

Why a Risk-Averse Value Investor Believes Today Is the Most Important Time in Our Investment Lives

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My deep-rooted risk aversion

As early as my first job interview in the investment field, I was focused on avoiding risk. In that encounter I wasn't very curious about my future boss's all-time best investments; I wanted to know about the decisions he had made before the biggest market crashes. I figured if I could know how to avoid losing it all, I would do just fine.

I don't know whether my risk aversion was hardwired into my DNA or developed while I grew up with raging hyperinflation in early 1990s Poland. Or maybe I soaked up my grandma's almost instinctual financial acumen, formed by the harsh days of the Great Depression and wartime shortages. My natural predisposition was further strengthened by Benjamin Graham's and Warren Buffett's school of thought.

Above all, they taught me to never lose money!

This deep-rooted risk aversion comes in handy in the career I chose. And in this extraordinary period for investors — potentially the most important time of our investment lives — I believe it will be essential.

Challenges of wealth preservation

Eastern Europe, where I grew up, experienced many brief, exciting periods of wealth creation. It was also influenced by a very mixed record of wealth preservation. If countless wars, loss of independence, and partitions among major powers didn't destroy individual wealth, then the communist regime made it disappear.

That may be why, as an avid student of history, I have always been fascinated by families that have managed to increase and preserve their wealth through multiple generations. Their choice of residence often made a big difference; family unity played a key role; but the investments they made during the most important time of their investment lives mattered the most.

Both the deep-rooted risk aversion, and the wisdom of worldly families that successfully preserved wealth through generations help me serve our clients better as an investment advisor.

We can ensure that our wealth is safe under a political and economic regime that is committed to protecting and honoring property rights. We can also maintain and nurture our family unity. However, today it is the choice of investments that will make the biggest difference over the next years, decades, and generations.

The bull market that never crashed

As of late 2017, we have had a bull market that's lasted as long as 40 years (depending on how you define it). It has coincided with a few unprecedented and unrepeatable economic tailwinds. We have witnessed interest rates come down from double digits to 0%. Meanwhile central banks have used their balance sheets to create an illusion of almost unlimited free money. We've seen government deficits expand and public debt balloon, while the consumer borrows continually to maintain the same lifestyle. What's more we've seen short-sighted investors encourage businesses to double down on their leverage for the instant one-time gratification of buybacks and dividends.

The result is an everything bubble. Today, with very few exceptions, assets globally are too expensive: equities, bonds, real estate. They have benefited from an ever-inflating debt bubble with ever cheaper money. Overeager central planners manipulating the cost of money (and distorting the incentive system in a naturally self-correcting capitalistic economy) have created a nightmarish, dead-end situation.

Everyone who is paying attention and has the audacity to think independently sees this clearly. Talking about the situation is difficult, though, and in the face of widespread inertia, complacency, and paralysis, acting on this situation seems almost impossible.

Yet if we were to pick the most important time in our investment lives – this is it.

It's time to act

Investors have done very well over the last few decades by following the crowd, but today couldn't be more different. We at Sicart Associates believe that how we invest today will affect our clients' and our financial well-being more than at any time in financial history with a possible exception of the Great Crash of 1929, when the Dow Jones Industrial Average fell almost 90% between 1929 and 1932.

What are we doing, then?

1/ At Sicart we continuously and diligently review all holdings. Then we gradually sell off the overleveraged, weakest, or riskiest securities, even it means that we part with some of our biggest winners.

2/ We hold a higher-than-usual cash (or equivalent) position. True, the US dollar may not be a great store of value over the next hundred years, but in the near term, \$100 is likely to remain \$100.

3/ We look into diversifying away from overpriced, overvalued assets through both inverse ETFs (which go up when the specific asset class goes down), and/or precious metal exposure.

A prime example

Leaving aside for now the first two big questions (which stocks to keep, and how much cash to hold), let's focus on an example of an investment that could help us diversify away from overpriced, overvalued markets.

Among that group, we'd consider inverse US high yield bond ETF products. High yield bonds (aka junk bonds) are among the best-performing assets since the Great Recession and over the last few decades. The yields and the spreads have never been this low, while corporate debt levels haven't been this high or the quality of the bonds this bad.

We see an extreme, ready to spring back and normalize. Once the rates head up, yields recover, and the historic monetary experiment comes to an end, many junk bond issuers will default on their debt triggering a major sell-off in the high yield bonds.

We always want to know how we can be wrong, though

In this case, it's easy. If the monetary experiment continues, and central banks expand their mandate, (effectively becoming buyers of last resort), high yield bonds will go up even higher. Steps taken by the Bank of Japan (which has become the largest owner of local ETFs), and the European Central Bank (which became a major holder of corporate bonds) show, though, that we might need to expand our imagination when it comes to how far and how long this global financial wizardry can go.

Remedy for imperfect timing

The only recipe for our imperfect timing is the very foundation of our process – doing everything gradually. We sell winners slowly, we raise cash levels slowly, we buy inverse ETFs at the same slow pace. That way our imperfect timing matters less. We'd rather be somewhat right than completely wrong (i.e. incurring a major permanent loss in all or most of our investments).

Excited about tomorrow

Patient, disciplined, investors trained in the value investing tradition have every reason to believe that before them lies an unprecedented bonanza when all assets will get repriced, and few investors will be around with dry powder ready to put to work. It could be the biggest revival of active investing ever witnessed by our profession. These are the days we patiently await, and they may come sooner than many expect.

We only need to ensure that we are making the right decisions in the most important period of our investment life.