Resolute
wealth advisor

MARKETS IN CRISIS: USING THE PAST AS OUR GUIDE

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Market Commentary
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> “ Each time we see a market reaction like what we are experiencing now, it feels like it’s the first of its kind because it is. ”

As many continue to search for a sense of stability during this challenging time, at Resolute Wealth Advisor, we begin to notice a consistent theme in the questions investors are asking. We are taking this opportunity to share with you some fundamental principles we rely on specifically because they have withstood the test of time – during good markets and bad – ultimately, witnessing the overall growth of the market.

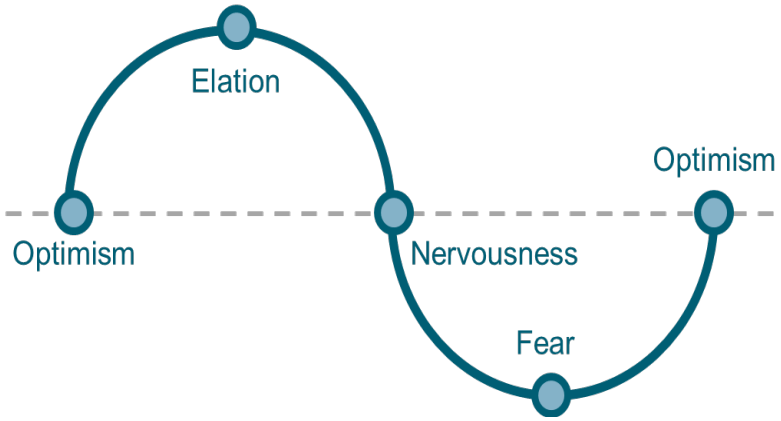
Some investors begin to wonder if their investment strategy is truly the right one or if current market events are so unique there’s no possible way to ever really plan or protect themselves. Others wonder if now is a good time to be investing more or if that is just as much of a gamble as taking their money to the casino.

While all periods of market uncertainty are unique, they are never outside the realm of possibility and are not all that dissimilar to other historic events we have experienced. Often, the most important thing that can carry you through a time like this is a simple shift in perspective and confidence in these few basic truths when investing.

The Natural Course of Emotions When Investing

We know that for many investors, tracking the market can take you on a bit of an emotional rollercoaster – from day-to-day, or even moment-to-moment – especially during times of market volatility. While we are very aware of the short-term discomfort investors are experiencing, the focus on the long-term is what continues to lead to the most success when it comes to investing.

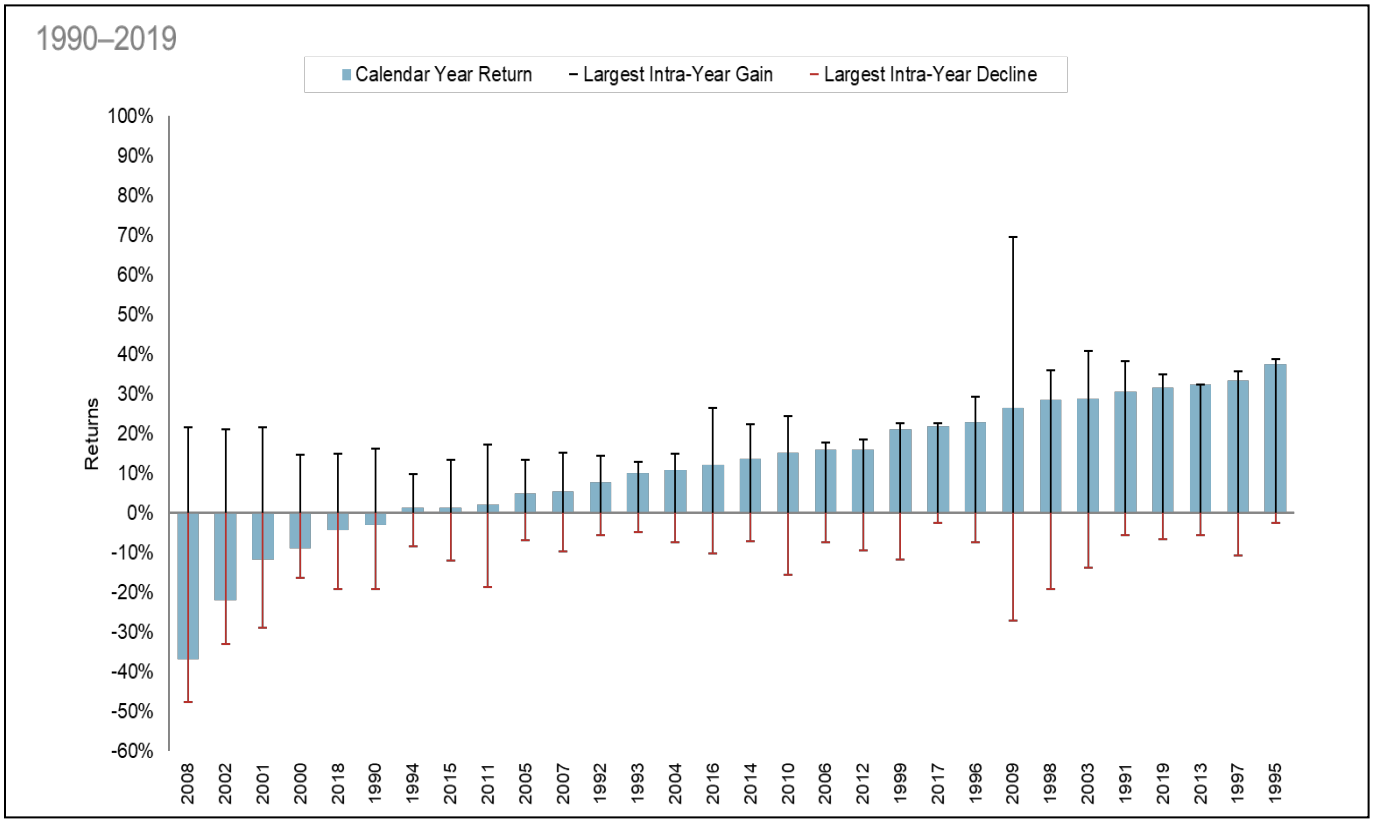
The question then becomes, "How do I expand my focus beyond the short-term to focus on a longer time horizon and know that my asset allocation is the right one for me?"



When investing, the two driving emotions in the market continue to be fear and greed. When we refer to the chart above, greed pushes prices higher between the investor's optimism and elation phases. Alternatively, fear is what causes markets to tumble when that elation eventually switches to nervousness surrounding uncertainties in the world. To take a step back and view these moments through a wider lens, we need to see what markets have done historically to be reminded that volatility is a normal part of investing.

A good lesson in volatility can be viewed in the following box and whisker chart detailing US large cap market intra-year gains and declines. This diagram organizes S&P 500 Index returns from lowest to highest, by year, since 1990 (the blue boxes depict the year-end returns). Despite the financial crisis of '08-'09, a dot-com bubble, trade wars, and oil prices spiking when Iraq invaded Kuwait, the year-end returns during this 30-year period were positive 24 out of the 30 years evaluated.

US Large Cap Market Intra-Year Gains and Declines vs. Calendar Year Returns



Source: Dimensional Fund Advisors.[1]

This chart further illustrates the largest intra-year gain and decline for each calendar year noted (the whiskers on each box give those highs and lows within the given year). It may be surprising to note that the average intra-year decline over this 30-year period was over 13%, with a third of those declines being greater than 15%. Declines are expected and even commonplace just as often within years we see high positive year-end results.

This data demonstrates that giving into fear-driven emotion during larger market dips could lead to missing out on resulting positive outcomes.

Is It Different This Time? Is It Time to Change Course?

Is today different from what we've seen in the past with major market events? Irrefutably, the answer is "yes," which is why it can feel so scary. No two market events are ever the same because the market is dynamic and constantly changing – pricing in new information as it becomes available. Each time we see a market reaction like what we are experiencing now, it feels like it's the first of its kind because it is. That being said, the fundamental principles of investing remain the same and markets are reacting exactly the way we would expect them to when processing new information.

It is important to feel comfortable with the investment allocation you have in place. You need to choose an allocation that you're comfortable with not just in good market times, but also during the more difficult

[1] In US dollars. Data is calculated off rounded daily returns. US Large Cap is the S&P 500 Index; S&P data © 2020 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Largest Intra-Year Gain refers to the largest market increase from trough to peak during the year. Largest Intra-Year Decline refers to the largest market decrease from peak to trough during the year. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Values change frequently and past performance may not be repeated. There is always the risk that an investor may lose money. Even a long-term investment approach cannot guarantee a profit.

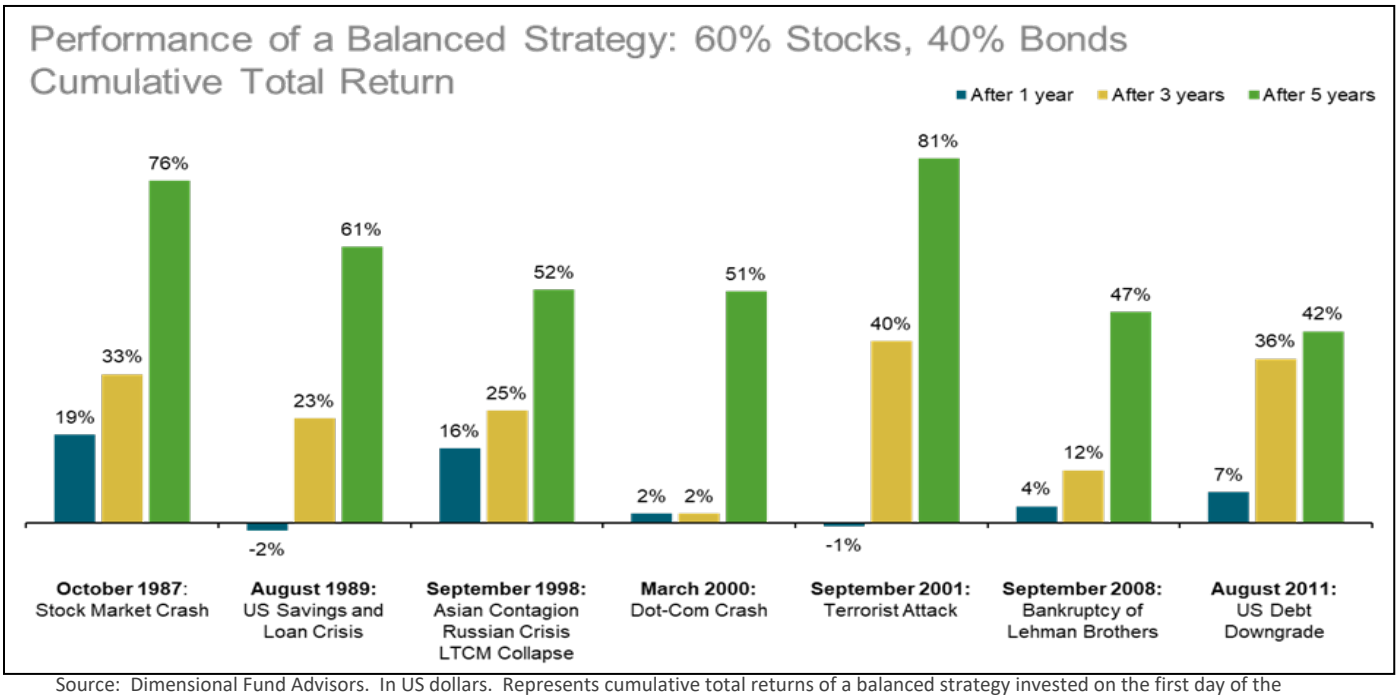
periods. It should not be an investment strategy you feel the need to readjust as a reaction to each separate market event, but one you maintain throughout each event. Otherwise, it simply becomes "market-timing."

It is natural to wonder what a market decline means to your portfolio going forward and if you should adjust your strategy. The benefit of maintaining a portfolio invested in a blend of stocks and bonds tends to be a smoother long-term ride to achieving desired target returns. Let's observe how a moderate portfolio would have responded following historic crisis events in the data below.

The chart below illustrates several previous large events and subsequent cumulative returns after 1 year, 3 years, and 5 years for a moderately invested portfolio containing 60% stocks and 40% bonds. Each of the large events noted in the chart below had its own unique feel at the time, yet the total growth of the subsequent 5-year periods for all events range between 42%, at the lowest, and 81% at the highest.

History would suggest that if achieving, not only recovery, but also, additional growth on your assets over the next 5 years is important for your success, then changing strategy during times of crisis would not be advised.

The Market's Response to Crisis



Source: Dimensional Fund Advisors. In US dollars. Represents cumulative total returns of a balanced strategy invested on the first day of the following calendar month of the event noted.[2]

Is Now A Good Time to Invest?

The final question we want to address that is being asked a lot by investors is, "well, is now a good time to invest in stocks?" This question is posed frequently both when markets are hitting all-time highs and when

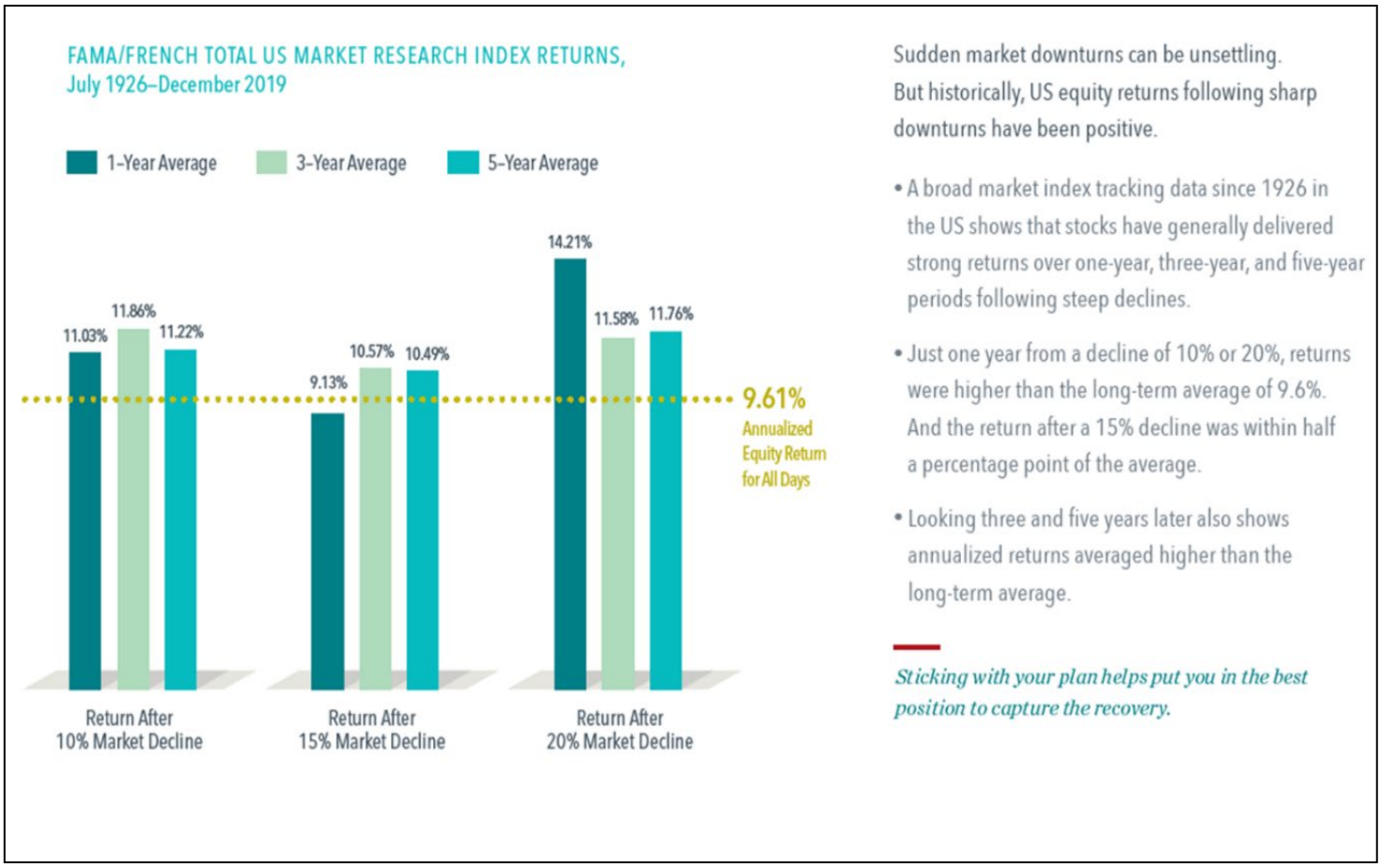
[2] Balanced Strategy: 12% S&P 500 Index, 12% Dimensional US Large Cap Value Index, 6% Dow Jones US Select REIT Index, 6% Dimensional International Value Index, 6% Dimensional US Small Cap Index, 6% Dimensional US Small Cap Value Index, 3% Dimensional International Small Cap Index, 3% Dimensional International Small Cap Value Index, 2.4% Dimensional Emerging Markets Small Index, 1.8% Dimensional Emerging Markets Value Index, 1.8% Dimensional Emerging Markets Index, 10% Bloomberg Barclays Treasury Bond Index 1-5 Years, 10% FTSE World Government Bond Index 1-5 Years (hedged), 10% FTSE World Government Bond Index 1-3 Years (hedged), 10% ICE BofA 1-Year US Treasury Note Index. Assumes monthly rebalancing. For illustrative purposes only. S&P and Dow Jones data © 2019 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. ICE BofA index data © 2019 ICE Data Indices, LLC. FTSE fixed income indices © 2019 FTSE Fixed Income LLC. All rights reserved. Bloomberg Barclays data provided by Bloomberg. Dimensional indices use CRSP and Compustat data. **Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Not to be construed as investment advice. Returns of model portfolios are based on back-tested model allocation mixes designed with the benefit of hindsight and do not represent actual investment performance.**

we see them correct – the reality is, if you believe you should be invested in the market, the right time to invest is simply when you're ready to do so. Whether seeing those highs or experiencing a significant drawdown, the long-term returns tend to be positive over time.

In the following chart titled, "US Equity Returns Following Sharp Downturns," the subsequent 1-year, 3-year, and 5-year average returns for the broad equity market are shown after experiencing 10%, 15%, and 20% market declines. It illustrates that maintaining the investment strategy across this broad market index over time produced a positive average annualized return of 9.61%. This return would likely be right in line with someone's expectations for portfolio growth.

Yet, there are those who would argue investing more after a sudden market downturn could be of even greater benefit in terms of portfolio return. The information in this table demonstrates the veritable truth behind that argument. When choosing to invest after a sudden 20% market drawdown, the 5-year average return becomes 11.76% – a 2.15% premium over the annualized equity return for all periods. For this reason, we would venture to agree that investing more after a significant market decline could help to improve your long-term portfolio returns.

US Equity Returns Following Sharp Downturns



Source: Dimensional Fund Advisors.[3]

[3] Periods in which cumulative returns from peak is -10%, -15%, or -20% or lower and a recovery of 10%, 15%, or 20%, respectively, from trough has not yet occurred are considered downturns. Returns are calculated for the 1-, 3-, and 5-year look ahead periods beginning the day after each downturn. Whether a period is considered a downturn is analyzed on a daily basis, and therefore, the 1-, 3-, and 5-year look ahead periods are overlapping. The bar chart shows the average returns for the 1-, 3-, and 5-year periods following 10%, 15%, and 20% downturns. For the 10% threshold, there are 3,442 observations for the 1-year look ahead, 3,396 observations for the 3-year look ahead, and 3,345 observations for the 5-year look ahead. For the 15% threshold, there are 3,175 observations for the 1-year look ahead, 3,167 observations for the 3-year look ahead, and 3,166 observations for the 5-year look ahead. For the 20% threshold, there are 2,561 observations for the 1-year look ahead, 2,560 observations for the 3-year look ahead, and 2,560 observations for the 5-year look ahead. Peaks and troughs are patterns that are developed by the price action experienced by all securities. Peak is the highest point prior to a drawdown, and trough is the lowest point after the peak. **Past performance is no guarantee of future results. Short term performance results should be considered in connection with longer term performance results. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.**

Perspective from an Amateur Investor

David Goetsch, Executive Producer of *The Big Bang Theory*, wrote an article titled, *A Transformed Investor's View of Market Volatility*, discussing his relationship with investing. Goetsch learned that adopting a new investment perspective by accepting a few simple truths can lead to a more pleasant investment experience, overall. He wrote the following:

1. "I have to understand the uncertainty of the market. The stock market, as measured by the S&P 500 Index, has returned about 10% per year over the last 90 years[4], but there are very few individual years in which it has ever actually returned that amount. I wish somebody would have explained that to me decades ago. Then I would have known to look at stock market returns in terms of decades – not years, months, days, or hours."
2. "In order to be a long-term investor, you have to have a long time horizon. This can be hard to remember when you're being assaulted by noise, but if you can stay strong, the results are stunning. By results, I don't mean the investment returns, which hopefully are good. The return I'm talking about is how I feel every day."
3. "I needed [an advisor] who could not just talk me through what my asset allocation should be, but also help me work through how I felt about investing and what exactly I could do to change my perspective."

Goetsch believes the reason he achieves success over decades, and not months, is specifically because markets are uncertain. He says, "If they weren't, we'd call them a savings account." Goetsch admits that, while he was a mess in February of 2009 when the stock market was down around 50%, learning to accept the uncertainty of the market and focus on a longer time horizon allows him to feel better and worry less about his investment experience.

[4] S&P data © 2018 S&P Dow Jones Indices LLC, a division of S&P Global.

Conclusion

Fear and greed can often cloud our view and interfere with our ability to focus on long-term outcomes. During times of low market volatility, we can be easily lulled into a false sense of comfort, which makes for a rude awakening when realizing how much we risk for that additional return. The emotional turmoil an investor can experience when becoming too focused on the short-term can lead to a detrimental change in strategy, creating lost recovery and growth opportunities.

However, as market uncertainty increases, the potential for greater returns (through the acceptance of higher risk or volatility) increases, as well. While volatility can be quite unsettling, we are reminded that it is a normal part of investing and can lead to greater opportunities when backed by a disciplined investment approach. We believe in the way markets work and stand behind the importance of having a strategy in place that can withstand a variety of market conditions.

While the circumstances related to the most recent market decline are different from those we've experienced in prior declines, the data reveals that a disciplined approach can lead to significant rewards following market downturns.

We, at Resolute, believe that maintaining an investment strategy during an unexpected market downturn is important to capturing the most recovery. However, at the end of the day, the best decision you can make with your money is one that allows you to sleep at night. If you feel you need to discuss other options during this time, please don't hesitate to reach out to us.

Until our next conversation, we continue to apply our fundamental beliefs that risk and return are related, markets are efficient over time, profitability matters, and diversification is key.

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