COMPASS WATCH

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A quarterly newsletter of Compass Capital Management, Inc. *Volume 28, Number 4: Winter 2016*

DO OUTCOMES IMPROVE BY BENCHMARKING YOUR PORTFOLIO?

At the time of this writing, the Dow Jones Industrial Average (Dow) has closed above 21000 for the first time; the latest milestone in the market's post-election rally. Moreover, investors continue to direct an avalanche of money into funds that only track indexes.

The Dow was created in May 1896. The first rendition included 12 "smokestack" companies—consumer goods and basic material suppliers like U.S. Leather and Tennessee Coal & Iron. Today, it includes 30 stocks. The Dow is a share-price index (i.e. companies with higher share prices have greater influence on the index performance), which over a century ago was quick and easy to compute each day before computers. Modern indices, such as the S&P 500, are weighted by market capitalization (the larger a company's market capitalization, the more impact it has on the calculation of index performance). The argument persists today over whether the Dow or S&P 500 is a better metric (or even relevant) for determining the strength of the stock market.

So, what can go wrong with benchmarking to an index? For starters, investors often interpret their results erroneously. More importantly, the "noise" created around benchmarking distracts investors from the real question—if there was no benchmark, how and where would investors need to focus their priorities? Might the answer be saving more? Spending less? Or, would investors focus on proper asset allocation, cash-flow planning, retirement analysis or paying down debt? The challenge for investors is that market indices and investors have two very different portfolios.

The annual Quantitative Analysis of Investor Behavior study by Dalbar[1] shows the dismal truth on the fallacy of chasing a benchmark index; that *average* investors consistently earn *below average* market returns.

PERIOD	INVESTOR RETURN	S&P 500 INDEX	DIFFERENCE
10-Year	4.23%	8.19%	**(3.96%)**
5-Year	6.92%	12.57%	**(5.65%)**
1-Year	(2.28%)	1.38%	**(3.66%)**

Why is this? As Wall Street continues to drill the mantra of "beat the market," this leads investors to make emotional decisions to buy and sell at the wrong times. While the chase to "beat the market" is great for Wall Street (as money in motion creates fees and commissions), most investors have fared much worse than the benchmark they are making comparisons to. Comparison of your performance to an index is not only destructive, but dangerous as an investor. Investing is not a competition and there are horrid consequences for treating it as such. The fallacy of chasing a "benchmark index" is:

- The index contains no cash—you may.
- It has no life expectancy requirements—you do.
- It does not have to compensate for distributions to meet living requirements—you do.
- It has no taxes, costs or other expenses associated with it—you do.
- It has the ability to substitute at no penalty—but you don't.

One reason money has value is because it gives us freedom to spend our time doing things that make us happy. For investors, the important variables are the goals you are working towards, how much money you will need to reach those goals and when you want to reach them. As long as your investment plan helps you reach those personal goals along your desired timeline, should benchmarking to an index really matter?

"Beating the index" may be an interesting game for some, but at Compass, we are playing a different game. Instead, we focus on helping investors meet a myriad of criteria (e.g. income needs, growth), not simply indexing. Proper investing must not only be sensible, it must meet your goals. How may we help improve your outcomes?

[1]2016 Dalbar study. Annualized returns are for the periods ended 12/31/15.

For more information regarding our company, disciplines and results; please call, write, e-mail or visit our website: www.compasscap.com

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