. Misunderstanding these dynamics can lead to **rapid losses**, especially with short-term or leveraged positions.

Professionals have the advantage of real-time data, advanced risk models, and strict discipline, while retail traders often lack the tools or experience to navigate this multi-dimensional landscape. This is why options, while powerful, are best left to those with deep knowledge and a solid risk management framework.



## Debt Done Right: A WACC-Based Approach To Personal Finance

In personal finance, managing debt effectively is crucial to achieving long-term financial stability and growth. While conventional wisdom often warns against taking on debt, financial theory — particularly the concept of the Weighted Average Cost of Capital (“WACC”) — suggests that a certain level of debt can actually be beneficial. This principle, widely used in corporate finance, can be adapted to personal finance to explain why there is an optimal amount of debt that minimizes the overall cost of capital.

WACC represents the average rate of return a company — or an individual — must pay to finance their assets, weighted by the proportion of debt and equity used. In corporate finance, the formula for WACC is:

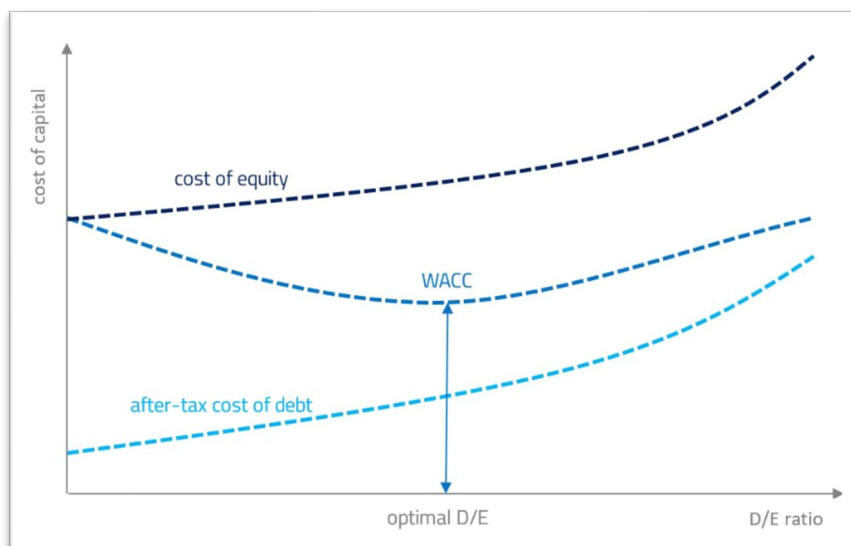
$$\text{WACC} = \left(\frac{E}{E+D}\right)r_e + \left(\frac{D}{E+D}\right)r_d(1 - T)$$

E is equity, D is debt,  $r_e$  is the cost of equity,  $r_d$  is the cost of debt, and T is the marginal tax rate. The key insight is that debt is typically cheaper than equity, especially after accounting for tax benefits. Therefore, introducing a moderate amount of debt can reduce the overall cost of capital.

Translating this to personal finance, individuals fund their investments and lifestyle through a combination of personal savings (equity) and borrowed money (debt). Using only savings may seem safe, but it can limit growth opportunities and carry an opportunity cost — such as missing out on investment returns. On the other hand, using some debt, like a low-interest mortgage or student loan, can be a cost-effective way to leverage future income or asset appreciation.

However, just as in corporate finance, there is a tipping point. Excessive debt increases financial risk, which can lead to higher interest rates, reduced creditworthiness, and psychological stress. This mirrors the rising WACC in companies that become over-leveraged. Thus, **there exists an optimal level of debt that balances the low cost of borrowing with the risks of financial overextension.**

### WACC and the Optimal Level of Debt



Source: <https://soleadea.org/cfa-level-1/optimal-capital-structure>.



In personal finance, **your capital structure** is your **mix of savings (equity)** and **borrowed money (debt)**. Your **personal WACC** is essentially the average cost of financing your life goals, investments, or purchases.

## Scenario: Buying real estate

You are planning to buy a \$300,000 condo and you are choosing between:

- **Option A:** Use \$300,000 of your savings (all equity)
- **Option B:** Use \$100,000 in savings and take a \$200,000 mortgage at 5% interest

We can calculate your **personal WACC** in Option B:

- Equity = \$100,000, with an assumed opportunity cost of 7% (what your money could earn in investments)
- Debt = \$200,000, at 5% interest
- No tax benefit for simplicity

$$\text{WACC} = (0.333 \times 0.07) + (0.667 \times 0.05) = 0.0233 + 0.0333 = 5.66\%$$

Compare this to using all savings:

- WACC = 7% (your opportunity cost only)

By combining equity and lower-cost debt, you reduced your personal WACC from 7% to 5.66%. This is a more **optimal capital structure** for your personal finances — you retain more capital for investments while keeping financing costs lower.<sup>4</sup>

In conclusion, the concept of WACC provides a valuable framework for understanding the role of debt in personal finance. By strategically incorporating debt, individuals can lower their effective cost of capital and enhance financial efficiency — so long as they remain within a prudent range that avoids excessive risk.

## The Case For Homeownership

Buying a house is like closing out a short position in real estate. **From the moment you are born, you are effectively "short" housing** — you need a place to live, but you do not own one. You are exposed to rising property prices and rent inflation, and you are paying someone else to use an asset you do not control.

When you buy a home, you are covering that short. You are neutralizing your exposure to rising housing costs by owning the asset directly. Instead of rent payments disappearing forever, your mortgage payments build equity over time. You shift from being vulnerable to rising prices to benefiting from them. Just like in the markets, staying short an appreciating asset is risky. Real estate tends to rise over the long term, especially in desirable locations. The longer you rent, the longer you remain exposed to that rising cost. Owning your home is a way of hedging against that — it is a financial and lifestyle asset that secures your place in the economy. In this sense, homeownership is not just a purchase — it is a strategic move to eliminate a permanent liability and turn it into a growing asset.

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<sup>4</sup> This example is provided for illustrative purposes only and is not intended to reflect an actual scenario.

Owning your own house offers more than just a place to live in, it provides financial and personal benefits that renting cannot match. When you own your home, you build equity over time, turning your monthly payments into an investment rather than just rent expenses. This equity can grow as property values increase, helping to build your net worth.

Homeownership also gives you stability and control. You do not have to worry about rent increases or a landlord deciding to sell. You can customize your living space to fit your needs and lifestyle. Additionally, owning a home often comes with tax advantages, such as deductions on mortgage interest and property taxes, which can help reduce your overall tax burden.

Finally, a home can act as a forced savings plan — each payment you make helps you move closer to fully owning an asset rather than paying someone else's mortgage. For many, a home is both a financial foundation and a place to call their own.

## **Taxes: It Is Not What You Make — It Is What You Keep**

Taxes play a crucial role in determining the real, after-tax return of an investment. While pre-tax returns are commonly used to compare performance, it is the post-tax return that reflects what the investor actually keeps. Different types of income — such as interest, dividends, and capital gains — are taxed at different rates, making tax efficiency a key component of a sound investment strategy. Over time, tax-aware investing can significantly enhance long-term wealth accumulation through improved compounding.

**Tax-efficient investing should complement your overall investment strategy, not drive it.** Your investment goals, risk tolerance, and time horizon should always be the primary factors in your investment decisions. Tax laws and regulations are complex and subject to change. Consulting with a qualified financial advisor or tax professional is crucial to ensure you are implementing strategies that are appropriate for your specific situation.

Financial advisors can guide clients in choosing investments that are tax-efficient, helping to minimize tax liabilities while maximizing returns. They may recommend strategies such as tax-loss harvesting, which involves selling securities at a loss to offset capital gains tax, or investing in tax-advantaged accounts like Roth IRAs or 401(k)s.

While RIAs can provide valuable tax planning advice, they are not necessarily tax preparers or accountants and should be clear about the scope of their services. You may also need to work with a Certified Public Accountant ("CPA") for specific tax advice and preparation.

## **DIY Investing? Why It Is Harder Than It Looks**

While it is certainly possible to manage your own investments, many private clients find that doing so effectively is much harder than it looks. Investing successfully requires not only understanding complex financial markets and products but also the discipline to stick to a long-term plan through ups and downs. Without professional guidance, it is easy to fall into common pitfalls — like reacting emotionally to market swings, chasing the latest hot stock, or misallocating assets.

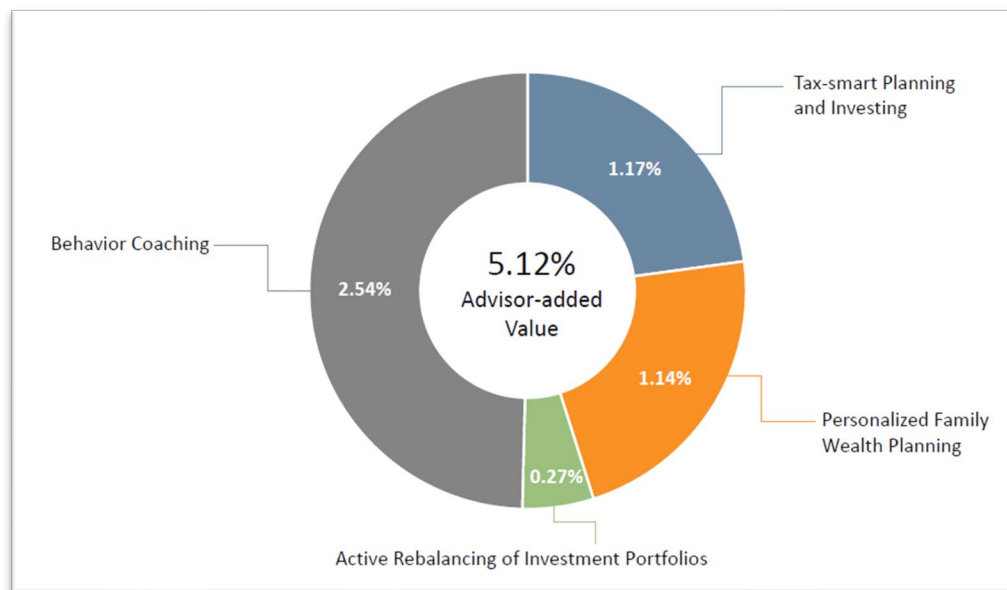
Moreover, as your financial situation becomes more complex — with multiple accounts, tax considerations, estate planning, and alternative investments — the amount of time, expertise, and ongoing attention needed

grows exponentially. Staying current on regulatory changes, tax laws, and market developments takes significant effort and specialized knowledge.

**A Registered Investment Advisor (“RIA”) brings experience, objectivity, and a fiduciary commitment to act in your best interest.** They help you create a customized strategy that aligns with your goals and risk tolerance, manage risks proactively, and handle administrative tasks like rebalancing and tax-efficient investing. This allows you to focus on what matters most to you, while knowing your wealth is being professionally managed.

While you can do it yourself, working with a trusted advisor often leads to better outcomes, less stress, and more time to enjoy life. Studies<sup>xii</sup> show that working with an advisor can lead to better financial outcomes.

### Quantifying the Value of an Advisor



Source: Source: Russell Investments, *Value of an Advisor Study* – 2023.

As a private client, working with an **RIA** offers a range of important benefits that go beyond what many other financial professionals provide. **RIAs are fiduciaries, which means they are legally obligated to act in your best interest, at all times.** This fiduciary duty creates a foundation of trust and ensures that the advice you receive is tailored specifically to your unique financial goals, risk tolerance, and circumstances — not driven by commissions or product sales.

An RIA provides personalized, comprehensive financial planning and investment management that can adapt as your needs evolve over time. Unlike advisors tied to big banks or brokerage firms, RIAs typically have more flexibility in the investment options they can offer, often including access to a broader range of strategies and alternative investments.

Additionally, RIAs tend to emphasize transparency — clearly explaining fees, potential conflicts of interest, and the rationale behind investment choices. This transparency, combined with a fiduciary standard, helps private clients make informed decisions with confidence.

For private clients who often face complex financial situations — such as estate planning, tax strategies, business ownership, or philanthropy — an experienced RIA can coordinate these elements into a cohesive plan that aims to grow and protect wealth over generations.

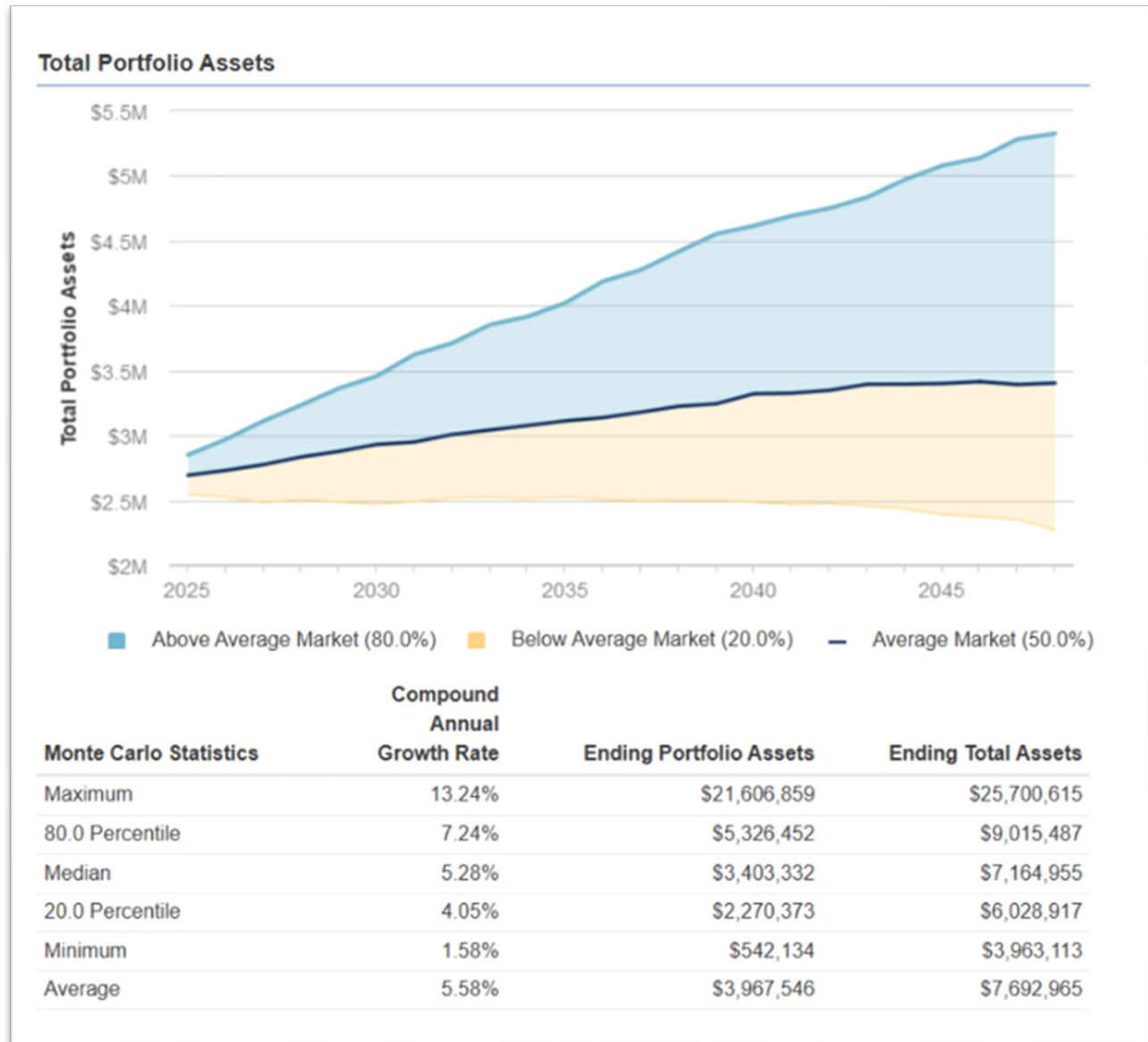
### **Your Financial Plan: “The Closest Thing We Have To A Crystal Ball”**

A financial plan offers a clear and organized approach to managing one’s income, expenses, and savings. It helps individuals set realistic short- and long-term goals, guiding their financial decisions with purpose. By creating a structured budget, people can allocate resources more effectively and avoid unnecessary spending. A solid financial plan also provides a safety net in times of emergency, reducing the stress that often comes with unexpected expenses. In addition, it encourages thoughtful decision-making when it comes to investing, borrowing, or making major purchases. Over time, this proactive approach leads to greater financial stability, security, and peace of mind.

**A financial plan helps individuals navigate the uncertainty of market returns by aligning investment strategies with personal goals, risk tolerance, and time horizons.** While market returns are unpredictable and often volatile, a well-structured plan provides a long-term perspective that minimizes the impact of short-term fluctuations. Rather than attempting to time the market or chase high returns, financial planning emphasizes consistent investing, diversification, and asset allocation. This approach allows individuals to benefit from market growth over time while managing risk appropriately. Ultimately, a financial plan acts as a stabilizing tool, helping individuals stay focused on their objectives regardless of market conditions.

Financial planners use Monte Carlo simulations because these simulations help them account for uncertainty and risk in financial markets. Unlike relying on a single expected return, Monte Carlo simulations generate thousands of possible future scenarios by varying key factors like market returns, inflation, and expenses. This allows planners to assess the probability that a client’s financial goals — such as funding retirement or paying for education — will be met under different conditions. By understanding the range of possible outcomes, planners can potentially create more realistic, flexible strategies that better prepare clients for market volatility and unexpected events. Ultimately, Monte Carlo simulations can improve decision-making by providing a clearer picture of financial risks and help tailor plans to the client’s individual risk tolerance and goals.

## Monte Carlo Asset Spread



Source: eMoney, Beacon Pointe.<sup>5</sup>

Monte Carlo analysis illustrates potential results of a plan using up to 1,000 randomly generated runs of market returns and volatility. In each run, the mean and standard deviation of a selected benchmark index for each portfolio is used. The hypothetical performance is combined with the detailed cash flow and tax calculations and the potential returns are a way of illustrating the probability of the plan's success.

In short, to quote Dylan MacDonald, one of our star advisors at Beacon Pointe, **“the closest thing we have to a crystal ball is your financial plan.”**

<sup>5</sup> This example is provided for illustrative purposes only and is not intended to reflect an actual scenario.

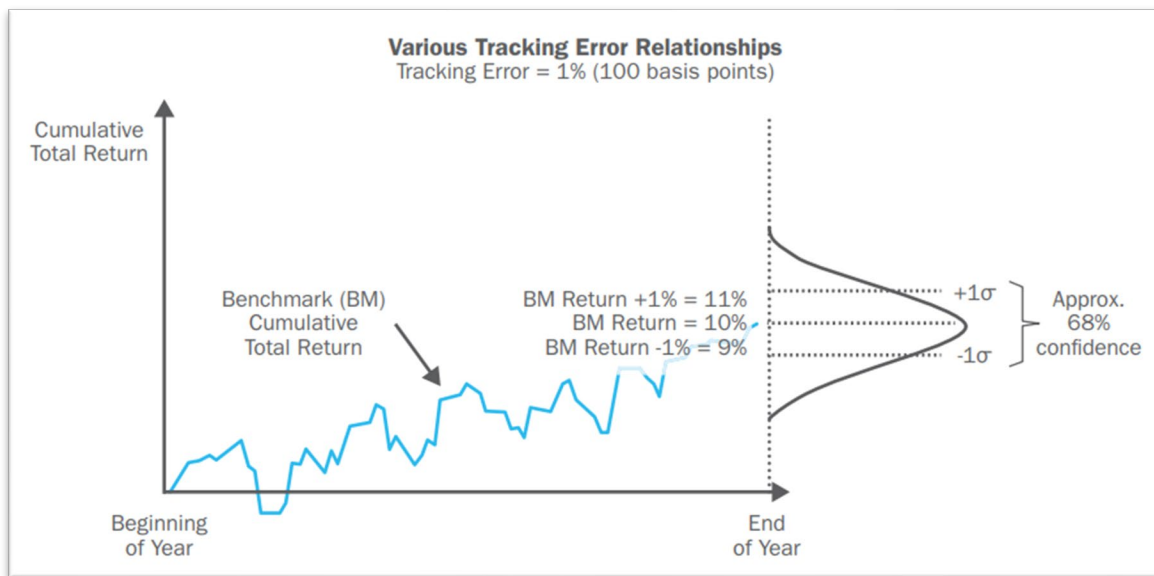
## Benchmark Returns And Tracking Error Volatility: What You (Or Your Advisor) Must Know

A financial plan is inextricably linked to the Tracking Error Volatility (“TEV”) of the portfolio because the financial plan defines the strategic asset allocation and risk appetite, while the TEV — which determines how much deviation from a benchmark is acceptable — is **the control mechanism for staying aligned with long-term goals set in the plan.**

Investors should care about **benchmark returns** and **TEV** because they help you understand whether your investments are doing their job — and how much risk you are taking relative to what you could get from a simple, passive alternative. A **benchmark** (like the S&P 500 for U.S. equities) serves as a reference point. It reflects what a typical investor could earn by simply owning the market. If your investments underperform the benchmark consistently, especially after fees, you are paying more for less. On the other hand, outperforming a benchmark can indicate real value added — assuming it is not just luck.

**Tracking error volatility** tells you how closely your portfolio follows that benchmark. A high tracking error means your portfolio behaves very differently, which can bring more risk. If you are deviating from the benchmark a lot, you should expect strong justification in terms of added return. Otherwise, you are just taking on more uncertainty without clear reward.

### Tracking Error Example



Source: Envestnet, PMC.

For example, if your portfolio has a high tracking error versus the S&P 500 but does not outperform over time, you are taking on more risk for no added benefit. That is a poor trade-off. On the other hand, if a manager delivers consistent outperformance with reasonable tracking error, that is true value.

In short, **benchmark returns show what is possible**, and **tracking error shows how far you may stray from that path**. Paying attention to both helps you stay honest about performance and risk — and avoid paying for complexity that does not deliver results.

## The Institutional Approach To Investing And Managing Risk

Knowledge of what you own is essential. **Assessing the likelihood of achieving your financial goals** is wisdom. The use of benchmark indices and risk modeling tools — the essence of institutional investing — is critical to gaining this wisdom.

A key input to any financial plan is the expected risk and return of the market over a long-term investment horizon. In this context, the market is defined as the return of a blend of stock and bond assets. As discussed in earlier sections, getting this mix right — **the asset allocation — is the most important risk-management decision you can make.**

Generally, an investor's asset allocation is determined via a process known as **risk profiling using a behaviorally based risk profile questionnaire** and fine-tuning based on additional client inputs. The result is typically expressed as a combination of equity and bonds such as 60/40 or 70/30, which serves as the starting point for portfolio construction and risk management. This risk-reward space must then be quantified to serve as a useful guide.

**Benchmark indices** help quantify this risk-reward space. For example, if the risk profile exercise leads to a **60/40 portfolio**, the investment process should begin by measuring not only the **market value weights** of the equity and bond allocation but also the **risk factors** of a blended portfolio of 60% stocks and 40% bonds. Institutional investors typically use a blended index of the **MSCI All Country World Index** and the **Bloomberg Aggregate Bond Index** for qualified plan assets. Importantly, the analysis of risk and reward is not done in isolation, but **in comparison to the benchmark**. This is essential because **financial plan assumptions** about risk and return are best estimated using benchmark indices—they serve as the **road map** to achieving the **investor's objectives**.

Institutional risk modeling tools, **specifically** multi-asset multi-factor risk models, **offer a significant advantage over relying solely on market values**. While **asset allocation based on market values is a good starting point, it lacks the granularity needed to identify the specific** drivers of portfolio risk and return. By using sophisticated tools that break down risk, investors gain a deeper understanding of their portfolio's vulnerabilities and opportunities.

In a modern risk model, portfolio risk is decomposed into two primary components: **systematic (factor) risk** and **idiosyncratic (specific) risk**. Systematic risk stems from exposure to broad market forces captured by predefined **risk factors** such as market beta, size, style, sector, geography, and interest rate sensitivity. Each asset in the portfolio is analyzed for its **factor exposures**, and these exposures are aggregated across the portfolio to estimate how much of the total volatility is driven by these common sources. The model uses a factor covariance matrix to quantify how these factors interact and contribute to overall portfolio risk. The remaining portion of risk — **idiosyncratic risk** — is the part of an asset's volatility that **cannot be explained by its factor exposures**. This includes company-specific events, security selection decisions, and other non-systematic influences. While factor risk is generally non-diversifiable, idiosyncratic risk can be mitigated through diversification.

A robust risk model — such as the ones we run on Bloomberg **Multi-Asset Class 3rd Generation Risk Model** — will present a full decomposition showing the percentage contribution of each factor, the total factor risk, and the specific risk, enabling investors to understand the drivers of portfolio performance and make informed adjustments aligned with their financial objectives. In addition to analyzing factor and idiosyncratic risks, a key benefit of advanced risk models is their ability to calculate **tracking error volatility**, enabling a

more nuanced approach to portfolio construction and improving the likelihood of success as outlined in the financial plan. **TEV** measures the expected difference between a portfolio's performance and its benchmark. It helps verify whether portfolios are taking the **appropriate amount of risk**, and whether investors are on track to meet their financial objectives. Using **state-of-the-art risk models** gives clients and advisors greater confidence in achieving the goals articulated in the financial plan.

These tools can also empower investors to assess the **compensation received for taking specific types of risks**. **Risk-adjusted returns** help evaluate whether the returns generated are adequate for the level of risk undertaken. This is crucial for individual investors whose financial plans rely on **return assumptions derived from benchmark indices**. By explicitly evaluating the **risk-reward tradeoff**, individuals can make more informed decisions about **capital allocation** across asset classes and potentially **optimize their portfolio** for both return and stability. For example, if a model reveals that investing in **U.S. Growth stocks** offers high potential returns but disproportionately high risk, an investor might choose to **reduce exposure** or **balance it** with lower-risk assets like **U.S. Value stocks**.

In short, incorporating **institutional risk modeling tools** into an individual's financial planning process can provide a **robust and personalized approach** to achieving long-term financial goals.

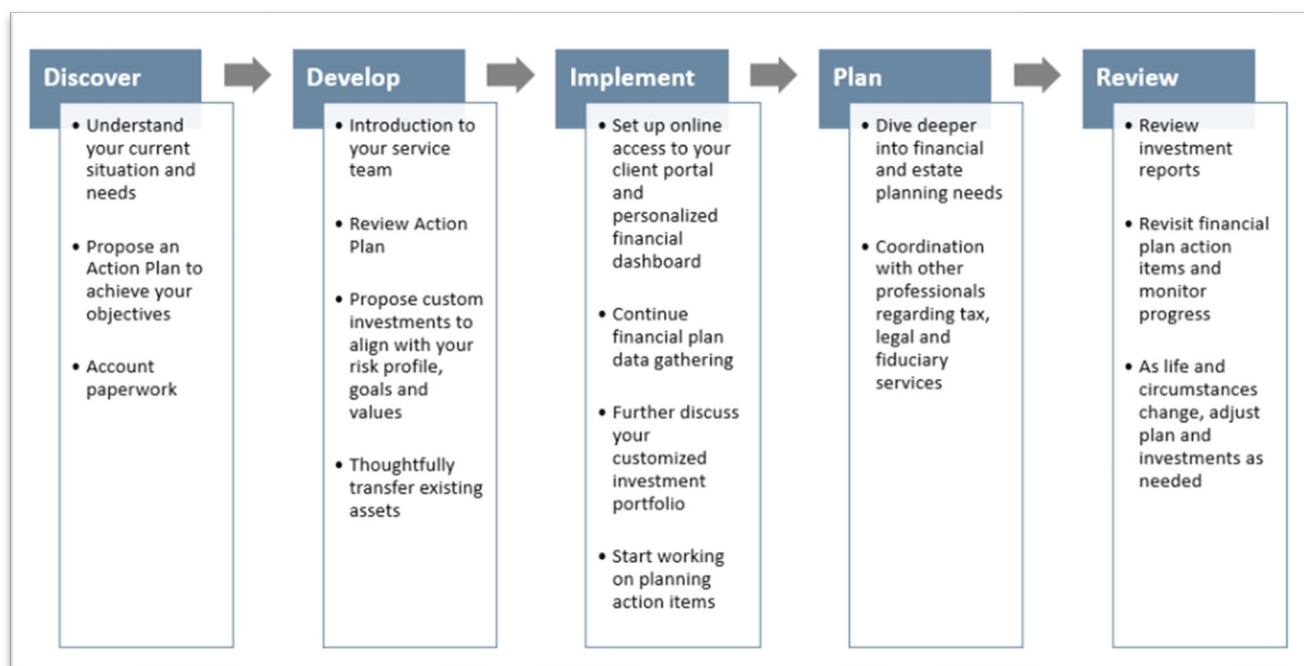


## Why Beacon Pointe? Our *a//WEALTH*® Process To Serve You

Beacon Pointe Advisors is a leading independent RIA that combines institutional investment knowledge with deeply personalized wealth management. As a fiduciary, we are legally bound to act in your best interest and seek to offer objective advice. With access to a wide range of investment solutions — including alternatives — and a holistic focus on planning, tax efficiency, and legacy strategies, Beacon Pointe strives to deliver sophisticated, client-centric guidance tailored to your financial goals.

Our #1 priority is to ensure you are living your best financial life. Our goal is to provide you and your family with peace of mind, knowing your entire financial picture is coordinated, strategically designed, and taken care of thoughtfully.

### Our *a//WEALTH*® Process to Serve You



Source: Beacon Pointe.

As of June 30, 2025, Beacon Pointe Advisors advises on approximately **\$47 billion in assets** and serves over **16,000 clients** nationwide. We have expanded to more than **600 employees** across over **65 offices** throughout the U.S., reflecting our significant growth and commitment to providing comprehensive wealth management services.<sup>6</sup>

<sup>6</sup> Firm Data as of 6/30/25, total firm assets include approximately \$43.5B in assets under management ("AUM") and \$3B in assets under advisement ("AUA"). AUM are assets the firm manages on both a discretionary and non-discretionary basis. AUA are assets on which Beacon Pointe advises but does not provide regular supervisory and management services (e.g., consulting services).

## Conclusion: My Survival Guide To Investing

Investing successfully starts with having **clear goals**. Whether you are saving for retirement, a home, or your children's education, knowing what you want to achieve helps shape the right strategy and keeps you focused along the way. It is equally important to **understand your own tolerance for risk** — both emotionally and financially — so you can build a portfolio that feels comfortable and prevents you from making impulsive decisions during market downturns.

**Disciplined investing** is not about predicting the next big thing, it is about **owning a piece of the whole economy and letting innovation come to you**, over time, at a price that reflects real, sustained progress — not hype.

**Diversification is your best friend in managing risk.** By spreading your investments across different asset classes, industries, and regions, you reduce the impact of any one investment performing poorly. Instead of chasing quick wins or just income, **focus on total return over the long term**, which combines income and growth to build lasting wealth.

Trying to time the market is notoriously difficult, and most investors end up losing out by jumping in and out. **Staying invested** through market ups and downs allows you to capture the full benefits of growth and compounding. Keeping your costs low by choosing affordable funds or ETFs helps ensure more of your money stays working for you.

It is a good habit to **regularly rebalance your portfolio**, adjusting it to your target allocation, and making the most of changing market conditions. Perhaps most importantly, **maintain emotional discipline**. Markets will be volatile, but sticking to your plan and avoiding fear- or greed-driven decisions should serve you well over time.

**Educating yourself continually** about investing basics and market developments gives you the tools to make informed choices and avoid common pitfalls. And when the journey gets complicated, **having a trusted financial advisor can provide guidance, perspective, and help keep you on track**.

By following these principles, you will build a resilient investment approach that can weather the inevitable ups and downs of the market and help **increase your chances of long-term success**.

At Beacon Pointe, we are dedicated to helping clients preserve and grow their wealth through a disciplined, fiduciary approach. Our global investment perspective prioritizes not just returns, but what truly matters — **risk-adjusted net returns**. By integrating **institutional-quality risk modeling tools** into tailored financial plans and asset allocations, we aim to deliver **a personalized and resilient strategy for long-term success**. The result is greater clarity, confidence, and control — so our clients can focus on what matters most: living life on their own terms.

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If you could benefit from a conversation with our advisory team, we would be happy to provide [a complimentary consultation.](#)

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