



THE TRUST COMPANY OF THE SOUTH

[investmentupdate]

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Unless you've been stranded on a deserted island or hiking the Appalachian Trail, everyone most assuredly is cognizant of the recent market turbulence. As of this writing the S&P 500 is down about 6% off its July 19th high of 1553. As we often say, the declines are real, the losses are not – as realizing losses requires selling. In what we believe is a testament to both our investment approach and our client education and counsel, we've had very few calls from clients expressing concern about the markets.

As clients of TCTS often hear, we don't put much faith in forecasting. Your investment success is not dependent on our ability to accurately predict what will happen in the markets. To the contrary, that approach usually results not just in underperformance, but underperformance AND manic behavior, a result that is surely contrary to the aim of employing an advisor.

What we've seen this summer is a reaction to the long overdue and well-deserved euthanasia of the sub-prime residential mortgage market. As I wrote in a piece for *Carolina Newswire* in August 2005 titled *Boy in the Real Estate Bubble*, (www.carolinanewswire.com) it was fairly evident that credit standards had eroded to alarming levels. However, recognizing excess and being able to consistently profit from it are two entirely different things. Too often people confuse correlation with causation, especially when it comes to investing.

Like a golfer who gets out of sync and can't seem to hit the fairway, a return to the fundamentals is often the best course of action. We believe when we experience market dislocations, revisiting our investment fundamentals provides reassurance. The fundamental concepts we consistently follow include:

- >> **Think counterintuitively.** Volatility is the long-term investor's friend. Declines (often severe ones) are a natural part of capital markets. Just as hurricanes and forest fires provide an opportunity for eco-system renewal, market declines do the same for capital markets. Weak investors are pruned out, speculators drown. These declines serve an important role in flushing out excessive speculation and are a harbinger of long-term market health.
- >> **Long-term investing success doesn't require "being right" about a forecast.** Investment success isn't a referendum on superior intellect. The list is long and distinguished of smart people who made monumentally stupid investment decisions.
- >> **The financial press specifically and the media in general are deterrents to investment success.** No one should confuse "news" with "information." Excess, whether it is Britney Spears or the mortgage meltdown, sells. Papers, magazines, TV all thrive in tumultuous times. Tune out the noise, you'll be happier, both personally and financially.

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>> **Accept the capital market return that is there for the taking.** The best protection against market declines is behavior modification and a portfolio comprised of 5-7 different asset classes. Except for a few isolated pockets of authoritarian regimes, capitalism won and communism lost. Markets work. If you are disciplined and diversified, your investment in capital markets will be rewarded.

Hyman Minsky, an American economist, theorized that the longer investors experience periods of economic and financial growth, the more immune they become to risk. During a client review earlier this month I was stunned to see her account had a 24.5% annualized return since October 1, 2003. It's easy to see how investors may become complacent about risk during periods of strong returns. Do you remain as comfortable with your asset allocation as you did six weeks ago? Will you maintain your investment discipline during a "Minsky Moment?"

It is quite possible that there's more downside to come. We simply don't know and it would be foolish for someone to contend that he/she does. The investment portfolios we've structured are designed to withstand catastrophic conditions. That doesn't mean they won't decline if the markets decline, but our portfolio construction is akin to building a hurricane-proof home. We may lose some shingles or a window, but when the wind passes, our home will be standing.



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