MOMMAERTS MAHANEY
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ACHIEVE MORE.

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Third Quarter 2021

Travel Restrictions

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One of our investors recently said to us "…you guys are really taking the CDC's Covid travel restrictions seriously…you don't even let your stocks travel internationally". We always appreciate our clients clever wit. It's true, Mommaerts Mahaney's Core Portfolios are currently 100% domestic. We have zero international stock or bond exposure. MMFS has always had systematically less international exposure than investment banks and academic studies recommend. We have further reduced international exposure based on forecasts from our frameworks.

There are two components to portfolio construction: *Strategic Allocation* and *Tactical Allocation.* Strategic Allocation is the starting point. It represents how we would allocate your assets if we believed all asset classes were at equilibrium (fair value). Sometimes the Strategic Allocation is referred to as the Naïve Portfolio or the 100-Year Portfolio. It is derived from using long-term historical averages as forecasts of future returns. The return, volatility, and correlation of these forecasts are then optimized to calculate the optimal long-term mix of assets for each investor's risk level. A simple way to think about Strategic Allocation is this; If we were not allowed to adjust your portfolio allocations, this is how we would invest your assets for the long term. Tactical Allocation represents our shorter-term expectations of market returns. It reflects our more immediate view of what asset classes we expect to outperform vs. underperform over the shorter-term. We *tactically* adjust your *strategic* allocation with the expectation of adding value beyond what your strategic allocation provides. This produces your final asset class allocation percentages.

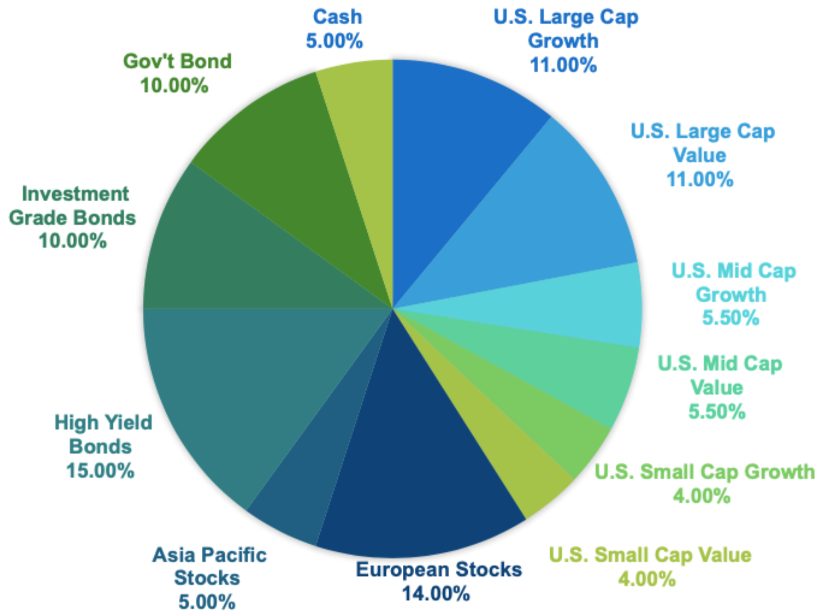
The investment community effectively never views assets as at equilibrium. This is because there is never a consensus outlook among investors. It's why the Bulls and the Bears yell at each other on CNBC all day. In fairness, we suppose it would make for boring TV and low ratings to have a bunch of market strategists all politely agree with each other. Contrasting outlooks create the opportunity for investment managers to *tactically allocate* and add value beyond that provided by the strategic allocation. Of course, the opposite is also true. Incorrect tactical decisions will detract value from the strategic allocation. We are always systematically (strategic allocation) underweight international. Prior to the pandemic, we also were tactically underweight international. During the pandemic, we tactically eliminated the remainder of your international exposure. We never imagined a situation where we would own zero international assets however our frameworks forecasted domestic assets to historically outperform international assets. Fortunately, that forecast panned out well. That's our long-winded way of explaining how we got to zero percent international exposure.

Percentage Change **Asset Class**	**Pandemic Lows**	**1 Year**	**YTD**
Domestic Small Cap Value	111.06	61.87	25.77
Domestic Mid Cap Growth	108.21	44.53	17.67
Domestic Small Cap Growth	108.21	53.15	18.50
Domestic Large Cap Growth	101.68	40.03	24.27
Domestic Mid Cap Value	93.56	44.41	22.46
European Equity	82.87	35.50	17.97
Domestic Large Cap Value	71.85	35.01	18.49
Asian Equity	63.88	28.51	9.49

What follows are some even longer-winded details and insights. We also thought it makes sense to distribute this commentary in pieces over the next few weeks. This first piece will focus on strategic allocation. We will use MMFS' Moderate Core Portfolio in our example.

Strategic Allocation – MMFS' Strategic Allocation to international assets is 19% (14% European Stocks and 5% Asian Stocks) in the Moderate Core Portfolio. This exposure is entirely in stocks. Forgive us for stating the obvious, MMFS does not invest in international bonds. More on that in the next commentary.

MMFS Moderate Portfolio



Earlier we mentioned that the majority of investment banks and academic studies recommend holding far more international exposure than we systematically hold.

Vanguard Investments – "To get the full diversification benefits, we recommend that you consider investing about 40% of your stock allocation in international stocks and about 30% of your bond allocation in international bonds."

A common thread in academic studies is the argument that a truly global portfolio needs to be allocated based on global market capitalization rates. For example, if the United Kingdom makes up 11% of global market capitalization, your portfolio should allocate 11% of your assets to the United Kingdom. This would translate into U.S. Investors that want a truly global portfolio allocating about 40% of their stocks internationally. It's a rationale that somewhat makes sense, therefore, we are somewhat sympathetic to it. Our issue is this; U.S. Stocks have and continue to systematically outperform International Stocks. (Emerging Market data is only available starting in 1995).

(Jan 1986 - Aug 2021)			
Asset Class	**Annual Return**	**Volatiltiy**	**Sharpe Ratio**
US Stock Market	11.12%	15.33%	0.57
Intl Developed ex-US Market	7.39%	17.48%	0.32
European Stocks	8.97%	17.65%	0.40
Pacific Stocks	5.92%	19.58%	0.24

(Jan 1995- Aug 2021)			
Asset Class	**Annual Return**	**Volatiltiy**	**Sharpe Ratio**
US Stock Market	11.01%	15.38%	0.62
Intl Developed ex-US Market	5.54%	16.39%	0.28
European Stocks	7.62%	17.68%	0.38
Pacific Stocks	3.17%	17.01%	0.14
Emerging Markets	6.55%	22.44%	0.30

The data shows a clear dominance by U.S. Stocks. When we break down this data into shorter periods this dominance continues. Over 10-year rolling periods, the U.S. consistently outperforms. Even more importantly, look at the Sharpe Ratio of each asset class. The Sharpe Ratio is the holy grail of our investment process. The higher this ratio the better. It measures how much return each asset class provides per unit of volatility. We choose the assets that give our investors the most return with the least amount of volatility. Therefore, our strategic allocation has systematically less international than most recommend.

The argument for international investing centers on the diversification benefits of international assets. We love diversification. However, critical to the diversification argument is the assumption that global equity market returns balance out over time. More specifically, the argument is U.S. stocks have been outperforming for quite some time, so international stocks should outperform in the future. We have and continue to disagree with this rationale. We believe there are societal differences between the United States, Europe, and Asia. U.S. companies tend to be more profit-oriented which leads to systematically higher earnings growth. This is why we believe global equity market returns will not balance out over time and that U.S. stock outperformance over international stock performance is systematic, not mean-reverting.

Over the years, we have received some push back on our thinking regarding Domestic assets vs. International assets. Sometimes we are accused of letting our home team bias impact our decision-making. It’s a fair concern. We are not cavalier about our thinking. On the contrary, we are quite insecure about it. We constantly revisit and reanalyze this conundrum. As of now, we believe it is in the best interest of our investors to systematically remain underweight International assets.

In our follow-up commentaries, we will explore tactical allocation, currency impacts, and global bond markets.

Be it ever so humble there is no place like home,
The Mommaerts Mahaney Financial Team

Jon C Mommaerts, CFP®: Jon is a Principal of Mommaerts Mahaney Financial Services, Inc. He has over 30 years of experience working with professionals and those about to retire. He is a member of the Financial Planning Association, as well as a member of the Preferred Financial Advisors.

J. Matthew Tuccini, CFP®: Matt has over 17 years of experience working in the financial services industry with vast experience in retirement planning, tax strategies, and financial planning.

Robert Kea, CFA: Bob has over 30 years of experience in portfolio management. He was a founding member and Co-Head on Putnam's Asset Allocation Group, which managed $12Bn in both retail and institutional assets.

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Mommaerts Mahaney Financial Services, Inc. provides advisory services through ERTS Wealth Advisors, LLC, a registered investment advisor.
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