Should You Put All Your Eggs In One Basket?

"An investment in knowledge pays the best interest."
– Benjamin Franklin

"ALL YOU'RE EVER INTERESTED IN ARE GET-RICH-QUICK SCHEMES. WHAT'S YOUR HURRY?"

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I enjoy traveling very much. Jungles, mountains, beaches, small towns and large cities – ship them in. Domestic and International destinations – I love them both. Developed or developing countries – I am happy either way. However, this wasn't always the case. Once upon a time, I needed some encouragement. Or maybe it was more of a minor threat…

Back in the mid 1990's I was dating a young lady who loved to travel. At the time, I was twenty-one years old and probably thought I had everything figured out. Looking back now, I see that the joke was on me. Anyway, after about three months of courting, she suggested we take a trip to Isla Mujeres, a quiet island located just off of Mexico's

Yucatan Peninsula. I protested, as I felt it was too early in our relationship to commit to that sort of thing. Her response, "Fine, I'll just go with someone else then." "Well," quickly imagining all the fun and romance she'd have without me, I shot back, "This better not be too expensive!"

As it turned out, it wasn't expensive. Our hotel charged $12 per night, food and beer was cheap, and the gorgeous beaches were free for all. The experience was life changing. Years later my lady friend agreed to make me an honest man and became my wife. Joining her on that trip was one of the best decisions I ever made.

My parents also enjoy traveling, however they prefer a more structured and elevated format nowadays. Cruise ships fit the bill for them as they seem pretty hooked on both the pampering and relaxing atmosphere. Thinking a cruise would be a nice way to bring the family together, my parents invited us all to join them on a 10-day trip from San Francisco down along the Pacific coast of Mexico this past January. We all had a wonderful time, however I realized for me that when it comes to traveling, I prefer the destination over the journey. Nevertheless, I had ample free-time to read and relax while onboard.

Benjamin Graham is considered the father of value investing. Warren Buffet (you know, that other famous value investor) was his student at Columbia University and even worked for his investment firm post-graduation. Graham's book, The Intelligent Investor is an important piece of work that embarrassingly I hadn't read until our recent trip. Relaxing on the ship's promenade deck and about half way through the book, I came across a thought provoking commentary written by Jason Zweig of The Wall Street Journal, "Should You Put All Your Eggs In One Basket?" The topic is relevant on many levels as typically those wealthiest among us have achieved outsized success as a result of past concentrated wagers.

Should You Put All Your Eggs In One Basket?

"Put all your eggs into one basket and then watch that basket." proclaimed Andrew Carnegie a century ago. "Do not scatter your shot… The great successes of life are made by concentration." As Graham points out, "the really big fortunes from common stocks" have been made by people who packed all their money into one investment they knew supremely well.

Nearly all the richest people in America trace their wealth to a concentrated investment in a single industry or even a single company (think Bill Gates and Microsoft, Sam Walton and Wal-Mart, or the Rockefellers and Standard Oil.) The Forbes 400 list of the richest Americans, for example, has been dominated by undiversified fortunes ever since it was first compiled in 1982.

However, almost no small fortunes have been made this way–and not many big fortunes have been ***kept*** *this way. What Carnegie neglected to mention is that concentration also makes most of the great* ***failures*** *of life. Look again at the Forbes "Rich List." Back in 1982, the average net worth of a Forbes 400 member was $230* *million. To make it onto the 2002 Forbes 400, the average 1982 member needed to earn only a 4.5% average annual return on his wealth-during a period when even bank accounts yielded far more than that and the stock market gained an annual average of 13.2%.*

So how many of the Forbes 400 fortunes from 1982 remained on the list 20 years later? Only 64 of the original members–a measly 16%-were still on the list in 2002. By keeping all their eggs in one basket that had gotten them into the list in the first place–once booming industries like oil and gas, or computer hardware, or basic manufacturing–all the other original members fell away. When hard times hit, none of these people–despite all the huge advantages that great wealth can bring–were properly prepared. They could only stand by and wince at the sickening crunch as the constantly changing economy crushed their only basket and all their eggs.

Often times, the skills and traits that help make someone wealthy in the first place are in conflict with preserving that same wealth later on. As expressed in the passage above, the best way to make a huge sum of money is to put all of one's eggs in a single basket and make a concentrated bet. Unfortunately, this is also the best and quickest way to the poor house. As an investment manager and adviser, I cannot be all things to all people. Some investors play for home runs – this is not me. My approach is conservative. I focus on preserving and growing client wealth over time. That may not be sexy, but neither is regret.

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It's 2018, and volatility is back! The market moves over the past few weeks caught many investors off-sides. Most concerning to me was watching both stock and bond prices decline simultaneously. I don't think any of us should be surprised. Equity markets had been marching relentlessly higher for some time, while complacency was also a feature in the bond market as well (particularly in long-term U.S. Treasuries), where leverage money had built up positions in yield curve flatteners (A yield curve flattening trade is a bet on the yield spread difference between long-term and short-term treasuries decreasing over time). I still believe as time passes yield curves will continue to flatten and long-term rates will ultimately go lower, but markets rarely move in a straight line.

In the short term, more air could seep out of the stock market as many investors had built equity heavy portfolios solely focused on returns while ignoring risks. My sense is that asset allocations are still a bit out of whack and heavily weighted towards stocks. Once positioning has been reconciled, I'll then become more positive on my outlook. But in reality, most everything had been bid up – crypto currencies, commodities, real estate, stocks, bonds, fine art, etc., and when this occurs cash is usually the only place to hide. Unfortunately, cash instruments do not hedge out declines in other markets efficiently for non-institutional investors, as to off-set losses in risk assets, a large amount of leverage must be deployed in a cash position.

Over the coming weeks I am looking for long-term U.S. Treasury rates to stabilize or even go lower providing shock absorption to equity market declines as they have done so historically. If we observe this change, then volatility will likely begin to settle down and some beaten down investments can be purchased at better risk/reward entry points. Stay calm and carry on.

Sincerely,

Justin Kobe, CFA
Founder, Portfolio Manager & Adviser
