HBKS Wealth Advisors

Vision

Investor Communication

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The HBKS Rationale for Maintaining Our Globally Diversified Investment Strategy

As investors review their portfolios to start the New Year, many are asking themselves if a globally diversified portfolio strategy is still the best solution for them. They see the S&P 500 Index at all-time highs after running up another 13.7% in 2014, outpacing small caps and foreign stocks by a wide margin, and believe they should put all of their assets into domestic large cap stocks.

At HBKS Wealth Advisors, we believe that while a portion of an investor's equity portfolio should be in large cap domestic equities, a globally diversified portfolio utilizing Alternatives to hedge against a potential downturn in stock markets is a more appropriate strategy. Today, the case could be made that maintaining a diversified strategy utilizing Alternatives is more important than ever because the risks are growing almost daily.

In a recent commentary Mohamed El-Erian, Chief Economic Adviser at Allianz, wrote that many assets, including domestic stocks, are priced with the assumption that everything will work out exactly as everyone assumes they will. Historically, that is a dangerous assumption. Here is his quote:

> "When I consider the prospects for the global economy and markets, I am taken aback by the extent to which the world has collectively placed a huge bet on three fundamental outcomes: a shift toward materially higher and more inclusive global growth, the avoidance of policy mistakes, and the prevention of market accidents. <u>Though all three outcomes are undoubtedly desirable, the unfortunate reality is that they are far from certain – and bets on them without some hedging could prove exceedingly risky for current and future generations." (emphasis added)</u>

It is somewhat surprising that stocks in the United States have risen for six straight years given all that occurred during that time:

- The period began in 2009 as the world emerged from the Great Recession that was caused by the financial crisis.
- In that year unemployment hit 10.2% and the Government bailed out General Motors and Chrysler to keep them afloat.
- The U.S. Federal Reserve began its unprecedented stimulus in response to the financial crisis.
- Over the next five years governments around the world built up large deficits causing the European sovereign debt crisis as Greece, Portugal, Spain and Italy were on the brink of collapse.
- In 2013 the US Government shutdown for the first time since 1995 due to political gridlock.
- Last year we were confronted with geopolitical turmoil on at least two fronts as Russia annexed Crimea and ISIS established a caliphate from which they intend to launch terrorist attacks on the non-Muslim world.

Through all of this turmoil the global economic recovery remained weak, with employment only gradually recovering. As we enter 2015 there are still numerous areas of concern:

- Growth in China is slowing.

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- Japan is in a recession.
- Tensions between Russia and the west remain elevated.
- Europe still has not solved its longstanding economic problems, and there is a significant risk that either the European Union will have to be revised or it will fall apart.
- While the U.S. economy is finally adding jobs, wage growth has been practically nonexistent.
- 2015 will mark the seventh straight year of global central banks employing aggressive monetary policy in order to stimulate growth and end the economic funk that has plagued the world since the 2008 Financial Crisis.
- The U.S Federal Reserve hopes to begin raising rates in 2015 but no one knows if the recovery is strong enough to withstand the removal of stimulus by the Fed. Already there are signs of weakening growth amid falling commodity prices, leading to concerns about the possibility of deflation.
- In this environment, will the Fed hold off raising interest rates from historical lows, or will they push forward raising rates?

All of this is not to suggest stocks in the United States are due for a bear market. To the contrary, there are many positives that should enable stocks in the U.S. to rise modestly over the next several years:

- The U.S. is further along in the economic recovery than most other countries – it was relatively quick to deleverage and was early to embark on quantitative easing.
- Also, although low oil prices will likely cause a decline in oil-related capital expenditures, this should be more than offset by the boost in discretionary income to the vast majority of the country. As a result, the near-term growth potential is higher in the U.S.
- As the largest consumer of goods in the world, the strong consumer spending in the U.S. can continue to benefit exporting countries of the world.

What we are suggesting is that, with all of the uncertainty, doesn't it make sense to continue to utilize asset classes with low correlations to domestic large-cap stocks in order to provide some hedging against an adverse event?

We believe it is prudent to stay the course while continuing to make modest adjustments to our clients' portfolios as market conditions fluctuate.

Regards,
Brian S. Sommers

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Director of Asset Management

As Director of Asset Management for HBKS® Wealth Advisors (HBKS®), Mr. Sommers oversees the firm's investment management processes for a distinguished group of nearly 30 investment advisory representatives. Mr. Sommers chairs the Investment Policy Committee of the firm and is instrumental in the identification, evaluation and recommendation of the investments that make up HBK's portfolios. He brings HBKS clients the expertise of more than 20 years managing a wide range of portfolios for both high net worth individuals and institutional clients.