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Back to the Investment Basics

Part 3: Our Marvelous Markets

In our last piece, we introduced the importance of saving, which is the first of five basics that have served investors well over time. Today, we'll look at where stock market returns really come from, and why that matters to your investing.

One of the best ways to combat recency bias is by focusing instead on the basics that have served investors well for centuries, if not millennia. In this series, we'll cover five of our favorites:

1. You can't invest if you haven't saved.
2. **Markets are inspired by ingenuity, tempered by diversification.**
3. The price you pay matters.
4. Patience is a virtue.
5. Investing is personal.

Markets are Robust and Random

Before we describe where stock market returns come from, consider these two quotes:

> "Whether the currency a century from now is based on gold, seashells, shark teeth, or a piece of paper (as today), people will be willing to exchange a couple of minutes of their daily labor for a Coca-Cola or some See's peanut brittle."
>
> —Warren Buffett, Berkshire Hathaway Chairman
>
> "Whenever you think you've found the key to the market, some SOB changes the lock."
>
> —G.M. Loeb, E.F. Hutton & Co. Founder

So, which is it? Are market returns driven by the inexorable wheels of commerce, as Buffett's quote suggests? Or do the market's mysteries remain under lock and key?

Markets Are Powered by Ingenuity

Viewing the market's daily frenzy, it's easy to forget where all that action is coming from to begin with. Close up, markets are a messy mash-up of companies, industries, sectors, and regions, often locked in fierce competition. But take a step back to view the whole. In aggregate, the stock market is also a forum for capitalizing on our collective ingenuity, which has generated amazing advances as well as strong investment returns over time.

This is at least the case for those who have been there to capture the returns when they occur. Examples abound to illustrate how often we may feel as if a source of returns has played itself out, only to find ourselves immersed in a fresh wave of entrepreneurs who have just begun to innovate. As Dimensional Fund Advisors' Weston Wellington points out: "Sticks and stones led to hammers and spears, the wheel and axle, the steam engine, and eventually semiconductors and jet aircraft."

Here's how the late, great Vanguard founder JoŠ "Jack" Bogle described it:

> "If you own the stock market for a lifetime, you get those returns. Playing games in the stock market, over every day of that time, is playing the stock market. The stock market game is rigged, the business of investing is not rigged."

Market Performance and Random Chance

Even as global enterprise continues to amaze us, it usually does so in a random walk. While you'll almost always find handfuls of remarkably winning investments at any given time, you'll also encounter bucketloads of losers. Moreover, the winners and losers can trade places on an unpredictable dime. As Dimensional's Wellington observes: "The benefits of innovation are widely dispersed throughout the economy, often in unpredictable ways."

It might help to think of the market as a mighty vehicle, like a train. When you climb aboard, your goal is to reach your desired destination by accumulating miles, or market returns, without derailing along the way. For that, you need a solid, Buffett-style engine of global commerce. But that engine also needs a supply of combustible fuel.

This illustrates why markets will always be messy and confusing at a close-up view. Only as we zoom out can we track our progress, in the shape of an upward line of market returns over time and across the long haul.

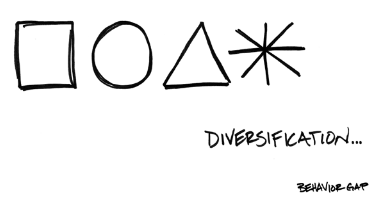
Because we expect the engines of ingenuity to continue chugging along, we have every reason to remain optimistic, and to stay invested as planned. We also understand why diversification remains equally essential to our efforts—because we never know just where the next sparks are going to fly.

By embracing the reality that stock market returns are random and robust, you can boost your ability to remain calm (or at least calmer) during the maelstroms, and improve your chances for reaching your investment goals over time.

Let us know if we can assist with that. Next up, we'll take a look at our third investment basic: The price you pay matters.

Until next time, no regrets!

Eric Hutchens
President & Chief Investment Officer



FINANCIAL PLANNING TIP

Should You Buy or Lease a Car?

Generally speaking, buying a car is better over the long term, but there may be situations where a lease makes more sense.

How Does a Lease Differ From a Car Loan?

With a lease, you are renting a car for 1-3 years. The "rent" is based on the car's depreciation cost, dealer's fees and costs, and a profit margin. The number of miles you drive annually and your credit history are also factored into the cost. A larger down payment will lower the monthly payments, but you will not get the down payment back. Cars that hold their resale value are typically a better value to lease. Also, driving fewer miles annually can reduce the lease cost.

The lease fee covers the dealer's financing costs to purchase the car from the manufacturer. If the dealer pays a higher interest rate, those costs will be passed on to the lessee. The lease payment includes an interest rate component called a lease factor or a money factor. It is interest on the above fees and financing costs that are paid for over the term of the lease. Your credit score impacts the rate you pay.

Why Would You Lease a Car Versus Buying It?

A lease can allow you to drive a more expensive car than you could afford to buy. If your loan payments would be too high for too long with a purchase, you probably could reduce your monthly expenses with a lease. If you like to drive a new car every few years, you could be losing money by buying a car and then selling it in the first few years when most of the depreciation occurs. If you need to finance most of the purchase, high interest rates may leave you underwater when you want to change out of the vehicle. Recently buyers have extended their car loans to up to ten years to lower their monthly payments. If you want to change vehicles after five years, you may find yourself owing more on the loan than you can get for the car. With a lease, you can just turn the car in at the end of the lease period and walk away.

When Should Buy or Lease a Car?

If you plan to change cars every few years and you drive less than 20,000 or so miles annually, you should consider leasing. Leasing saves money on maintenance as the car would be under warranty during most or all of the lease period. Also, if you choose a car that holds its value and you are careful to maintain it, you could receive a benefit if it holds its value. Most leases give you a residual price that you can buy the car for at the end of the lease. This price is determined at the origination of the lease based on the expected milage, depreciation and normal wear and tear. If the value of your car is actually higher at the end of the lease than the residual price in the lease, you could buy the car for the residual price and sell it or trade it for more money. Conversely, if the actual value is lower than the residual price, you can just turn it in and move on.

You would buy instead of lease if you had the money to pay cash, especially in this high interest rate environment, and you plan to keep the car for more than five years. Buying a car outright can save you a lot of money. You avoid monthly payments and can usually negotiate for a better deal than a buyer who needs financing. You can drive any number of miles without penalty, and you don't have to worry about following strict maintenance guidelines.

Who Should Buy a Car?

If driving a brand-new car is not of utmost importance to you, buying a vehicle and keeping it for the long haul will save you money. Once you have gone beyond the initial depreciation period, most cars roughly hold their (depreciated) value. Auto insurance rates and license tab charges usually go down as the car ages. If you put a lot of miles on your car and you are an experienced owner who knows when and how to maintain a car as it gets older, owning a vehicle may make more sense.

Online Calculators:
Edmunds: https://www.edmunds.com/calculators/car-lease.html
Cars: https://www.cars.com/articles/how-do-i-calculate-if-a-lease-is-a-good-deal-431421/
Bankrate: https://www.bankrate.com/loans/auto-loans/lease-vs-buy-calculator/
Nerdwallet: https://www.nerdwallet.com/article/loans/auto-loans/nerdwallet-lease-calculator

Headlines

- David Bromelkamp presented at the Broadridge Webinar Program on December 5, 2023. His topic was *Nonprofit RFP: Prudent Process to Select a Financial Advisor.*
- Our office will be closed on December 25, 2023. We will also be closed January 1 and 14, and February 19 for company holidays in 2024.
- Allodium welcomed seven new clients in the third quarter of 2023.

To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

Upcoming Webinar

EVENTS

The AdvisorSmart® Guide to Selecting a Fee-Only Advisor

Webinar: Thursday, January 25, 2024 at 2:00 p.m.

Many investors struggle to find an objective advisor. In this presentation, featured speaker and author, David Bromelkamp, will explain his new book called *AdvisorSmart® for the Individual Investor: Your Guide to Selecting a Financial Advisor to Get Better Financial* Advice (scheduled to be released in the summer of 2024).

David will help us understand the various types of financial advisors so we can make more informed choices. This webinar will focus on the following learning objectives:

- Sources of financial advice
- Sources of financial advice to avoid
- What good financial advice looks like
- How to introduce your friends and family to good financial advisors
- How to find professional financial advisors
- How to select and retain financial advisors

David Bromelkamp, AIF®
CEO, Allodium

WE APPRECIATE YOUR INTRODUCTIONS

To optimize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers. If you know someone who may be looking for this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3700 or dbromelkamp@allodium.com to arrange a friendly, no-obligation introduction.

Steward is published quarterly by Allodium Investment Consultants. Please contact iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.

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