Triweekly Series

Ideas and Nuggets of News You Can Use!

LINDNER INSIGHTS

Diversification, Helping and Hurting

"Diversification is an established tenet of conservative investment."

Benjamin Graham

LINDNER CAPITAL ADVISORS, INC.

A Registered Investment Advisor

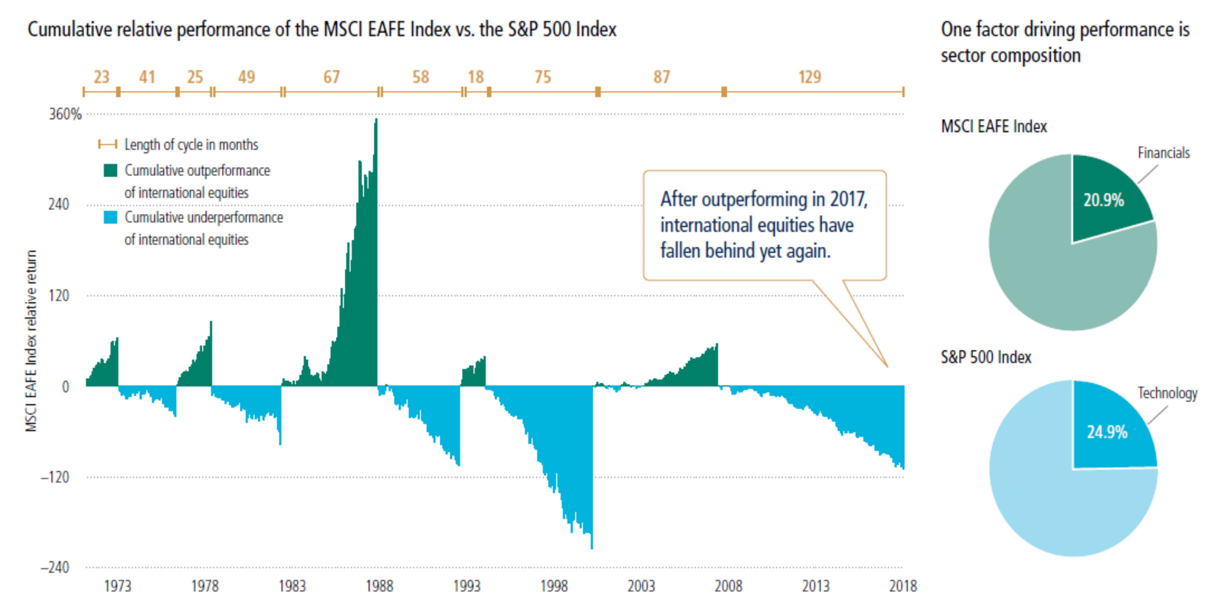
600 Village Trace, Building 23 | Marietta, GA | 30067

"Big enough to deliver, small enough to care" *by* Chris Briggs, CFP®

Diversification, Helping and Hurting……

Over the past ten years a diversified portfolio, for the most part, has underperformed the S&P 500. This is due to a large degree in how the S&P 500 is constructed. The S&P 500 is a capitalization weighted index, giving the highest weight to the largest component. As of August 1, 2018, the top 5 companies in the index are Apple (AAPL) at 3.92% of the index, followed by Microsoft (MSFT) at 3.40%, Alphabet (GOOG & GOOGL) at 3.09%, Amazon (AMZN) at 3.01%, and Facebook at 1.72%.[1] These five companies represent a whopping 15.14% of the S&P 500 index. As we saw recently on July 26, 2018 when Facebook dropped 19% following a disappointing earnings miss, movement in the largest S&P 500 stocks can be the difference in the market (S&P 500) being up or down.

The simple fact that these big tech firms are in the S&P 500 and not included in overseas indices like the MSCI EAFE, has caused an interesting divergence. Consider the chart below.



Source: Bloomberg, FactSet, as of 6/30/18. International equities are represented by the MSCI Europe, Australasia, and Far East (EAFE) Index, which tracks the performance of publicly traded large- and mid-cap stocks of companies in those regions. Total returns are calculated gross of foreign withholding tax on dividends. U.S. equities are represented by the S&P 500 Index, which tracks the performance of 500 of the largest publicly traded companies in the United States. Japan, the United Kingdom, France, Switzerland, and Germany are represented by the MSCI Japan Index, the MSCI United Kingdom Index, the MSCI France Index, the MSCI Switzerland Index, and the MSCI Germany Index, respectively, which track the performance of publicly traded large- and mid-cap stocks of companies in those countries. It is not possible to invest directly in an index. Past performance does not guarantee future results.

With a 24.9% weighting, if technology stocks do well, there is a good chance the S&P 500 will do well. Overseas, the MSCI EAFE's heavy weighting to financials of 20.9% will likely drive its performance or underperformance. A pause in the performance of tech stocks here domestically or some of the uncertainty among the big financials being lifted overseas could reverse the relative outperformance of the S&P 500.

[1] https://www.slickcharts.com/sp500

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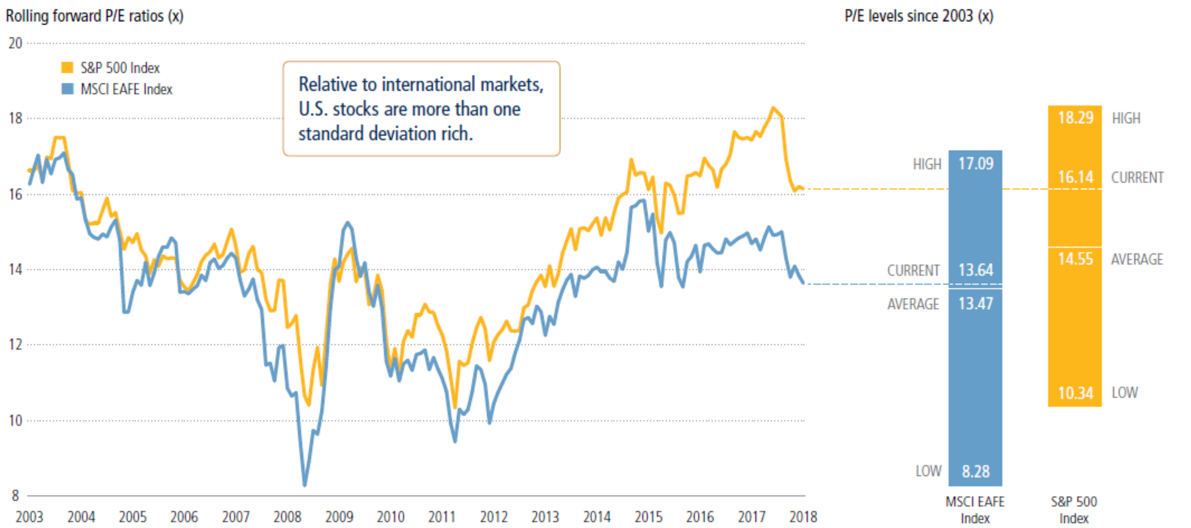
We believe strongly in the work of Ken French and Eugene Fama on the Value Effect. Not overpaying for a set of assets greatly improves the probability of investment success. What is interesting at this moment is that technology stocks have driven our domestic market (S&P 500) to valuation levels a full standard deviation outside of their historic relationship with foreign stocks (MSCI EAFE).

A valuation gap has emerged between U.S. and non-U.S. stocks

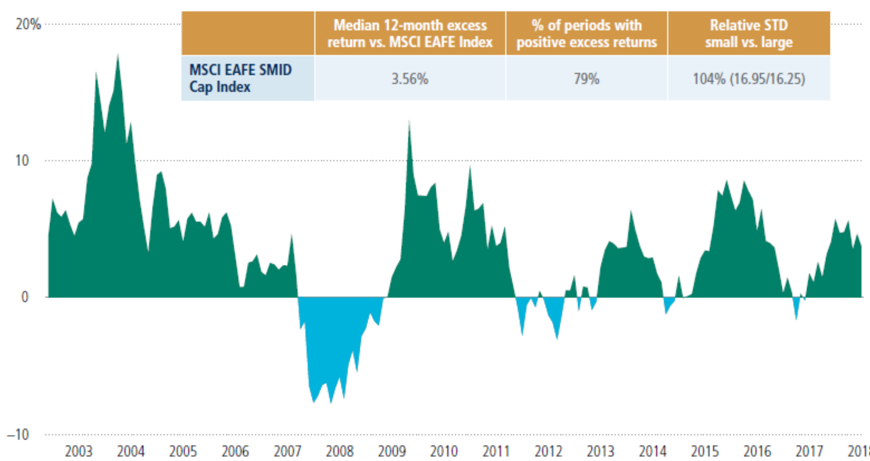


Source: FactSet, as of 6/30/18. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. The MSCI Europe, Australasia, and Far East (EAFE) Index tracks the performance of publicly traded large- and mid-cap stocks of companies in those regions. It is not possible to invest directly in an index. Price to earnings (P/E) is a valuation measure comparing the ratio of a stock's price with its earnings per share. Past performance does not guarantee future results.

International small and mid-cap stocks look even more attractive on a relative basis.

International small-cap stocks may be poised to build on their historical performance advantage over large caps

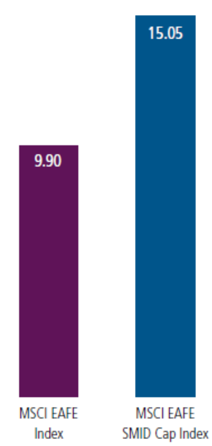
Rolling 12-month excess returns and volatility of international small-cap stocks vs. international large-cap stocks



	Median 12-month excess return vs. MSCI EAFE Index	% of periods with positive excess returns	Relative STD small vs. large
MSCI EAFE SMID Cap Index	3.56%	79%	104% (16.95/16.25)

Small- and mid-cap companies have higher EPS growth forecasts

2018 earnings estimates (%)



Source: FactSet, as of 6/30/18. The MSCI Europe, Australasia, and Far East (EAFE) SMID Cap Index tracks the performance of publicly traded small- and mid-cap (SMID) stocks of companies in those regions. The MSCI Europe, Australasia, and Far East (EAFE) Index tracks the performance of publicly traded large- and mid-cap stocks of companies in those regions. It is not possible to invest directly in an index. Standard deviation (STD) is a statistical measure of the historic volatility of a portfolio. It measures the fluctuation of a fund's periodic returns from the mean or average. The larger the deviation, the larger the standard deviation and the higher the risk. Earnings per share (EPS) is a measure of how much profit a company has generated calculated by dividing the company's net income by its total number of outstanding shares. Past performance does not guarantee future results.

We overweight our portfolios to small and mid-cap stocks here domestically and overseas. Our globally diversified portfolios haven't kept pace with the S&P 500 recently largely due to the outperformance of a very narrow group of stocks here domestically.

In our November 28, 2016 addition of Triweekly we point out how random returns can be and how unreliable recent performance is as an indicator of future returns. The chart below shows cumulative global index returns from January 2000 – December 2009.

	Total Cumulative Return (%)
S&P 500 Index	−9.10
MSCI World ex USA Index (net div.)	17.47
MSCI World ex USA Value Index (net div.)	48.71
MSCI World ex USA Small Cap Index (net div.)	94.33
MSCI Emerging Markets Index (net div.)	154.28
MSCI Emerging Markets Value Index (net div.)	212.72

MSCI data © MSCI 2016, all rights reserved. ***Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.*** [2]

An investor in large US stocks, especially US technology stocks, had a tough decade through 2009. Compare that performance to a diversified portfolio like our LCA Traditional Retirement 65/35. Our portfolio returned a cumulative performance of 42.51% for the same decade. Many of the assets that are currently underperforming are exactly the ones responsible for most of the 65/35 portfolio's positive performance from 2000 – 2009. People have short memories and need to be reminded why their portfolios are so diversified. To quote our founder Bob Lindner, "sometimes diversification can be negative, neutral or positive. Right now, it is neutral."

[2] https://my.dimensional.com/csmedia/cms/issue_briefs/2016/03/issuebri_2/Why_Should_You_Diversify_US.pdf

About LCA…

Lindner Capital Advisors, Inc. is a federally Registered Investment Advisor based in suburban Atlanta, Georgia, with representation throughout the United States. Our investment platform provides access to institutional fund strategies and exclusive money managers that are not readily available to the retail market. Our portfolios are designed to be consistent with a client's unique investment objectives, individual time horizon, and tolerance for risk. LCA has been CEFEX certified since 2006 and is committed to our fiduciary responsibility.

Ask your Relationship Manager for a copy of "The Educated Investor" written by Robert Lindner.

For more information, call (770) 977-7779 or email portfolios@LindnerCapital.com.

Visit LCA's website at www.LindnerCapital.com

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