Y O S E M I T E C A P I T A L M A N A G E M E N T

Third Quarter 2015 – COMMENTARY

Rationality is essential when others are making decisions based on short-term greed or fear. That is when the money is made. – Warren Buffett

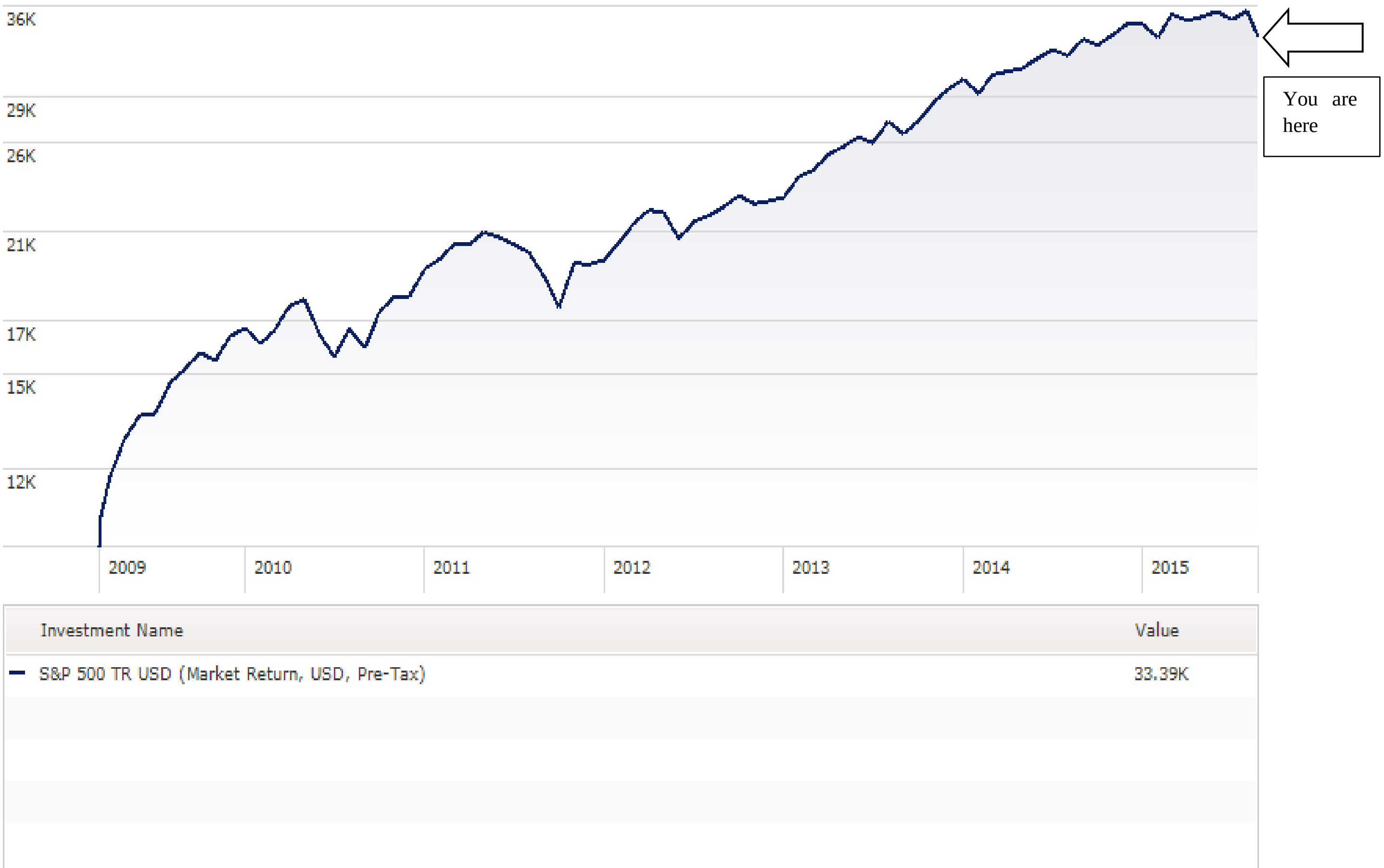
Using intraday numbers, the S&P 500 Index fell about 7.7% from its high on May 20, 2015 to its low (so far) on Friday August 21, 2015. This kind of mid-single digit decline is ***routine***. There have been several such episodes and a fewer bigger declines just in the current bull market that began in March 2009 as can be seen in Exhibit 1.

Many have called for a bear market throughout the last six years, and presumably because so many have had far too much of their portfolios in a swath of woefully underperforming assets such as cash, foreign stocks, or alternatives, this very strong run that has confounded so many has been called "the most hated bull market in history".

Exhibit 1

S&P 500 (SPX) since the current bull market began on March 10, 2009

"The most hated bull market in history"



Courtesy of Morningstar

As a result, many wonder if the recent dip, mild and routine as it is, might be the beginning of something more serious. This is not an unreasonable thought, especially given the news background, from the serious financial crisis in Greece and the ramifications of that country being forced to leave the Euro zone, to China and its decelerating economy and plunging stock market, to the continuing possibility that the Fed will raise the federal funds rate in ~~April~~, ~~June~~, September (or December, or sometime in 2016, or …), to tepid economic growth, etc.

We cannot tell if a bear market is about to appear because we cannot predict the future -- and nobody else can either. Instead, it is much more important to reframe the thought process, especially before anything serious develops.

Successful long term investors know and take to heart the following ten points:

1. ***ONE'S STRATEGIC ASSET ALLOCATION ALREADY TAKES CARE OF THE PROBLEM OF VOLATILITY IN THE FINANCIAL MARKETS***. The bond portion of a portfolio already reduces exposure to the stock market. In cases of stock market declines, bonds often (though not always) maintain flat if not higher returns to at least partially offset what the stock market does. See 2007-09, 2000-03, 1998, 1987, etc. This is why the long term strategic asset allocation is so important and that it is properly determined BEFORE market storms erupt. ***Successful investing is about structuring a portfolio that has an optimized balance between risks and rewards according to one's goals, objectives, and circumstances***.

2. ***WE LIVE IN A TIME AND PLACE WHERE STOCK MARKET DECLINES ARE TEMPORARY AND NOT PERMANENT***. See every single market decline in American history without exception, a 100% rate of recovery. In spite of some very real problems, the United States of America is economically very strong, has very solid financial and economic structures, and has a culture of resiliency and optimism. The USA is not Greece or Argentina or Zimbabwe or any other of the many countries around the world that have severe shortcomings in their structure, attitude, resources, etc. We are fortunate to live in our circumstances. ***Successful investing is about taking advantage of the opportunities at one's disposal***.

3. ***ONE TREATS LONG TERM ASSETS DIFFERENTLY THAN SHORT TERM ASSETS***. When does one need their money? The portion of one's money needed within the next two to four years should not have much if any exposure to the stock market in the first place so that market volatility does not matter. The portion of one's money needed in three to eight years should have only a limited exposure to the stock market so the effects of market volatility are greatly mitigated (see Point 1 above). The portion of one's money needed after six to ten years or so can have more exposure to the stock market because there is time for portfolios to recover from market volatility (see Point 2 above). ***Successful investing is about structuring a portfolio that takes necessary risks where appropriate and avoids taking unnecessary risks where inappropriate***.

4. ***BEAR MARKETS DON'T WRECK PORTFOLIOS OR LIVES, ONLY BAD INVESTOR BEHAVIOR WRECKS PORTFOLIOS OR LIVES***. Humans often let their emotions, especially fear, override logic and common sense, and often at the worst possible time. History demonstrates that sticking to a sensible long term plan through good times

and bad reaps far higher rewards than reacting to emotions. ***Successful investing is about maintaining the discipline and patience to stick to a long term plan no matter what is happening in the markets, keeping one's emotions in check, and not reacting to or trying to anticipate short term temporary volatility***. ***Successful investing is about riding through bear markets and not trying to avoid them***.

5. ***THERE IS A HUGE DIFFERENCE BETWEEN A TEMPORARY DECLINE IN THE VALUE OF A PORTFOLIO AND A PERMANENT LOSS***. (See Point 2 above.) Only an emotional panic reaction will cause the two to equate. ***Successful investing is about having a long-term attitude of optimism because the history of humankind has always been about growth and improvement, even if the path is not smooth***.

6. ***MARKET VOLATILITY IS NORMAL***. History demonstrates that on average the American stock market has a 5% decline two or three times every year, a 10% decline about once every year or two, and a 20% decline about once every four years. ***Successful investing is about accepting periods of short term declines as part of the required price to pay in order to reap larger long term returns***.

7. ***MARKET VOLATILITY IS SOMETHING TO TAKE ADVANTAGE OF, NOT AVOID***. Because the long term trend of the American stock market is up, market volatility provides an opportunity to buy at lower prices. Therefore, lower prices are good news, just like lower prices for groceries are good news. ***Successful investing is about taking advantage of buying at lower prices by making additional contributions or at least by rebalancing a portfolio***. ***Successful investing is not about avoiding market declines***.

8. ***THE FINANCIAL MARKETS ARE NOT PREDICTABLE OR KNOWABLE IN ADVANCE***. Nobody can make accurate predictions on a consistent basis about the extent or timing of declines or increases. ***Successful investing is about achieving long term results and not about predicting the future for either the short term (less than three years) or even the intermediate term (three to ten years)***.

9. ***THERE IS ALWAYS SOMETHING TO WORRY ABOUT***. There are always problems, whether known or unknown. Conditions are never perfect and the future is never clear. ***Successful investing is about looking beyond today's problems to a better future because the history of humankind has always been about overcoming and solving problems***.

10. ***THE ECONOMY IS NOT THE STOCK MARKET***. The economy and the stock market are only loosely related. In the long run, the stock market is driven by earnings and

interest rates, but in the short to intermediate term the stock market can be driven much more by emotion and irrationality. ***Successful investing is about knowing that "good news" for the economy does not necessarily equate to advances in the stock market and that "bad news" for the economy does not necessarily equate to declines in the stock market***.

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We encourage clients to read the YCM Commentaries on our web site, at least those since 2012, as some of the material over this time covers some of these points in more detail.

http://www.YosemiteCapital.com/News-Commentary

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