



CONNECTING QUARTERLY JULY 2016

Dear Friends,

Summer has roughly reached its midpoint, and for my immediate family that means it's time for our annual beach vacation to Southern California. It's 10 days when I get to indulge in one of my favorite, but rare, pastimes: Surfing. Make no mistake, I'm a terrible surfer, and by picking up the sport at age 40 and only getting in the water 5-10 times per year, I'm confident there is a ceiling on my skills. But my own limitations don't stop me from being in awe of skilled wave riders, particularly "big-wave" surfers who challenge 30, 50 even 70-foot waves crashing over jagged reefs in search of the ultimate ride.

There's some element of danger involved in surfing the puny waves that I venture into, but those risks obviously magnify tremendously in the big-wave world:





While the aerial view of these wipeouts is frightening, the real danger lies below the surface. The spiraling, helpless rider can be plunged up to 50 feet underwater, where they must wait to stop spinning and figure out which way is up. They then have less than 20 seconds to ascend to the surface before the next wave is upon them.

In reading and watching interviews with the men and women who challenge these monstrous waves, I've seen a number of commonalities that they attribute to their success:

1. Preparation. Big wave surfers need to prepare not only their bodies, but their minds. Obviously, training one's lungs to be able to survive 20 seconds or more underwater is challenging, but many surfers claim that the biggest risk isn't physical, it's panic. When presented with a precarious situation, panic exacerbates the circumstances, resulting in even greater danger. During a wipeout, novice surfers thrash, fight and use more oxygen, which in turn increases the urge to breathe, and a vicious cycle quickly begins. Alternatively, experienced surfers perform lung capacity exercises in a pool and even wrestle each other underwater to know exactly how many seconds of air their lungs can hold under stress, increasing their confidence when presented with real-life danger. This "informed confidence" allows them to keep panic at bay, stay calm and conserve their precious oxygen.
2. Don't go it alone. Most big-wave surfers rely on coaches who help them get in top condition before venturing out into giant surf. But even the best surfers acknowledge the foolishness of challenging big waves without a "buddy" in the water with them. A competent buddy can help reorient the surfer after a wipeout and even drag them to safety if all else fails.
3. Acknowledge and embrace fear. Fear is a natural human emotion; we can't avoid it, we can only attempt to manage it and not let it control us. Even the greatest big-wave surfers are quick to point out that they are fearful every single time they attempt to stand up on the face of a giant swell. They recognize that an acute mindfulness of fear actually improves their physical skills and makes them better at their craft than if they were numb to their intimidating surroundings.

These lessons don't just apply if you're paddling out on a board, they can also apply to successful investing. Preparation is critical. Successful investors understand that, just as every surfer wipes out at some point, the stock market experiences a material decline almost every year and sometimes multiple times in a year. Just like a surfer trains to tackle big waves by holding their breath in a calm pool, investors should try to simulate being temporarily submerged by a stock market decline. How might it feel when the value of your stocks is down 20%, 30% or 40%?

Have you quantified the impact, if any, that such a decline will have on your short-term and long-term goals?

Understanding that the stock market gyrates and structuring your portfolio so that you won't be a "forced seller" of stocks when the market is down can help to give you the same "informed confidence" as a well-prepared surfer. And it may help you keep your worst enemy—panic—at bay when times are stressful.

Having an experienced coach and "buddy" with you in the financial sea can also be valuable. An objective coach can help you plan by providing information about how markets behave, what risks are worth taking and how to construct your portfolio to give you the best odds of success. But even with all of that groundwork, having a knowledgeable buddy alongside you each day is still invaluable. When stressful events occur (and they will), your buddy should be there to listen to your concerns, help you understand the impact on your financial goals, and keep you from making a critical mistake in the heat of the moment.

Finally, managing the fear of the unknown is an integral part of stock market investing. If the stock market wasn't uncertain all the time, and if people weren't scared of investing in stocks, everyone would buy them. This demand would push stock prices higher to the point where their future expected returns would be no more than other "safer" assets like Treasury bonds and cash. Said differently, it's the fact that stocks will always be uncertain and sometimes scary that gives them their higher historical and expected returns. You can't have one characteristic without the other. Patient, long-term investors should embrace the fact that fear may actually be a good thing for potential future long-term returns, not something to be avoided.

As always, we welcome your thoughts and questions.

Hang Ten,



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