Known Unknown vs. Unknown Unknown

In this week's reading you too may be confused. I have read many conflicting reports and the most interesting are the two following philosophies.

The first is, "It's not the known unknowns that worry me, rather the unknown unknowns that causes the change." Donald Rumsfeld was notorious for speaking about the of known unknowns and unknown unknowns he faced.

You can think of the known unknowns as inflation, price of oil, war in Ukraine, supply chain challenges, government reactions and others. They are known because you hear about them every day on television or on the radio. Everyone speculates about them, even me, and yet they are still unknowns.

Now what about the unknown unknowns that either turn the market up or turn it further down. This list is empty because of their definition – unknown unknowns. Who was expecting COVID-19, a pandemic and the shutdown of businesses and the economy?

Then I am hearing people quote Mark Twain; "It's not what you don't know that kills you, it's what you know for sure that ain't true." This is something that frankly haunts me because everything I do is based on an understanding of how the world works, how numbers and mean reversion works, and that understanding is based on a set of critical assumptions that have been true for decades.

So, what can we do in times like these? Here are a few suggestions:

1. First, revisit the assumptions you make. Are they short-term or long-term?
    a. We did not think Ukraine would be attacked by Russia, yet long-term, this war will end.
    b. The 2008 mortgage crisis was resolved in 15 months when many thought it was long-term crisis.
    c. Federal Reserve Chairman Jerome Powell said on Oct 3, 2018, about the Fed Rate, "We may go past neutral, but we're a long way from neutral at this point, probably." That statement ended the 9 year bull market. Yet, he changed his mind on December 24 and the market recovered in 6 months.
2. Second, create a cash management strategy. List the goals you have that will require cash. Examples are home improvements, travel, or savings for a major purchase. Many of your goals may require cash up front. Or you may choose to get a 12-15 month interest free for credit card and pay over time instead of selling an investment. Write down the amount of cash needed and work toward that goal.
3. Third, review your property and auto insurances. When was the last time you got a quote from another company for your home (replacement) and auto insurance? Many of your agents represent multiple companies and may be able to provide you significant savings. I recommended this to two clients and they came back with $200 and $300 per month in savings.
4. Think long-term about things that are long-term. Inflation is the significant. Currently it is at 8.3%. That current rate is not the rate over your full working career or retirement. How should you think about inflation? There are 5 year and 10 year Treasury Inflated Protection Security (TIPS) that have a break-even rate of what the market thinks will be the inflation rate. Over the next 5 years the TIPS break-even rate is 3.0% and the 10 year break-even rate is 2.5%. Therefor we use those rates as our inflation gauge.

If you would like to review your strategy or discuss your individual situation, please contact me and let's talk.

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