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summaries

SIGMA INVESTMENT COUNSELORS

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THOUGHTFUL INVESTING AND RISK MANAGEMENT

All investors love to talk about their winners. It can feel great to tell friends and family at a dinner party how well a particular stock in your portfolio is doing. And while selecting winning investments is an important aspect of long-term investment success, there is another, even more important aspect: avoiding the losing ones.

Here at Sigma, we are not just stock pickers, we are portfolio managers. And prudent portfolio management requires maintaining a properly diversified portfolio and managing risk, two of the key tenets of our "Thoughtful Investing" philosophy. One of the main mechanisms we use to achieve these aims is position sizing limits. Whether it be a stock, bond, ETF, or other investment, we have limits on how large a single position can be within client portfolios, and we will look to trim the position if it grows beyond those limits. This is an important risk control that aids in disciplined portfolio management, as it can be tempting to allow strong performers to become outsized positions that increase portfolio risk.

Risk management recognizes that the future is uncertain. Is NVDA going to continue its recent streak of triple-digit annual returns, like in 2023 and 2024, or is it going to lose roughly half its value, like in 2022? No one knows for sure. But by limiting position sizes to manage risk, you ensure that even if one particular investment within a portfolio performs poorly, the impact on the total portfolio will be minimal.

As portfolio managers, we add value not only by what we buy, but also by what we avoid. A brokerage statement or quarterly report will show the performance of the investments in your portfolio, but it will not show the numerous investments that we conducted thorough and careful due diligence on and ultimately decided weren't appropriate for your portfolio. Our Thoughtful Investing approach leads us to say "no" much more frequently than we say "yes," and we take pride in looking back on those investments which we have passed on, and still track, and seeing that many of them have gone on to perform poorly.

A final example of Thoughtful Investing and risk management is our approach to Bitcoin/cryptocurrencies. It can be easy to see a lack of Bitcoin exposure in your portfolio and conclude that this is something that we have overlooked. However, we are constantly evaluating new investment products and asset classes, and Bitcoin is no exception. Not including Bitcoin in your portfolio was a deliberate decision, and one we have arrived at after careful deliberation.

As advisors with a fiduciary duty to act in our clients' best interest, we are not able to recommend an allocation to Bitcoin. When analyzing a stock, such as Apple, we can forecast what the likely future cash flows of the company will be, and use that forecast to determine if Apple's current stock price is fair. As I mentioned above, the future is uncertain, and

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Apple's actual financial results will likely be somewhat better or worse than our forecasts. However, Apple has products and services that people use that back those cash flows, and we can analyze the company's fundamental business drivers. For an asset like Bitcoin that does not generate any cash flows, we are not able to estimate a fair price. The price of Bitcoin is simply a reflection of what people are willing to pay for it, rather than a reflection of some fundamental value. Bitcoin is currently trading ~$82,000. Will it be worth $200,000 in a year, or will it be worth $0? Since we can't estimate the fair value, we are not able to determine if Bitcoin's current price is a fair one.

Another aspect of our due diligence was having a meeting with Bitcoin experts from a leading asset management firm. We have been skeptical of the asset class due to our internal research and discussions, the myriad scams that have plagued the crypto industry, and the contradictions and false claims made by industry participants. One contradiction is that the main reason many like crypto is that it is "off the grid" from the traditional financial system, yet Bitcoin spiked in popularity ~1 year ago when major financial institutions launched Bitcoin ETFs. A false claim is that Bitcoin is uncorrelated with traditional asset classes and acts as a portfolio "diversifier," even though the price charts clearly show that it tends to trade down when the overall stock market does, and experiences greater losses. That said, we approached the meeting with an open mind and made a good-faith effort to learn more about the asset class. We were not satisfied with many of the answers, and the meeting confirmed our decision to exclude Bitcoin from client portfolios.

This week marks the 25th anniversary of the peak of the dot-com bubble. Past bubbles, including dot-com, Dutch tulip mania in the 1600s, and the South Sea Bubble in the 1700s show that speculative investments can perform well, even for extended periods, before ultimately deflating. Thoughtful Investing requires a long-term perspective and a strict adherence to risk management principles to meet your long-term goals.

I want to thank each of you for entrusting us to serve as your investment advisors. Working every day to help you protect the wealth you have worked to build is a responsibility that we do not take lightly.

David Drogheo, CFA
Chief Investment Officer

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