ECONOMY

Most stocks and indices finished the week on a very high note

THINK STRATEGICALLY:

The Behavioral Perspective

Until P.R. Gov't is Able to Seek Investment-Grade Rating, Investors Exploring New Strategies, Diversifying Exposure Beyond One Asset

BY FRANCISCO RODRÍGUEZ-CASTRO | frc@birlingcapital.com

Diversify. Don't keep all your eggs in the same basket.

The behavioral perspective: New P.R. investment trends

The behavioral perspective is often explained in theoretical terms in which learning and behavior are described and explained as stimulus-response relationships.

Thus, the behavioral perspective of the Puerto Rican investor has significantly changed because the Government of Puerto Rico lost its investment-grade rating. With this downfall, it had an impact on any and all securities that have large amounts of exposure to the Government of Puerto Rico, which creates billions in losses to most investors that relied solely on these instruments. For years, this was the standard way to invest, and it was very profitable for those investors that could realize 6 percent returns from tax-free bonds or Puerto Rico mutual funds. Until the government can seek an investment-grade rating, investors have been exploring new strategies for their assets.

Below are some of the strategies being implemented:

•**Money managers with diverse strategies.** This strategy was often used by large institutional clients and, some years ago, became quite feasible for retail investors to select five or six money managers with a diverse array of strategies to professionally manage their portfolios. Some include BlackRock, Vanguard, State Street, Fidelity and Pimco.

•**Exchange-traded funds (ETFs).** These funds have become popular because they allow investors to quickly own a diversified set of securities, such as stocks, at a meager cost. They also allow investors to get exposure to areas of the market, such as countries, industries and asset classes.

•**U.S. municipal bonds, funds.** There are hundreds of issuers in the U.S. with solid credit quality, which are rated "AA" and higher, with prospective growth; there are also mutual funds that include in their strategies a 100 percent U.S. focus or an 80 percent U.S. focus, as well as many other mutual funds with a diverse set of investment strategies.

•**U.S. Treasuries.** The United States, with a "AAA" rating, has always been a safe-harbor investment that produced decent returns with minimal risk. Currently, the 10-year note closed Friday at 2.50 percent.

•**Alternative P.R investments.** With private equity, loan funds and other new opportunity funds, there is much to consider when forced to change strategies, and this is one of those instances. When investors are accustomed to tax efficiency, favorable inheritance laws, high yields and names you knew and trusted; when changing all you know, you need trusted expert advice.

Week in markets: DJIA, S&P 500, Nasdaq show double-digit growth

There was significant activity in the markets globally as most stocks and indices finished the week on a very high note. The Dow Jones Industrial Average (DJIA) closed the week at 26,424.99, a rise of 496.36, or 1.91 percent, and a year-to-date (YTD) return of 13.30 percent; and the S&P 500 closed at 2,892.74, a gain of 18.34, or 0.64 percent, and a YTD performance of 15.40 percent. The Nasdaq closed at 7,928.69, an increase of 199.37, or 2.58 percent, and a YTD return of 19.60 percent. Meanwhile, the U.S. Treasury's 10-year note increased to 2.50 percent, or a rise in yield of 4.17 percent.

Emerging markets growing faster than expected

We must look at the pace of growth for international stocks. Most emerging markets have outperformed all others. We note that most cyclical sectors have outpaced the defensive sectors, which is a clear sign that there is trust in current economic conditions. The principal thrust for the global rally was positive news coming from China. One of the items we review is the China Purchasing Managers' Index and, for the month of March, it showed a return to expansion after more than six months of contraction. This is a clear signal that the tax cuts and other policies in China's domestic market are producing modest growth.

U.S. adds 196,000 jobs in March

The U.S. Bureau of Labor Statistics reported that total nonfarm payroll employment increased by 196,000 in March, with the unemployment rate unchanged at 3.8 percent. Jobs growth occurred in healthcare, and professional and technical services. With hiring strongly rebounding in March, the fears of a dramatic slowdown of the labor market have subsided.

Final word-diversify, diversify: The discipline of protecting life's work

As we have discussed many times, diversification is the discipline of protecting your life's work. In our view, there are at least three critical benefits of diversification, and they include:

•**Minimizing risk of loss.** If some of your investments perform poorly over a certain period, other investments may perform better over that same period, reducing the potential losses of your investment portfolio from concentrating all your capital under one type of investment.

•**Preserving capital.** Similar to our lives at various stages, investing must be tied to our lifespan in the same way. For young people, this is about accumulation and, for older folks near retirement age, they must have goals toward preserving their capital to last through retirement and diversification, which is the key to help protect their savings.

•**Generating returns.** Investments often do not always perform as expected, and when you apply the benefits of diversification, you are expanding your sources of income. Just like you do not have just bread and water in your fridge, your investments must be a vast array designed to balance your risks in times of market turmoil.

The key with all portfolios is always to diversify them in a way that the investor does not have any more than 10 percent exposure to one strategy or asset class.

Probably the best way to present diversification is with a story. In 2006, we visited the patriarch of an ultra-high-net-worth family, and we had a great visit that I will never forget.

During that visit, the client was explaining that he was so well-diversified that he did not need to worry. We asked him how so? He explained that in addition to his general construction, he had a block and paver factory, an industrial hardware company, a quarry, a sand and gravel operation and a scaffolding renting operation.

We told him that what you are describing is not diversification. You are vertically integrated into the construction sector. If a construction crisis emerges, your entire business will suffer. He was startled and asked us how we could help. We developed an action plan that involved performing an enterprise valuation on all his business. After many discussions, we implemented the plan, which called for selling some of the assets and keeping the real estate for development and rental income. In two years, we were able to increase his holdings in the millions of dollars while maintaining some assets that were part of his original operations. When the construction crisis arrived, our clients had zero debt, income had grown by 35 percent, and the exposure to construction was only the development company, which is in the business of developing real estate for rental income.

This is the power of sound advice using diversification.

Market Close Comparison

Markets	3/29/19	4/7/19	Change	YTD%
Dow Jones Industrial Average	25,928.63	26,424.99	1.91%	13.30%
Standard & Poor's 500	2,874.40	2,892.74	0.64%	15.40%
Nasdaq	7,729.32	7,928.69	2.58%	19.60%
U.S. Treasury 10-Year Note	2.40%	2.50%	4.17%	-0.19%

Francisco Rodríguez-Castro, president & CEO of Birling Capital, has more than 25 years of experience working with government, and multinational and public companies.