Thoughts that count

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Putting the pieces together

My niece refuses to play Monopoly with me. So does the rest of my family, but my niece was the last family member to agree to wage battle. I am lukewarm about most boardgames, but Monopoly is in a class of its own. Admittedly, the combination of business theory, competition and luck raises my excitement level above most other players, which is why no one wants to play with me.

My kids will certainly not play Monopoly with me. They will however, let me play Lego with them. We build *Star Wars* spacecrafts and pretend we are fighting alongside the Rebellion against Darth Vader and the Dark Side. Sometimes we use the building instructions from inside the box and sometimes we use only our imaginations.

My temperament is much calmer playing Lego than Monopoly. Why should that be? Both Monopoly and Lego are family games, played with people I care about and are meant to be fun. Why would my behaviour differ between two games? Why do my family members refuse to play one type of game with me, but cherish time spent playing another? The answer lies in an unconscious mental construct of someone like myself; I am competitive.

Though I (reluctantly) admit I am competitive while playing Monopoly, my ambitiousness does not manifest when playing Lego. This is because a competitive mindset is counter to Legos' purpose, rules of play and success. I have summarized the differences between these games below.

	Purpose	Rules of Play	Success
Monopoly	One winner, many losers.	Win by accumulating properties to the exclusion of all other players. The game ends when your opponents are financially extinguished.	The total devastation of everyone else's finances, resulting in anger and tears.
Lego	Creativity. No winners or losers.	Maximum creativity is rewarded. The game can continue indefinitely.	Having fun using imagination.

When making an investment, should you think like someone playing Monopoly or Lego? Is it better to view investing as a 'win or lose' endeavor or is it more advantageous to be more contemplative? In other words, is investing a competition?

If we view investing as a competitive win or lose exercise, we tend to ask only two questions when faced with an investment decision; how much money will I make and how fast will I make it? As competitions only have binary outcomes, (win or lose) we miss the opportunity to evaluate investment ideas with more subtle but equally important inquiries.

Of course, all investors only want to put money into things that increase in value. However, it is also critical to understand how investment pieces fit together. Like bricks in a Lego set, investment ideas need to make sense as part of a larger structure. One way to qualify an investment under consideration is to ask whether it's compatible with your investment personality? In other words, is this the kind of investment you can live with owning for a while? The world is full of investment ideas that seem exciting but are incongruent with the general investing population. As an example, most people should not invest in companies that do not consistently make a profit, yet they do so regularly. Companies that do not earn profit are very Monopolistic; either they grow quickly to profitability or they will cease to exist. A very risky proposition. Most would find it shocking that currently 40% of all US stocks belong to profitless companies, the highest proportion since 1999.

Another often overlooked query is how investments fit with each other. In other words, are each of your investments complementary? The goal of creating a portfolio is diversification, which means owning things that possess different properties. Duplication is the enemy of diversification. This sounds simple, but it means not all your investments will increase at the same time or rate. This can cause significant investor angst but is a necessary ingredient in a healthy portfolio.

Two thousand twenty has injected all kinds of uncertainty into our lives. The economy has not been spared; it has taken a beating. If we think about the economy in Monopolistic terms, we will think in binary outcomes; the economy is either good or bad. With this perspective, only if the economy is good will investments do well. That is a lot of pressure to put on one data point, which is often just an opinion. This point of view makes it extremely challenging to make wise investment decisions.

If we are a little more contemplative, we might recognize that the economy is a nuanced machine that cannot be boiled down to good or bad. As well, not all investments perform alongside the direction of the economy. Just as a Lego set has different shaped pieces for different functions, investors can access different strategies to take advantage of differing economic states.

In describing our current mix of investments, consider three pails, each holding Lego bricks with a different sensitivity to the economy. The first pail, *Economically Sensitive*, contains bricks which share the Monopolistic characteristics of the world; they will perform along the direction of the economy. If the economy rises, so will these investments. If the economy falters, the investments will too. This is the pail containing stocks, so it gets the most attention. If you are reading somewhere how the “market” is doing, it is in this pail that the answer will be found.

The second pail, *Economically Irrelevant*, gets limited attention. This is because it is not nearly as exciting as the first pail. These bricks have no consistent relationship with the economy. This is because they are obligated to receive a consistent income stream, irrespective of whether the economy is performing well or not. This is the most dependable pail.

In the third pail, *Economically Inverse*, the bricks act in the opposite direction of the first pail. If the first pail bricks increase in value, the third pail bricks decline. The opposite is also true, if third pail bricks increase, then first pail bricks decline. They are the yin to the first pail’s yang. This pail acts as protection against a volatile economic outlook.

The purpose of having exposure to each pail is balance. Monopolistic investors use only bricks from the first pail and miss out on the smoothing effects of the other pails. Varying the weights of each pail in a portfolio gives us control over our investment experience. Below is a chart listing examples of the kinds of investments (bricks) inside each pail.

Pail 1: Economically Sensitive	**Pail 2: Economically Irrelevant**	**Pail 3: Economically Inverse**
Stocks	Cash	Gold
Corporate IOU’s (Bonds)	Government IOU’s (Bonds)	Long term IOU’s (Bonds)
Real estate	Derivatives (options)	Hedges (portfolio insurance)

When uncertainty is low, and the economy is robust, it is advisable to hold the greatest percentage of a portfolio in pail 1 ideas. It is here that growth is usually highest. But as ambiguity rises, adding pail 2 investments is prudent. These investments will smooth returns by providing a fixed income stream even when pail 1 investments are not performing well. When economic confusion persists, pail 3 investments should be added in significance. These investments further balance a portfolio because they offset volatility in other pails. Like creating with Lego, enough pieces are pulled from each pail to form a coherent and pleasing structure.

Our portfolios today are made up of a close to equal weight from each pail. In these unsettled days, building a portfolio to stand up to fast changing economic conditions is the optimal strategy. Pursuing any investment without thinking about how it fits with the rest of the puzzle is as arbitrary as sticking a Rebellion Lego piece on a Darth Vader spacecraft.

Your *loving everything about playing with Lego except stepping on the pieces* investment advisor,

Duncan Stewart, MBA, CIMA, FCSI, CFP, CPWA

duncan@stewartfinancial.ca / duncan@manulifesecurities.ca