January 2026 – Diversification, Risk, and Tax Efficiency

“Diversification is a safety factor that is essential because we should be humble enough to admit we can be wrong” – Sir John Templeton

Conflicting Goals

A year ago, we noted in our letter that the market had experienced two particularly good years. We also said that two good years did not foretell that 2025 was going to be a down year. And, happily, it was not. We also acknowledged that risk tolerances can and do change over time. In this letter we want to re-visit that theme and discuss how we approach managing the sometimes conflicting goals of diversification, risk, and tax efficiency.

Our stated philosophy includes being diversified, adhering to our clients’ risk profiles and tolerances as well as being mindful of income tax effects. However, these factors can cause conflict. For example, it is commonly acknowledged that too much diversification will lead to only very average results.

Not that this is all bad. After all, over an extended period the stock market has provided for an annual return of ten to eleven percent. We find that clients are willing to have a lower return if their portfolio has more stable value. We have noted before that the pain of a loss exceeds the joy of a gain.

In the past year, much has been written and commented on the Magnificent Seven (Google/Alphabet, Apple, Amazon, Microsoft, Meta/Facebook, Nvidia, and Tesla). They deserve the recognition. However, performance can and did still vary significantly among them. Google was the best with a return of 65%. Amazon was the worst with a positive total return of about 5.2%.

Even if you were strictly a Magnificent Seven investor, you may now be inclined to sell some Google and buy some Amazon. However, such a transaction has an adverse effect in taxable accounts. We believe that while we are very comfortable with our clients owning Google, we realize that too large a position would not be consistent with their risk tolerance. Accordingly, we would want to take some “Google money” off the table and invest it elsewhere including adding to your Amazon position.

We also look at the different sectors of the economy and consider whether more focus should be given to other sectors. For example, given the amount of funds being invested in Artificial Intelligence and Defense, it would be reasonable to consider investments in Energy (natural gas), Industrials (power), Financial Services (project financing), and Utilities (power).

Sectors and companies can get seriously overvalued or undervalued. During the dot.com era Information Technology was extremely overvalued and Energy was extremely undervalued. During the 2008 financial crisis, Financial Services was overvalued compared to all the other sectors. Today, some are questioning the valuations of Information Technology and Communication Services. However, we believe that in these sectors there is still opportunity despite some specific stock valuations reaching speculation territory.

Particularly for Artificial Intelligence, we must be cautious if the promises of the sector do not come to fruition. For example, Nvidia was up +39% for 2025 and continues to grow, but 40% of their revenue comes from only two customers. If enthusiasm, confidence, or investor pressure changes, a correction might happen quickly.

The decisions that we, as advisors, make in such sectors must be balanced with such considerations in mind.

Making such investment decisions is difficult, and we strive to be very diligent about it. We believe this is how we strive to deserve your trust.

Please let us know if you have any questions, comments, or concerns. As always, we are grateful for your trust in us.

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