WESTBOURNE
INVESTMENT ADVISORS

INVESTMENT PERSPECTIVE — SECOND QUARTER 2021

"My guiding principle is that prosperity can be shared. We can create wealth together. The global economy is not a zero-sum game."– Julia Gillard, Former Prime Minister of Australia

Against a backdrop of forward but uneven progress on the vaccine front, capital markets were up again in the first quarter, anticipating a return to robust economic growth. While *Technology* stocks drove market gains over the last few years, in Q1 we witnessed a transition to stocks in other sectors such as *Financials*. Our portfolios saw marked success due to our overweighting of *Financials* and *Energy* as investors shifted to these sectors as part of the "re-opening trade." Considering global demand growth, we continue to identify value within these sectors.

While bear markets crush our collective confidence and often trigger survival mechanisms, rising markets evoke an old saying describing a cautionary ascent: "Bull markets climb a wall of worry." The latest market worry, ironically driven by high levels of confidence, is inflation coupled with rising interest rates. In a few short months, sentiment has flipped from skepticism about global recovery to the other end of the spectrum – a worry that economic growth fueled by liquidity, stimulus, strong demand, and strong corporate earnings ***will come too fast, and create inflationary pressure*****.** While the market flip-flops on its worry *du jour*, world economic growth churns forward, and we remain steadfast in our belief that long-term portfolios should remain invested mostly in equities.

"Know what you own, and know why you own it." — Peter Lynch

We often discuss the need for adequate allocation in equities to achieve long-term wealth creation, balanced against near-term liquidity needs. The recent rise in equities has created pockets of speculation in the market, while interest rates remain very low. In this *Investment Perspective*, we return to the basics of the underlying investment instruments of Equities (Stocks) and Fixed Income (Bonds).

What is a Stock?... and Why do we own them?

Admittedly a basic question, but appreciating this fundamental concept helps to understand the underlying criteria for choosing equity investments and to assess relative risk between various investments. Simply put, a stock is a proportional ownership share of a company. Investing in shares of public companies provides investors with the privilege of ownership participation in the best companies in the world alongside the best investors, best business managers, and best capital allocators. Stock ownership provides a prorated claim on the assets of these companies, including future earnings streams. Among the benefits of stock ownership are:

- ***Capital Growth* -** The equity owner's stake can grow substantially in value as their stake in a company grows in value through increasing cash flows and asset appreciation. This opportunity for participation in virtually unlimited upside is possibly the most important feature of equity investments.
- ***Management* –** Investment in equities not only avails shareholders to invest alongside the best investors in the world but also allows them to invest in companies run by talented professional business managers whose interests are aligned with shareholders. The best public companies are run by top-flight management teams who are dynamic capital allocators seeking the best returns for shareholders.
- ***Dividend Income*** – In addition to asset value growth potential, many companies distribute portions of their earnings to shareholders in the form of dividend payments.

- ***Diversification*** – A diversified portfolio of equities allows investors to invest in companies of various sizes and shapes in multiple business models, geographies, and sectors. Equity investors may invest in anything from small regional banks to a multi-national conglomerate – from established companies with a stable income streams, to cutting-edge technology companies with huge growth potential.
- ***Inflation Hedge*** – While fixed income instruments have finite pre-defined income streams, equity holders can participate in the growth of the underlying company's business model and assets, as well as their market-based pricing power in an environment of rising prices.
- ***Liquidity* –** The stocks we own are typically highly liquid (i.e., easily convertible to cash without price disruption) via low-cost buy/sell transactions on national stock exchanges.
- ***Tax benefits* –** Equity appreciation is not taxed until a stock is sold (realized), and capital gains tax rates are lower than ordinary income rates. Holding stocks for long periods allows indefinite tax deferral.

"How many millionaires do you know who have become wealthy by investing in savings accounts?"
—Robert G. Allen, motivational speaker

Why own bonds when they pay only ~1.7%/year, less than the rate of inflation?

An important component of our portfolios is Fixed Income, specifically bonds and bond funds. Fixed income instruments are exactly as they sound; investment obligations that produce income, usually in the form of fixed interest payments. We use fixed income instruments as a reliable place to store near-term liquidity needs (3-5 years) while using equity investments for that portion of the portfolio that has a longer-term investment horizon. The main advantage of fixed income investment is their relative stability (lower volatility) that produces a modest income stream. The disadvantage of fixed income investments is that, by definition, their growth is pre-defined and limited. In the current environment of sub 2% interest rates for low-risk bonds, returns are below the long-term prevailing inflation rate, a yield known as a *negative real yield* -- returns are negative when inflation is considered. For these reasons, coupled with the wealth creating opportunities provided by equities, we limit the allocation and the duration/term of our fixed income investments and favor stocks.

"The individual investor should act consistently as an investor and not as a speculator." — Ben Graham

Q: Should I buy Game Stop? It seems to go up every day. A: No.

A final thought on the risky market activity we saw in 1Q21 where several stocks (e.g., GameStop, vaccine timing plays, etc.) were driven to stratospheric levels and hyper-volatility based on gamesmanship between internet speculators and hedge fund traders, often without regard for the underlying value of the companies. These trades are more akin to gambling, not investing. While admittedly fun to watch, we believe this activity is not prudent, and chasing stock-of-the-moment *meme* companies is a poor strategy for creating long-term wealth.

As always, we thank you for your trust and we welcome your questions and comments.

All the Best,

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