GREENSPRING

What Do Jelly Beans And The Stock Market Have In Common?

Many of you who attended our client appreciation event participated in an experiment we held to demonstrate stock market efficiency and the wisdom of crowds. For readers who weren't present, we asked participants to look at a large jar of jelly beans and guess how many were in the jar. While it was a simple exercise, the results were fascinating:

67 *Number of participants*

94 *Lowest guess*

5,000 *Highest guess*

1,533 *Average guess*

1,610 *Actual number*

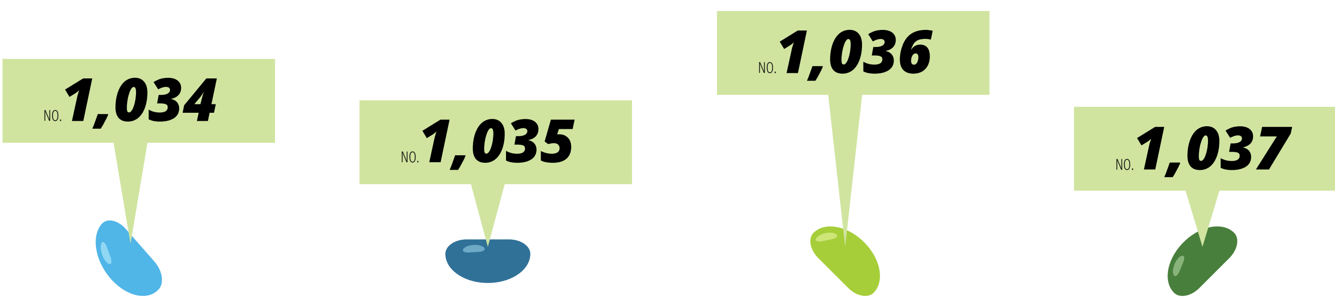
The average guess of the entire group was within 5% of the actual number of jellybeans. Even more interesting, out of 67 participants, only 3 had guesses that were closer to the actual than the average of all 67.

Together, We Know More Than We Do Alone

With this experiment we find the combined intelligence of a group is better than the knowledge of one person. We see this phenomenon in another area: the investment markets. Droves of participants trade stocks around the world each day. Instead of 67 participants like our jelly bean experiment, there are millions of buyers and sellers trading stocks at a price they believe is fair. This doesn't mean that a price is always right because there is no way to prove that, but just like the jelly beans, investors can accept that the price millions of buyers and sellers have set is the best estimate.

If you don't believe this simple truth- if you believe that the market has it wrong, you are pitting your knowledge or hunches against the combined knowledge of millions of other market participants.

So, knowing this information, what's the best way to invest?



Conventional Management

The dominant or "conventional" investment approach assumes that prices are not accurate. This leads to an attempt to predict the future or outguess the market. Conventional management attempts to pick a handful of stocks that are expected to do well in the future while selling securities that are expected to underperform. This conventional approach only works if a manager can consistently outguess the crowd. Remember the jelly bean experiment. It is extremely difficult to do this over time. The results of this approach are what you might expect.

Only a fraction of mutual funds survive and outperform their respective index (i.e. the "crowd') over time. During the 10 year period ending in 2013, only 19% of stock managers, and 15% of bond managers outperformed their benchmark[1]. Should you be surprised by these results? Not really. If you believe that market prices are the best estimates of actual value.

There is another way.

[1] "Mutual Fund Landscape", Dimensional Fund Advisors, 2014.

Evidenced Based Management

Greenspring approaches investing differently. Inspired by academic research and the view that market prices reflect all available information, Greenspring focuses on the areas of investing that we actually have control over.

Portfolio Structure

Greenspring views the market through a different lens. Rather than seeing the market universe in terms of individual stocks and bonds, we define it along the dimensions of expected returns, identifying broader areas that have similar relevant characteristics. Some market areas have higher expected returns than others. For example, in the stock market, the dimensions are size (small vs. large), relative price (value vs. growth) and expected profitability (high vs. low). When we design portfolios, we structure them to take advantage of areas of the market that have been proven to have higher expected returns.

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Diversification

Rather than trying to outguess the market by picking the best securities, Greenspring builds broadly diversified portfolios that emphasize the areas of the market that offer the potential for higher expected returns. By remaining diversified with the portfolio, Greenspring can capture the dimension of the market rather than the noise that comes with a concentration of stocks.

Fee Consciousness

Fees matter when it comes to investing. In a study by Morningstar[2] , they found that in every asset class measured over a five-year period, low fee funds outperformed high fee funds. The old notion that you get what you pay for just isn't true when it comes to investing. Greenspring believes that by keeping fees low clients can keep more of what they earn.

Tax minimization

Similar to fees, by reducing the amount of tax "drag" on portfolios, clients can generate higher after-tax returns. By focusing on putting tax inefficient investments like bonds and real estate in a client's tax-deferred accounts and their more efficient investments in their taxable accounts, clients can realize more after-tax wealth. In addition, taking advantage of tax loss harvesting, the act of selling investments at losses to offset future gains, can also have positive impact on after-tax wealth.

[2] "How Expenses and Stars Predict Success", Morningstar, August 2010.

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About Greenspring

Greenspring Wealth Management is a fee-only comprehensive wealth management firm. We maintain a strict "no-conflict-of-interest policy," truly sitting on the same side of the table with our clients when helping them evaluate their best financial and investment options. Greenspring is 100% employee-owned/operated and 100% of our revenues are derived directly from our clients (the Firm accepts no commissions for the sale of any products).

www.greenspringwealth.com