

October 2023

One quarter ago I discussed the inadvisability of living in the future (or the past), at least as far as investing goes. Much better, we said, to stay in the present, investing in *what is*, not *what if*. Today we deal with the difficulty of investing in the *present*. The recent past has delivered a decade's worth of crises: a global pandemic, war in Ukraine, a resurgence of inflation, rising interest rates, a U.S. banking crisis, political polarization and paralysis, possible government shutdown, an auto industry strike, increasing "great power" tensions, and now...a war in the Middle East.

Go, go, go, said the bird: human kind  
Cannot bear very much reality.

(Burnt Norton, I, 44-45. I promise to quote a poet other than T.S. Eliot in future letters.)

Investors, like most people, prefer to have reality approach little by little, rather than all at once. But, as my colleagues are probably tired of hearing, "We don't get to invest in the world that we wish we had, only in the world we have."

So, how is an investor to deal with such an onslaught of reality? Today, we sing an ode to Asset Allocation. By asset allocation, we mean the practice of diversifying one's entire portfolio of investments by asset type. The reason to do this is that different classes of assets not only perform differently over time, but also respond differently to events. This is essential *because no one can predict the future*. While the recent run of extraordinary events appears unusual to many, our experience is that, in the world of investing, the extraordinary *is* ordinary. One must be prepared for anything.

We believe the best way for an investor to be prepared for anything is to have one's assets diversified by type. And we're not just speaking of stocks and bonds (or even different types of stocks and bonds), but all assets, including commodities, currencies (most easily accessed via assets denominated in foreign currencies), gold (more of a currency than a commodity), real estate, and even "good old-fashioned" cash.

As noted above, not all assets respond to reality in the same way. In almost any of the myriad of possible economic, geopolitical, and market environments, some assets will do meaningfully better than others. For example, when war breaks out in the Middle East, the prices of oil, gold, defense stocks, Treasury bonds, and the dollar usually rise, even while the prices of many other assets decline. Sensible diversification by asset class can bring a measure of stability to a portfolio even on days of crisis.

If we knew that today's winning stocks would continue to work forever, we would not need asset allocation; there would be no need to own multiple asset classes if we knew precisely

what was going to happen a year from now. But since we don't know the future, we diversify by asset class. This is the same reason that we buy insurance on our cars. If we knew for a fact that we would never have an accident, such insurance would be a waste of money. But we don't know that, so keeping the car insured is prudent.

Asset allocation is for every investor. And you do have an asset allocation, even if you've never thought about it. But thinking about it is the first step toward modifying it to best fit your needs. Regardless of which Confluence strategies (Value Equity, International Equity, Alternative Investment, or Asset Allocation) you might be invested in or what other investments you may have, it is important that you thoughtfully evaluate your asset allocation. We encourage you to sit down with your financial advisor to plan an asset allocation strategy that is right for your risk tolerance and long-term objectives. At Confluence, we believe asset allocation is the most prudent way to maintain investment stability when reality seems too much to bear.

We appreciate your confidence in us.

Gratefully,

Mark A. Keller, CFA  
*CEO and Chief Investment Officer*

*This letter was prepared by Mark Keller of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change. This information does not constitute a solicitation or an offer to buy or sell any security.*