GRYPHON
ADVISORS

Mind Over Matter

Whom the Gods would destroy they first make mad.

In the sixth part of Longfellow's poem, The Masque of Pandora, Prometheus issues this warning to Epimetheus. It aptly describes how it feels to invest in the current market climate; particularly, in stocks.

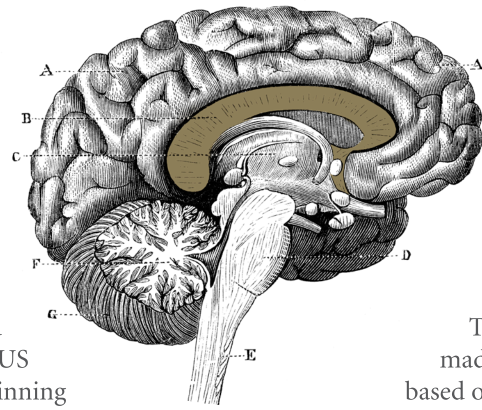
Despite entering the year with historically attractive valuations, emerging market equities returned (15.47)% through the end of the quarter while equities from foreign developed markets returned (5.28)% and domestic market equities returned (5.45)%. Widely-owned low correlation diversifiers such as REITs and commodities generated losses of (4.52)% and (15.80)%.

Fortunately, global fixed income came to the rescue by generating returns of …(2.25)%. Ugh! Through the first nine months of the year, there was nowhere to hide. No country within the developed or the developing market indexes generated positive returns. The best that could be hoped for was a small loss of (1.12)% in Ireland or (3.10)% in emerging Hungary. Fortunately, one commodity generated positive returns; you could have made +13.42% for the quarter if you invested in lean hogs! In fact, all those risk asset classes, with the exception of REITs and commodities, had positive returns heading into the third quarter. On August 24th alone, the Dow fell by 1,089 points, more than the decline in the "Flash Crash" of May 2010, before rallying 500 points to close down 588 points.

Since that raucous week in August, the domestic, foreign developed and emerging market equity indexes are up around +10%. Bonds are up about +0.50% over that time frame. Feels crazy, right? Feels like you don't have control? Feels like you are on a rollercoaster, and don't know if the coaster will stop lower or higher than its point of origin? Of course it feels that way!

And that's why Gryphon never invests based on how things feel. We didn't sell any risk assets and sprint to cash on that volatile August Monday, even though other investors felt like doing that. Similarly, we didn't place all our portfolios into US stocks after the S&P 500 returned +14% in 2014, even though that would have felt good. If Amazon or Google are up +50% over the next three months, don't expect to open your statement and see a portfolio chock-full of tech stocks. An investor cannot outperform the market by investing in what feels good at the time. It's the opposite; the investments that feel the worst to buy almost always generate the best performance going forward.

Reject the urge to invest based on your feelings.



Why? *Human Nature.*

Most investors want to purchase securities that feel good to own; stocks with lovely stories that the media fawns over. Investors bid up the price of these "feel good" assets, like US stocks at the beginning of 2015…or at the beginning of 2000. From 1995 to 2000, US equities returned +15.8% per year. Meanwhile, investors often sell investments that feel bad to own; like emerging market equities at the beginning of 2015…or at the beginning of 2000. From 1995 to 2000, emerging market equities returned (6.7%) per year. By bidding up the price of "feel good" assets today, investors take away most of the potential for meaningful future returns. By pushing down the price of "feel bad" assets, investors create room for meaningful future returns. How did the S&P 500 fare relative to emerging markets after 2000? From 2000 to 2010, US stocks had a lost decade with slightly negative annualized returns while emerging market equities returned +13.5% per year.

Whom the Gods would destroy they first make mad. Yes, the market will try to madden you through volatility, before destroying you as you abandon proven principles in favor of "feel good" investing.

In Longfellow's poem, The Masque of Pandora, Epimetheus counters Prometheus' warning; *Shall I refuse the gift they send to me?* Prometheus is steadfast; reject all gifts that come from higher powers. That is how you survive these seemingly maddening markets. Reject the urge to invest based on your feelings.

Weight your investments towards those assets that are priced to deliver the most attractive risk-adjusted returns going forward, even if it feels difficult to own them. Do this because the historical, factual evidence is overwhelmingly in your favor if you do this. Discipline over emotion; there is no other way. ❧