



## Saturdays with Jim: Past Performance Is Not Indicative of Future Performance

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I typed 2010 for the first time in today's date stamp. Remember 1999 and Y2K? Now that was much ado about nothing. The episode illustrates a solid point - when there is enough concern about this or that, it won't materialize. Or at least it won't materialize in the way you think it will.

Swine flu may fall into the same category and, looking forward, so may the vaunted inflation that many are abuzz about.

As we intimated in the title "past performance is not indicative of future performance." Well, that may be true. The specific numbers one puts up in a decade past may or may not repeat - you have to look into what went into "making the numbers." But this much is surely true... human behavior is remarkably consistent.

You'll hear a lot about how bonds beat stocks this decade. But who was talking about bonds in 1999? If we had bought bonds for you (when you were younger) you would have fired us as not keeping up with things. One very respected investment manager was indeed fired from his job in late 1999, just a few months before markets turned sour against the speculation of the previous several years. He invested in out of favor stocks. Too bad for him that they remained out of favor for a very long time due to the speculative fever about the Internet that was sweeping the country. Folks, one might argue that getting the mix of securities "right" is the cornerstone of success. But as right as you might be proven by history, if your timing is faulty (either too early or too late) you suffer mightily.

This said, it is quite possible to make an excellent record in investing by going against the crowd at particularly high emotional points and playing along with it the rest of the time. Still, timing is everything. Take the 2007-2009 downturn.

Anyone who bailed out in October and November would have looked great in March, but would look awful now. Unfortunately, all crystal balls break the first time they are used. Their value is in the aura of protection they give, false security but some semblance of calm nonetheless. Who knew that the Lehman bankruptcy would be so catastrophic across the entire world? From this vantage point in January 2010, we can now see that Lehman's economic tentacles spread far and wide - even to world trade. So we now have

past performance. Will bonds outperform stocks in the coming decade? Will gold and other commodities continue to roar ahead? Will the U.S. experience inflation in excess of 3% anytime soon? Will the U.S. be a laggard from now on, kowtowing to China? Here's what we think:

- Stocks will outperform bonds in the decade to come, but not without some "Perils of Pauline"
- Inflation will be higher than it has been, but it's not yet a significant threat
- Bond yields (interest rates) will creep up in the years to come
- Gold and other commodities will do just fine but they may not be the best investment of the decade
- The U.S. will outlast the "China" surge as it outlasted Japan

What are the implications of these views on your investments?

The biggest one is this. What works in one situation fails badly in the situation's mirror image. Stocks and real estate did great in the 20's while government bonds languished. In the depression of the early-mid 30's, stocks and real estate absolutely crashed while government bonds shined. The story repeats countless times. The wise investor (hopefully us) conquers emotion and invests based on the logic of valuation and foresight. Some say that a mixed portfolio of stocks, bonds and cash sprinkled with commodities does well over any cycle. But who has the wisdom and patience to see something badly lagging in the portfolio for very long? In other words, who has the patience and the good sense to hold the greyhounds and the mutts together, the mutts one day becoming the "new greyhounds"? Virtually no one. So what's the next best-or maybe even the best - way to construct a portfolio?

Ahem. Maybe the way we do it...

- We only buy cheaply
- We rarely buy all at once
- We diversify according to the present conditions
- We sell when fundamentals change
- We limit risk by "position sizing" and by strict stop loss disciplines

All of this good stuff aside, as much as we predict presciently, we react furiously at times because unexpected things happen - with such frequency at times to make one wonder if the "expected" ever occurs.

In short, we want our track record of successes in the past to hold up into the future. Your accounts gained 50% and more this year (with few exceptions) and we want to hold on, awaiting the "next great opportunity." We want the future to be always bright, for we know that you depend on us. So... after large gains of the 50% magnitude we have begun to raise cash and to be more defensive. There will be a good buying opportunity sometime this year. Let's be there with cash when it avails itself.

Happy New Year and thank you for investing with us!

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