PREPARING FOR VOLATILE MARKETS

And the case for staying invested…Always!

Investing is hard. Not because *actual* investing is hard (although it is…), but more so because human beings are emotional, and emotions have never mixed well with investing. Exuberance attracted billions into overvalued dot-com stocks in the late '90's, while extreme fear separated investors from their positions to the tune of hundreds-of-billions-of-dollars around the market lows in 2009 – precisely at the wrong time.

With our hindsight colored by those experiences, it's only natural that today, nine years into a bull market, we get a lot of questions about when to "get out." It's also natural that some view seemingly cliché investment advice – like "stay the course" or "it's about time in the markets, not timing the markets" – with skepticism.

Allow us to explain why we believe that staying invested through the entire cycle is generally the right approach for most long-term investors.

Diversification works. One of the bedrock principles of investing for the long-run is that you should never put all your eggs in one basket. The idea being, of course, that a diverse portfolio should help insulate against losses in a downturn. The trade-off? A diverse portfolio won't keep up with the stock market on the way up. The picture below illustrates the concept visually, where the grey line represents "the cycle," and the dotted blue line a hypothetical portfolio.

Why reducing volatility can help you stay in the game. This bedrock principle is so powerful because, mathematically, a less volatile portfolio will compound returns at a higher rate. Below we show three hypothetical portfolios. Each assumes an *average* annual return of 10%, but with different degrees of volatility. Simply put, the portfolio with the least volatile return stream saw the highest portfolio value at the end of 10 years. So diversification is a powerful tool to help you stay the course.

Growth of $1mm over 10 years
Average return of 10% and….

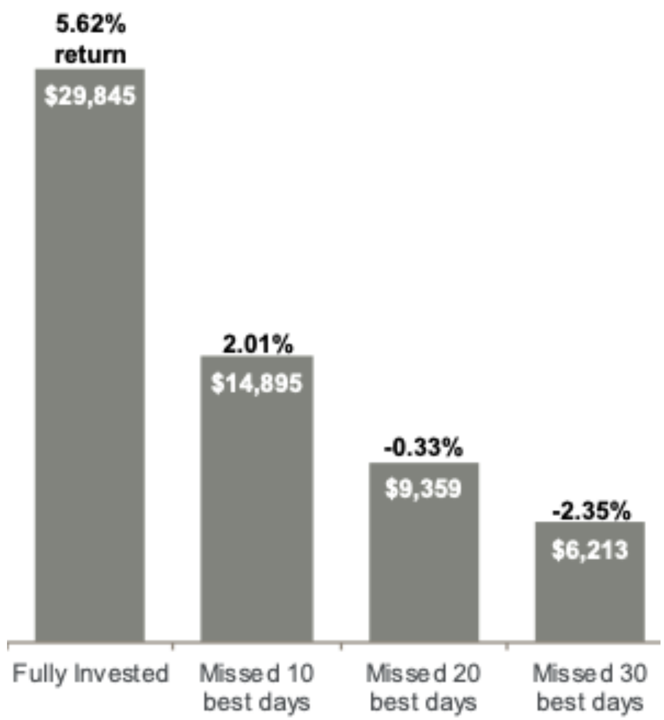
20% Volatility	10% Volatility	5% Volatility
Compound return = 8.3% Ending Value: $2.2mm	Compound return = 9.6% Ending Value: $2.5mm	Compound return = 9.9% Ending Value: $2.6mm

Investors are bad at timing the market. Imagine you're in stop-and-go traffic. Your lane isn't moving, so you move to the left lane. As soon as you make your move, that lane grinds to a halt and your old lane starts moving again. Pretty irritating.

DALBAR, a leading industry research firm, studied aggregate mutual fund flows and the timing of those flows, and found that investors behave in exactly the same way. Based on their study of flows, DALBAR was able to approximate the return achieved by the "average investor." Despite strong overall capital market returns over time, investment flows achieved an inferior 1.9% annualized return for the last 20 yrs ending in 12/31/2018, as compared to 5.6% from the S&P 500. Unsurprisingly, DALBAR attributes most of this gap to bad timing and human behavior. **Sometimes the best way to get ahead is to just stay in your lane.**

How bad can market timing be? Really bad. The chart below shows what might happen if you were to miss some of the *single best days* in the market (I know what you're thinking: "Miss the ten best days? Yeah right… that would never happen. The analysis is way too hypothetical."). But consider this: in the last 20 years, **6 of the 10 *best days* occurred *within two weeks of the 10 worst days*.** So next time volatility rears its ugly head and has you second guessing your strategy, think twice about getting out; there could be a 6 in 10 chance you'll miss one of the best days.

20yr annualized returns of $10k in the S&P 500 (1999-2018)



Source: Data from Bloomberg. Returns are based on the S&P 500 Total Return index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Indices do not include fees or operating expenses and are not available for actual investment. The hypothetical performance calculations are shown for illustrative purposes only and not meant to be representative of actual results while investing over the time periods shown. The hypothetical performance calculations are shown gross of fees. If fees were included, returns would be lower. An individual cannot invest directly in an index. Past performance is not indicative of future returns. Data as of December 31,2018.

It's always something. Investors should also remember that there is always something to worry about. Some years, it's trade wars, other years real wars, or rising rates, politics, the length of the cycle, potential pandemics. Since 1998, an investment in the S&P 500 would have doubled in value (almost twice!), despite a series of worries that kept too many investors sidelined.

Year	Event
1999	Y2K
2000	Tech wreck; bubble bursts
2001	September 11
2002	Dot-com bubble: market loses -49%
2003	War on Terror - US invades Iraq
2004	Tsunami kills 225,000+ in southeast Asia
2005	Hurricane Katrina
2006	Not a bad year, but Pluto was demoted from planet status
2007	Sub-prime blows up
2008	Global Financial Crisis; bank failures
2009	Cont': market loses -56%
2010	Flash crash; BP oil spill, QE1 ends
2011	S&P downgrades US debt; 50% write-down of Greek debt
2012	2nd Greek bailout; existential threat to Euro
2013	Taper Tantrum
2014	Ebola epidemic; Russian annexes Crimea
2015	China FX devaluation
2016	Brexit vote; US election
2017	Fed rate hikes; North Korea tensions
2018	Trade tensions; -20% market selloff to end the year
2019	US/China trade tensions escalate
2020	Coronavirus

I'm just afraid of investing at the top. We get that. Allow us to illustrate a really bad scenario to make a point. Imagine you just sold your business for a cool $1,000,000. Congratulations! The date is October 9, 2007 and you have no idea that today is going to be the last good day before the Global Financial Crisis kicks in. You invest the entire sum in one of the large S&P 500 ETFs'. The market proceeds to plummet **-56%** until its eventual bottom in March of 2009. **How much is your original $1,000,000 investment worth at the end of 2019, assuming you stayed invested?** How does roughly $2.64million sound?

Your portfolio is not an "on-off" switch: Investing is not binary. We encourage clients not to think of their portfolio as an "on-off" switch, but rather, as a series of dimmer dials. Rather than "getting in" or "getting out," we think it makes sense to calibrate the exposures in your portfolio depending on the cycle. There are a number of dials to consider, including stocks vs. bonds, US vs. international, growth vs. value, long duration vs. short duration, quality, and so on.

A combination of diversification, volatility reduction, and time in the market can help investors achieve their long-term goals without the pitfalls of emotionally-driven, badly timed mistakes.