



Capitalism is Alive and Well

"Our system works...Over time, people will live better and better. We overshoot and undershoot sometimes, but your kids and grandkids will live better than you. Over time, we move ahead at a pretty damn rapid rate."

- Warren Buffett, 2009

The world, and mankind, do move ahead, as Mr. Buffett put it, "at a pretty damn rapid rate." In just a few short years we have seen the exploration of Mars, Apple's debut of the iPad, and via social media, a level of human communication and connectivity greater than anything we could have imagined in the early days of the internet.

Mr. Buffett also points out, however, that we sometimes overshoot and undershoot. Since the beginning of the global financial crisis in 2007, stock markets around the world have been challenging, to say the least. The collapse of the real estate bubble in 2007 was followed by a decline of more than 50% in global equities that lasted into early 2009. Since then, stock markets have been held back by concerns about government debt levels in the UK and US, recurring crises in Greece and other southern European countries, violence in the Middle East, a slowdown in the growth of the Chinese economy, and most recently, plummeting oil prices and fears of deflation. In addition, the

proliferation of "reality TV" shows may have set our culture back a decade or more.

The anemic returns in equity markets over this tumultuous period has led some investors to question whether investing in stocks still works. The answer is "yes." We are confident that investing in stocks remains the best way to generate wealth over the long-term, but the difficult market environment since 2007 shows how important it is to understand what works and what does not work when it comes to investing. With this in mind, let's address some of the questions investors are asking about stock markets.

Given the events of the past several years, does it still make sense to invest in stocks?

We emphatically answer "yes" to this question because **capitalism works**. Humans work hard, innovate, and take risks because we want to build wealth for ourselves and we want our children to have a better life than we do. Long-term growth in the stock market is the inevitable result of this human tendency for productivity. Stock markets can have long periods of exuberance followed by long periods of frustration and fear, but capitalism

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continues to work in the background. For those who are patient and maintain a long-term focus, wealth creation is the eventual reward. Unless you believe that the world has fundamentally changed in such a way that capitalism can no longer function, stock market investing still provides the best opportunity for success.

If that's the case, then when should I buy stocks?

We believe a wise investor will buy stocks in *all* market environments because **markets work**. Stock prices reflect all available information, good and bad, about the current financial state of the world. The presence of fair prices that reflect this knowledge makes it very unlikely that any investor, amateur or professional, will be able to consistently guess the right time to buy or sell stocks. The good news is that this market efficiency allows a committed investor to profit from the power of capitalism without ever having to speculate on the short-term fluctuations of the markets.

With all of the recent volatility, is diversification still helpful?

Yes, **diversification works**. Cervantes observed in the early 17th century, *“Tis the part of a wise man to keep himself today for tomorrow, and not venture all his eggs in one basket.”* Diversification is an ancient idea, and its ability to reduce risk is intuitively obvious, but most investors fail to take full advantage of it. Owning a few, or even a few-dozen, household-name American stocks does not constitute proper diversification. True diversification involves spreading one's risk among thousands of stocks and bonds of many different industries from countries all around the world. Employing comprehensive global diversification allows an investor to harness the power of capitalism while protecting himself from the downside risk of catastrophic loss due to the bankruptcy of a single company, a crisis in a particular industry, or dire economic conditions in a particular region of the world. Cervantes was not

an investment strategist, but he had the right idea.

Shouldn't I just trust my gut instincts?

Impulsivity and emotions will not serve you well in a volatile investment market, but **discipline works**. Markets are unpredictable and it is critical to resist the temptation to shift your plan based on your feelings about the latest news headlines or a hot tip you heard at a cocktail party. In this way, investing is no different from dieting, studying for an exam, or training for a marathon; even the best plan is useless without discipline.

The market environment since the onset of the global financial crisis has certainly been trying, but it is not abnormal, and none of the rules have changed. **Capitalism works, markets work, diversification works, and discipline works**. The global capital markets have faced protracted periods of sub-par growth in the past, but they have proven resilient in the end, and this time is no different. Markets are still unpredictable, diversification reduces risk, and discipline is more important than ever. So, for those investors wondering whether there are still good reasons to invest in the stock market, we emphatically say “yes.” Capitalism moves forward in fits and starts, but it has produced huge rewards over the long term and there is no reason to doubt Mr. Buffett's belief that we will continue to “move ahead at a pretty damn rapid rate.”

Heritage Investment Group provides wealth management and investment guidance to high-net-worth individuals, families, charitable foundations and qualified plans. We provide seasoned financial guidance, with respect and integrity, backed by a disciplined investment process. Since 1993 we've built our firm on a strong foundation of family and friendships with guiding principles of ethics and integrity.

The original version of this article was written by Heritage for the May/June 2016 edition of The Light, a local magazine serving Broward County, Florida.



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