JAG CAPITAL MANAGEMENT LLC

QUARTERLY COMMENTS
3rd Quarter 2018

3rd Quarter 2018: Lapping Lehman

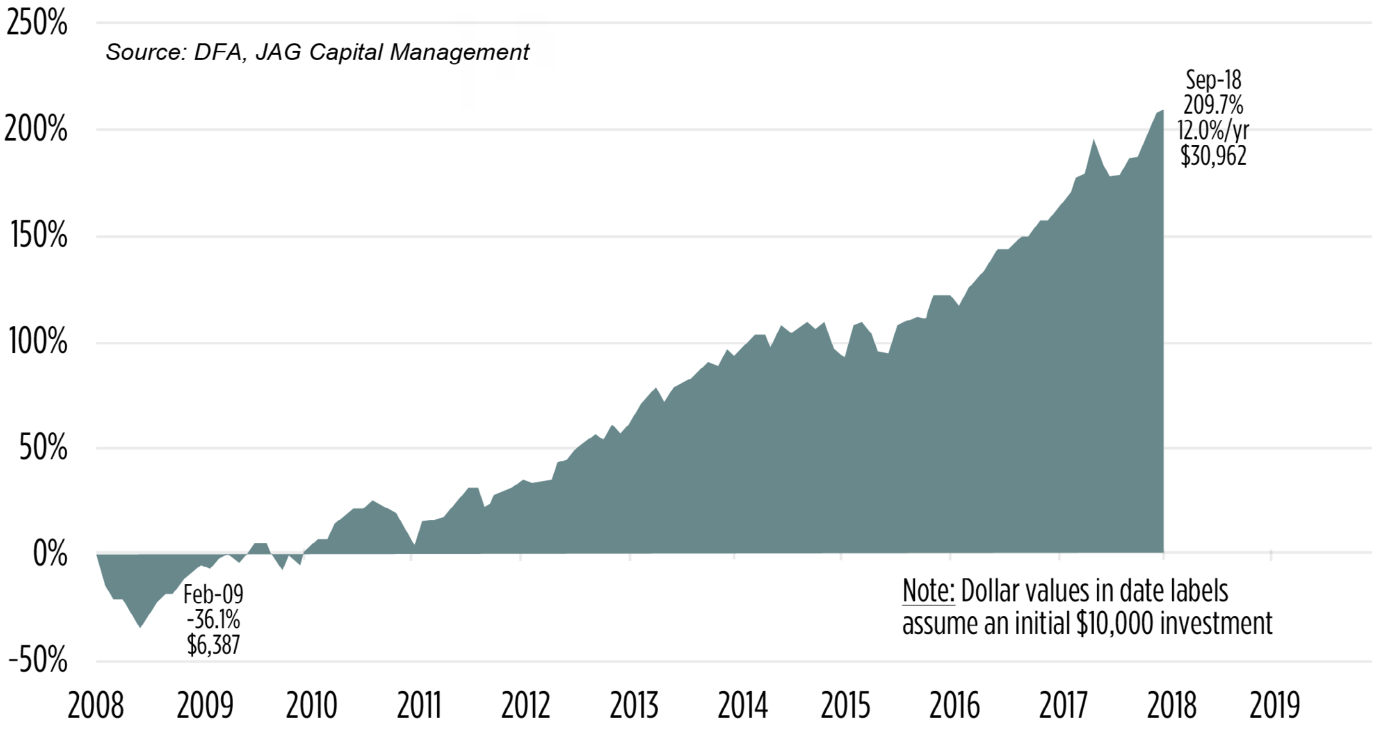
Norm Conley | CEO & CIO

Investment performance is often measured in convenient slices of time. For example, most experienced investors are familiar with mutual fund advertisements detailing a fund's trailing 1-,3-, 5-, and 10-year performance. Of those periods, the last one - the immediate past decade of average annualized returns – tends to carry a lot of psychic weight for investors. This makes some sense. Although ten years is infinitesimal in the grand scheme of history, in stark actuarial terms it represents a good chunk of the total amount of time we can hope to spend on this mortal coil. Even for Warren Buffett, who has been investing since he was a teenager and is now 88 years old, ten years represents more than 15% of his entire body of work as an investor. For most of the rest of us, who started saving and investing later than Mr. Buffett, and who may not be blessed with his Methuselah-like lifespan, 10 years probably amounts to as much as 25% of the total amount of time most of us have available to invest and accumulate wealth. Nothing to sneeze at!

With that in mind, we note that the calendar is (finally) beginning to "lap" the Great Financial Crisis of 2008-2009. By this we mean that it has now been more than ten years since Lehman Brothers spectacularly failed on September 15, 2008, which kicked off the climactic phase of the worst economic and market event since the Great Depression in the 1930's. Post-Lehman, the S&P 500 gyrated through another six months of gut-wrenching volatility before finally bottoming for good in March 2009.

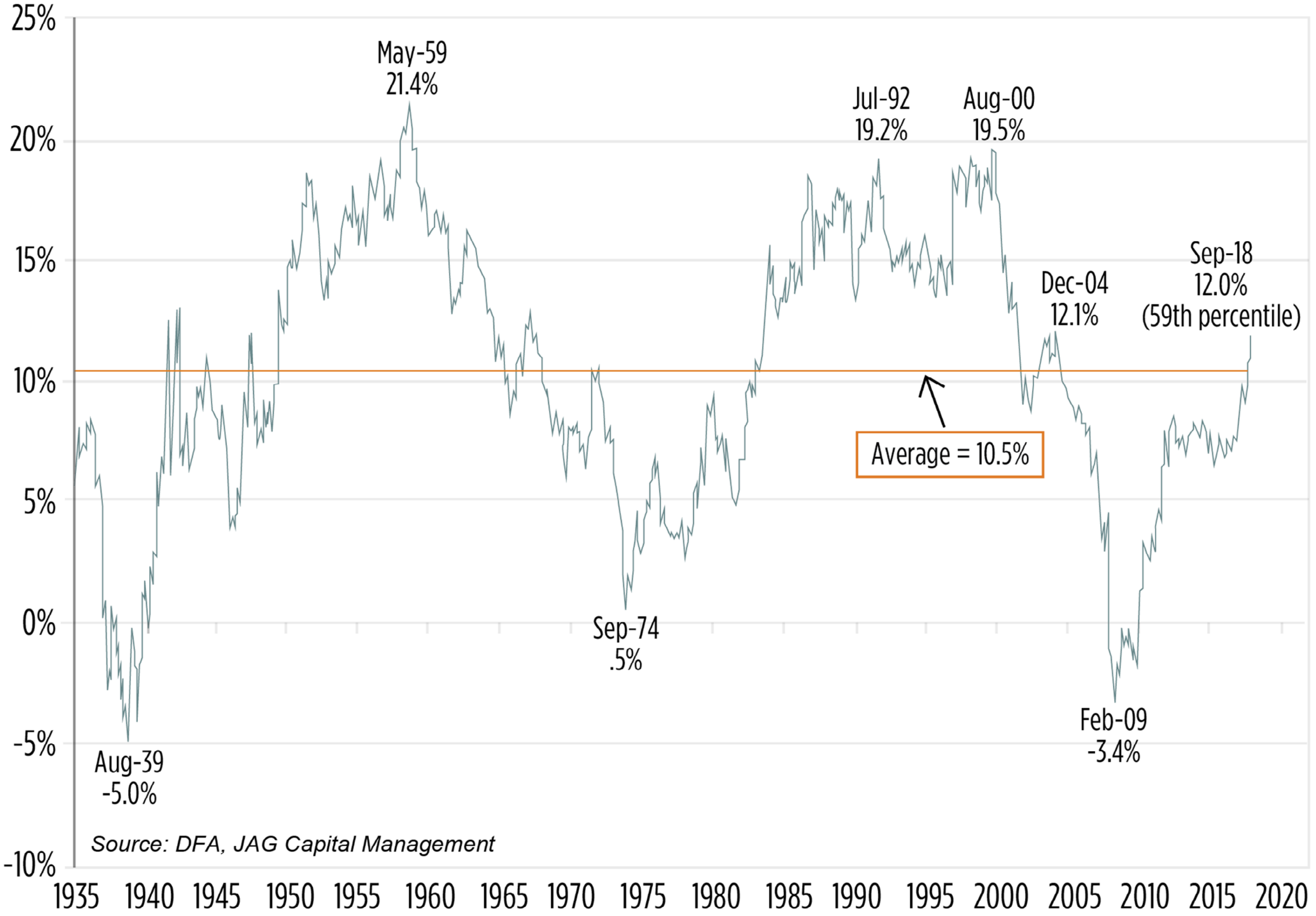
Therefore, by March 2019, the worst parts of the Crisis will have receded more than ten years into the past. These are welcome anniversaries for investors and investment managers. They also provide us with an opportunity to re-emphasize the importance of a truly long-term approach to investing.

S&P 500 Sep-2008 - Sep-2018

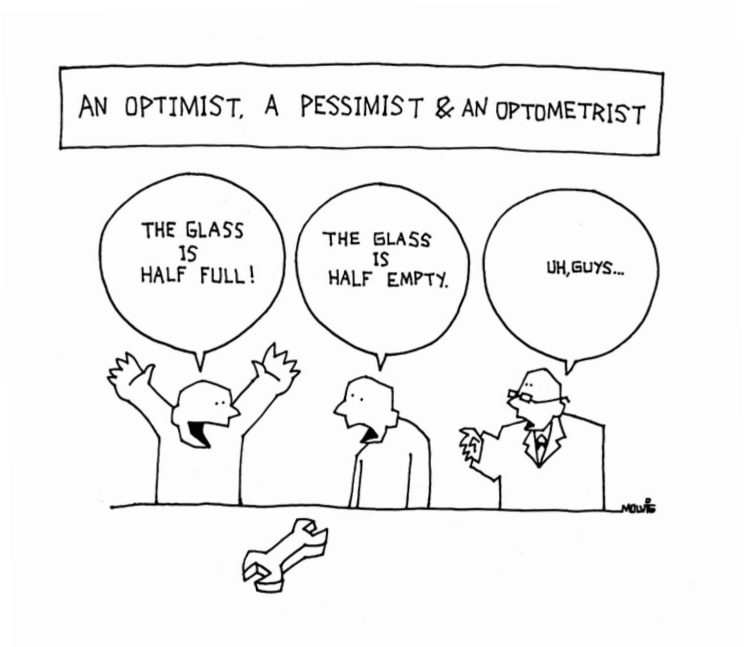


We need to highlight and appreciate the fact that the post-Crisis era has been a great time to be stock investor. For the past ten years through 9/30/18, the S&P 500 Index has delivered average annual returns of almost 12%. It is also worth noting that as good as it has been, this last decade ranks only in the 59th percentile of all rolling 10-year periods for the S&P 500 since 1926. There have definitely been bigger bull markets in the past, including in the 1950's and 1990's.

S&P 500 Trailing 10 Year Return, Nov-1935 - Sep-2018



But at the risk of stating the obvious, these returns were only available to investors who – wait for it – remained fully invested in stocks. Unfortunately, we know from personal and professional experience that many people simply could not stand the emotional pain of the market declines in 2008 and early 2009. They liquidated their portfolios and fled to the safety of cash or sought out investment vehicles that promised "safety" or "low volatility" or esoteric "tactical market timing" expertise. Broadly speaking, many of these investors have experienced profoundly disappointing results, especially compared to great gains experienced in the broader equity market.



This is not to minimize the difficulty of maintaining a long-term position in the stock market. As boxer Mike Tyson once famously said, "Everyone has a plan until they get punched in the face." Successful investing requires a long-term outlook and – at times – nerves of steel. Bear markets happen from time to time, and they are always painful. Since 1960, the S&P 500 has experienced 6 declines of at least 20%, or an average of every 9.8 years. Investors who are lucky enough to be active for 50 years are likely to experience no fewer than 5 nasty declines in the value of their stock portfolios.

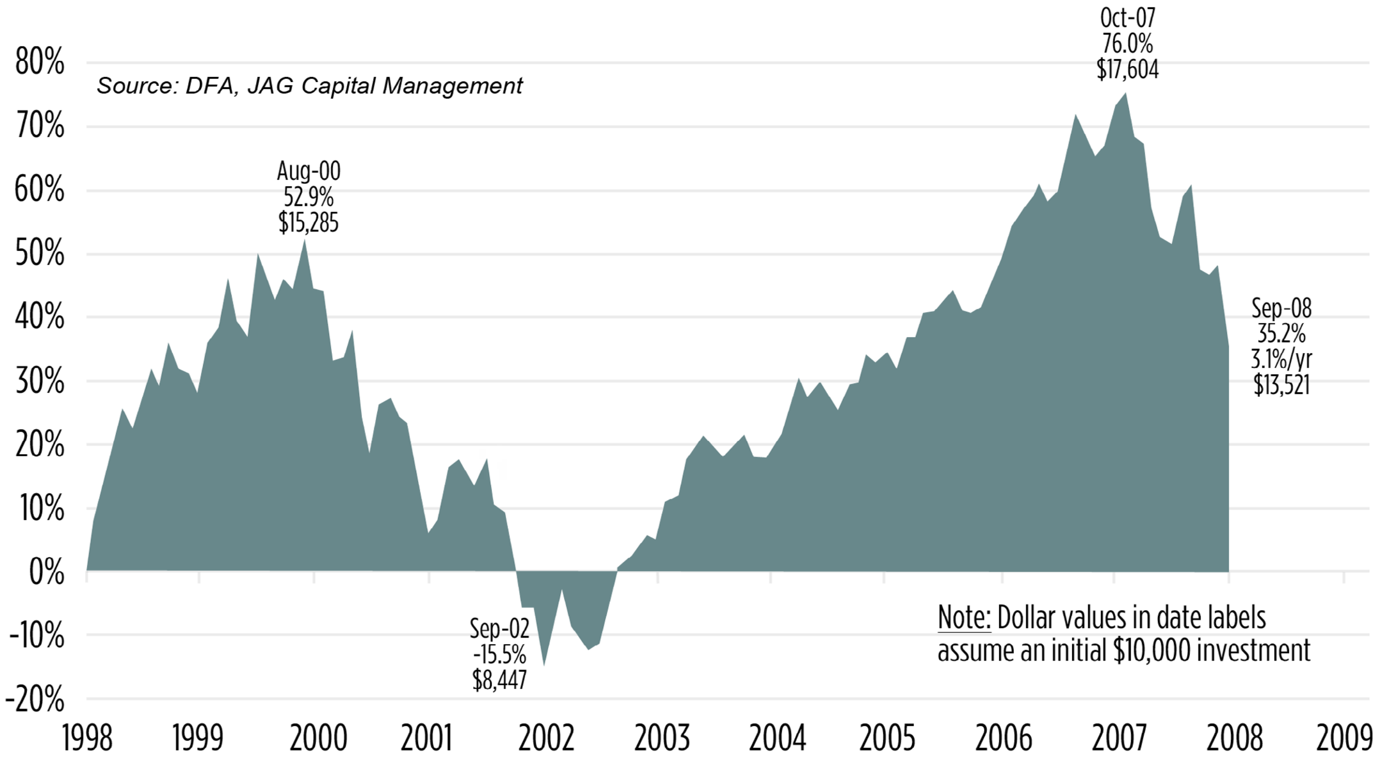
As an illustration of how difficult it can be to be a successful long-term investor, consider the hypothetical experience of a person who invested $10,000 in the S&P 500 on September 30, 1998 (roughly ten years before the failure of Lehman Brothers). As some of us remember, the late 1990's was characterized by a tremendous bull market, led by technology and telecommunications stocks that were powering the then-nascent Internet. So our investor did quite well initially, earning more than 50% between 9/30/98 and 3/31/00. But then the so-called Dot Com bubble popped, stocks swooned, and a recession hit in 2001-2002. The S&P 500 fell by roughly 50% between March 2000 and September 2002. Stocks recovered over the next several years, eventually hitting an all-time high in October 2007. But by then, the first signs of trouble were already emerging in the financial markets – specifically in the massive but opaque market for complex mortgage-backed securities.

*"My optimism is at an all-time high.
All I need is the means to express it."*

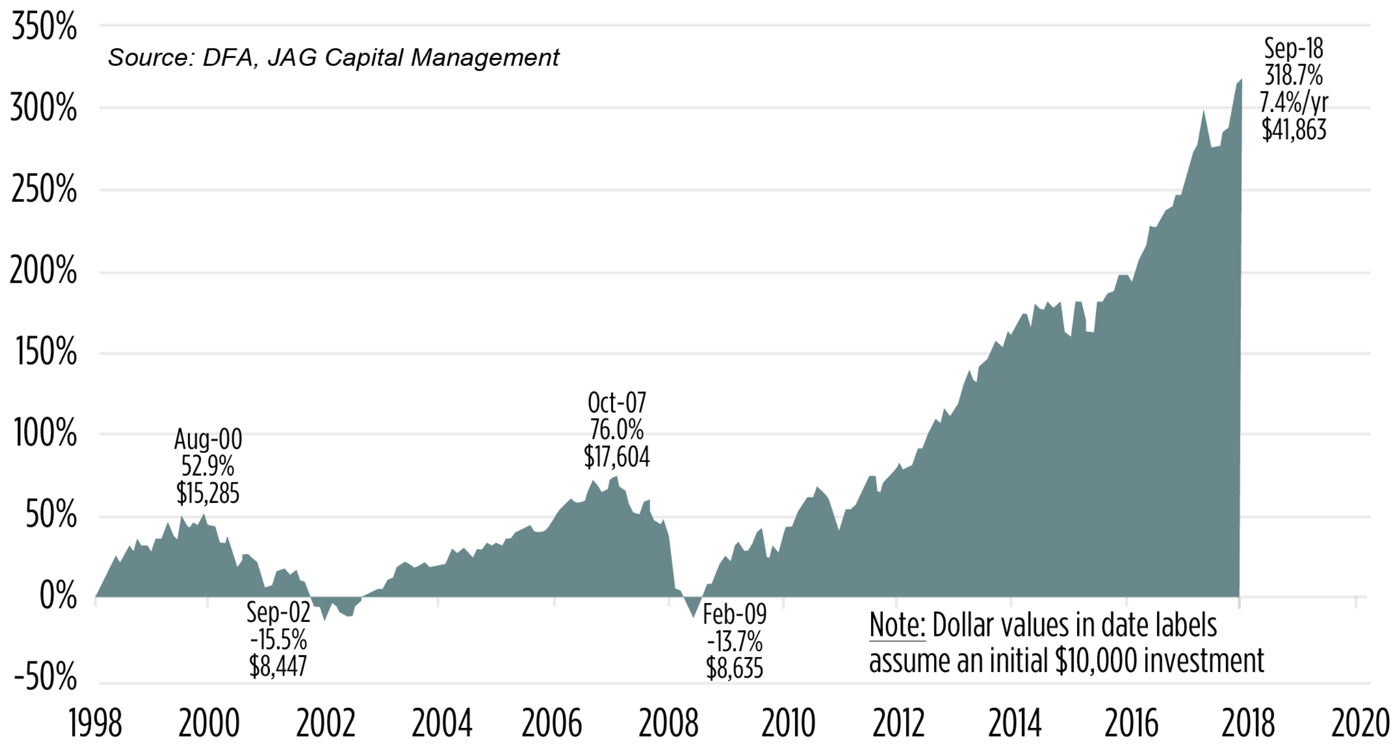
Within a few more months, the crisis began in earnest and culminated with the collapse of Lehman Brothers in September of the next year. By the time the bell sounded to end the 3rd quarter of 2008, we find that our hypothetical investor had earned a meager annualized return of only 3% per year for the first ten years of her investing journey. Considering the long-term average annual return of the S&P 500 since 1926 has been 10.2%, this result was disappointing. After all, she did the "right" things with her portfolio. She focused on the long term, she maintained a diversified portfolio (via the S&P 500 Index), reinvested her dividends, and successfully weathered two bear markets without panicking or liquidating. In that light, her below-par 3% return seems like thin gruel indeed, especially when we note that she found herself staring in the face of another big bear market in late 2008.

Despite her disappointment and her fears of the future, our investor persevered. As we mentioned earlier, the second decade of her investing career was much, much better than the first. In fact, she quadrupled her average rate of return in the second decade (12% vs. 3%), even though she maintained the same simple strategy (buying and holding the S&P 500 Index) throughout. And now, with 20 years of investing under her belt, we find that she has earned an annualized total return of approximately 7.42% since 9/30/98. She has more than quadrupled her original invested capital, thanks to both the magic of compound interest and her ability to remain calm during periods of market distress.

S&P 500 Sep-1998 - Sep-2008



S&P 500 Sep-1998 - Sep-2018



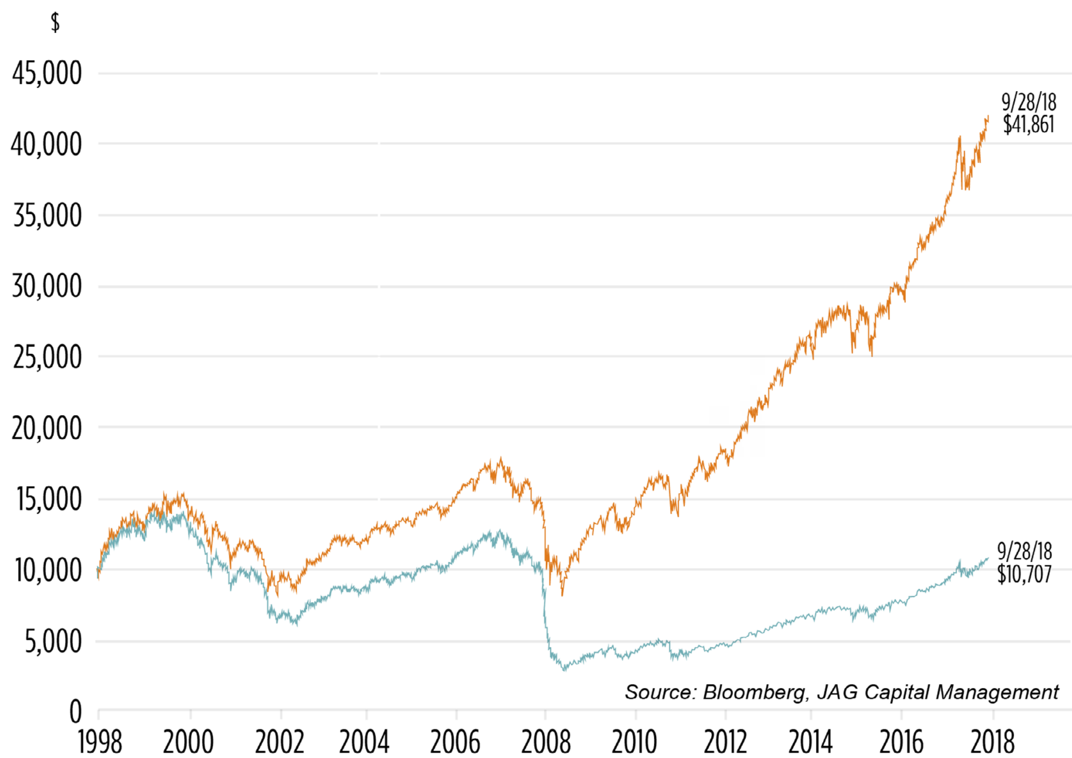
We started off this note with an opinion that ten years is a reasonably-long period of time to evaluate the relative success of an investment strategy. While we think that is true, here are a few caveats and addendums:

- *When it comes to investing in stocks, longer time horizons are preferable to shorter ones.* In other words, ten years is a decent representation of what many people consider to be a "long" span of time. But twenty years is a better horizon than ten, and thirty is better than twenty, and so on. Investing is hard under the best of circumstances, but maintaining a long-term outlook makes it easier to withstand the inevitable set-backs that one will encounter in financial markets.

- *For better or for worse, in "real life" our hypothetical investor is (almost) as rare as a unicorn.* As we described, she successfully navigated several dramatic down-swings in the value of her portfolio. She was resolute in the face of adversity and she stuck to her plan. Many, if not most, people lack the ability to emotionally withstand this sort of volatility. As a practical matter, investors with a diversified portfolio that allocates among stocks, bonds, and cash are more likely to experience a smoother ride – which makes them more likely to stay the course during periods of stress.

- *Market-timing doesn't work.* Were it possible to do so accurately and reliably, market-timing would be an insanely-successful investing strategy. Unfortunately, as Warren Buffett once said, "the Hall of Fame for market timers is an empty room." This is largely because long-term investment returns are heavily dependent upon a vanishingly small number of daily returns. Missing just .5% (approximately 25 days) of the best daily returns in the S&P 500 over the past 20 years slashed the annualized return from 7.4% per annum to a mere .3%. At .3% per year, a $10,000 investment grows to only $10,707 in 20 years vs. almost $42,000 at 7.4%. And it goes without saying that nobody – not even Mr. Buffett – can expect to achieve 99.5% accuracy in their investment decisions.

S&P 500 Growth of $10,000 -
Miss the 25 Best Days (blue line) vs. Buy and Hold (orange line)



S&P 500 25 Best Daily Returns Sep-1998 - Sep-2018	
Date	S&P 500
10/13/2008	11.6%
10/28/2008	10.8%
3/23/2009	7.1%
11/13/2008	6.9%
11/24/2008	6.5%
3/10/2009	6.4%
11/21/2008	6.3%
7/24/2002	5.7%
9/30/2008	5.4%
7/29/2002	5.4%
12/16/2008	5.1%
1/3/2001	5.0%
3/16/2000	4.8%
10/20/2008	4.8%
8/9/2011	4.7%
10/15/2002	4.7%
8/11/2011	4.6%
5/10/2010	4.4%
1/21/2009	4.4%
4/5/2001	4.4%
9/18/2008	4.4%
11/30/2011	4.3%
10/16/2008	4.3%

- *An Asset Allocation policy, combined with regular rebalancing, works well.* In contrast to market-timing, asset allocation policies with regular re-balancing are effective and achievable. As we have described, our hypothetical investor was 100% invested in the S&P 500 for the last twenty years and earned an average return of 7.42%. If she had instead maintained a consistent 60/40 allocation between the S&P 500 and intermediate-term bonds, she would have earned average annual returns of 6.36%, while experiencing 40% less volatility. In other words, she would have earned 86% of the returns generated by her stock-only portfolio, while sharing in only 60% of the volatility. For many investors, it is worthwhile to make this sort of trade-off between risk and return.

More than ten years after Lehman Brothers' bankruptcy, the Great Financial Crisis continues to cast a shadow over investors. This may be why most people don't seem to be overly enthusiastic about stocks, despite the fact that the S&P 500 has more than quadrupled since March 2009. According to a poll from Gallup only 55% of investors own stocks today, compared to 65% in 2007. As noted by Barron's Magazine in their 9/10/18 issue, "...the market's gains simply haven't registered [with many Americans] on an emotional level." Buttressing that point is some astonishing (to us) recent survey data from the robo-advisory firm Betterment. Of the 2,000 respondents to their survey, 48% believe the stock market had not gained at all in the past 10 years. If that is not surprising enough, 18% of the respondents actually think the stock market has declined over the past 10 years!

Barron's puts this disconnect in historical perspective, citing a 2007 paper by researchers from Berkeley and Stanford that examines past generations who came of age during prior periods of turmoil: "People who were teenagers or adults during the Great Depression were less than half as likely than young adults during the post-World War II boom to invest money in stocks throughout their lives, with just 13% participating in the market...Adults who came of age just after the recession in the 1970's similarly avoided stocks." In other words, significantly negative market events can have long-lasting effects on individuals who experience them firsthand. Judging by the data cited by Gallup and Betterment, it seems that the events of 2008 may have created yet another "lost generation" of investors. This would truly be a shame. Today more than ever, the onus on saving for retirement is squarely on the shoulders of regular individuals. Traditional pension plans, and their promises of life-time income in retirement, are almost extinct in most of corporate America. Especially for younger investors, excluding equities from a long-horizon investment plan is extremely likely to harm their ability to achieve their financial goals.

Norm Conley
CEO & CIO

DISCLOSURES

These comments were prepared by Norm Conley, an investment advisor representative of JAG Capital Management, LLC, an SEC registered investment advisor. The information herein was obtained from various sources believed to be reliable; however, we do not guarantee its accuracy or completeness. The information in this report is given as of the date indicated. We assume no obligation to update this information, or to advise on further developments relating to securities discussed in this report. Opinions expressed are those of the advisor listed above as of the date of this report and are subject to change without notice. Opinions of individual representatives may not be those of the Firm. Additional information is available upon request.

The information contained in this document is prepared for general circulation and is circulated for general information only. It does not address specific investment objectives, or the financial situation and the particular needs of any recipient. Investors should not attempt to make investment decisions solely based on the information contained in this communication as it does not offer enough information to make such decisions and may not be suitable for your personal financial circumstances. You should consult with your financial professional prior to making such decisions. For institutional investors: J.A. Glynn Investments, LLC, and JAG Capital Management, LLC, both have a reasonable basis to believe that you are capable of evaluating investment risks independently, both in general and with regard to particular transactions or strategies. For institutions who disagree with this statement, please contact us immediately.

PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. ANY INVESTMENT CONTAINS RISK INCLUDING THE RISK OF TOTAL LOSS.

This document does not constitute an offer, or an invitation to make an offer, to buy or sell any securities discussed herein. J.A. Glynn & Co., JAG Capital Management, LLC, and its affiliates, directors, officers, employees, employee benefit programs and discretionary client accounts may have a position in any securities listed herein.

JAG
CAPITAL MANAGEMENT LLC

9841 Clayton Road | St. Louis, MO 63124
800.966.4596 www.jagcapm.com