High Probability ADVISORS

INVESTING INSIGHTS

Unprecedented – Part II

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As the realities of the Coronavirus induced economic shut-down came into focus, investment markets suffered a dramatic "meltdown" in March. I wrote "Unprecedented," which aimed to provide some perspective for investors. Now we are 2+ months removed from that wave of panic; it is time to make some follow up observations to prepare investors to deal with the road ahead.

GRIM REALITIES AND AN UNCERTAIN PATH FORWARD

With 20-20 hindsight, we now know that "shelter in place" can bring the pandemic spread under control. The fears of overwhelmed hospitals, shortages of ventilators and the attendant despair that we saw in parts of Italy, did not play out in America. Yes, New York City came close, but on balance, the pandemic's trajectory was successfully modified.

> "When the word "unprecedented" is applied liberally in the media, it might lead us to forget that much of the economic and investing experience has broad precedent. As Mark Twain is reputed to have said, "History doesn't repeat itself, but it rhymes."
>
> *Unprecedented, March 2020*

However, we can see the massive cost society will bear in exchange for "flattening the curve." Businesses from hairdressers to hospitals, airlines to retailers are lurching toward bankruptcy. With massive job losses and shattered dreams for business owners, the pressure to heal those self-inflicted wounds is building. Will it be fast enough to save the vulnerable? Will consumers and businesses return to historical patterns? Will the infection rate spike higher as the economy re-opens, creating a second wave crisis? Many pundits have opinions, but the future is difficult to forecast now, as always. We should assume there will be more bad news to come. However, investors have already begun to factor in the rebound. As I said in the March paper, "The depth and duration [of the recession] are an open question, but not the inevitability of an economic recovery."

> "Especially noteworthy is that fear, uncertainty and doubt cause us all to shift our time horizon to the short term: what will happen tomorrow? We agonize over the potential for further losses in the next month and become blind to the improved outlook for returns over the next year."
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> *Unprecedented, March 2020*

THE MARKET TIMERS DILEMMA

Fortunately, none of HPA's clients were frightened out of the stock market during the March swoon. However, many professionals and amateurs sold in the meltdown…after all, that is the definition of a panic! Many more sold into the market's early rebound in April. I am sure many of them watched the market's continued rebound in disbelief. How could the market go up when the economic news is so bad, when the risk seems so foreboding?

I believe most investors don't start out trying to time the market's moves. Instead, they are dragged into unplanned market timing forays due to "fear response" during periods like we just experienced. They are driven out of their long-term investment game plan by fear of further loss, then sit on the sidelines as the market recovers, wondering if they should go back to the plan.

"…the stock market typically begins to rise powerfully even while the economic data is still negative. In fact, there is never a time when the economy and investment markets are free of worry."[1]

Michael Jones, Rochester Business Journal, March 10th 2020

Index	2/20/20- 3/23/20	3/23/20 – 5/31/20	YTD
S&P 500	-33.8%	32.6%	-5.0%
S&P SmallCap 600	-41.3%	33.3%	-20.8%
MSCI ACWI Ex. US	-32.9%	22.8%	-14.8%

*Data as of 5/31/20

One of the precedents we've often noted is that the stock market will typically rise well in advance of any good economic news. There are a few items of "good news" in the headlines now; progress is being made in therapeutic treatments, vaccines, and re-opening of the economies. But significant hurdles remain. As we remind ourselves in every bear market, if you wait for an "all clear" signal, the market will pass you by.

If you tried to "time" the market and got out in March, you are now faced with a dilemma arising from the April-May rebound: ***Should I get back in now after it has gone up, or hope that something else bad happens and the market goes back down so that I can buy in at or below the prices where I sold?*** There is a strong behavioral tendency to avoid admitting a mistake, so most market timers will face this dilemma by sitting on their hands and hoping. Sadly, they will likely not get back into the market until it rises higher and the memory of the painful sales and risk reduction in the panic is dimmed by time. The data shows that many investors kept large holdings in money market funds through the entire 2009-2019 bull market. Those investors were trapped in an unfortunate market timing mistake from which they were psychologically unable to return to an appropriate investment allocation. The same phenomena will hamstring many investors in the post Covid-19 era.

"Trying to time the market is the #1 mistake to avoid."

Warren Buffett

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THE COST OF MISSING THE BOUNCE

In March's article, we included a chart that showed the damage to investor returns from missing the better days in the market. Missing just a few of the best days reduced the past 30 years of equity returns significantly. A vivid illustration of this is seen in the weeks following the March swoon. We've experience several days of outsized returns and a period in which the stock market regained much of its losses. If you are in a "time out," the damage has been done.

Is it over already? Certainly not. We should expect setbacks on the health care and economic front as we move back toward a functioning society and economy. The stock and bond markets will have setbacks too. The economy and investment markets never advance smoothly higher in a straight line. Volatility is a fact of life. But progress will be made, obstacles will be overcome.

INVESTING WITHOUT THE CRYSTAL BALL

The good news is that we do not need a crystal ball to plot an effective investment strategy. In fact, seeking a crystal ball or fortune teller is the downfall of most investment efforts. The first step toward a successful investment plan is admitting we cannot get "in and out" of the market profitably. Become an ***investor***…in for the long term because throughout all the changes, a diversified portfolio of business is the most likely route to financial success. We must accept volatility in stocks and bonds. We then put rules in place (asset allocation, diversification, rebalancing protocols) to help navigate the periodic busts and booms that make headlines. The final piece of the plan is to understand and combat the "behavioral biases" that will inevitably arise during our effort. Gaining an understanding of market volatility and historical perspective is the best route to avoid damaging "unplanned" market timing. Creating and maintaining an investment plan based on these concepts provides the highest probability for long-term success. The ***precedents*** are clear. High Probability Advisors' mission is to bring these disciplines, grounded in evidence-based investing, to bear on behalf of our clients.

> "Simple observations of history tells us that "bad stuff happens" to the economy and corporate earnings periodically, but corporations are adaptive entities, able to adjust and change in ways that have produced economic gain over time. With this understanding, the ability to withstand the periods of "bad stuff" is strengthened and allows us to be patient through the difficult times."[1]
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> *Michael Jones, Rochester Business Journal, March 10th 2020*

[1]Jones, M. (2020, March 10). The past is prologue: What to expect from coronavirus-related market swings. Rochester Business Journal.

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Call **(585) 485-0135** if we can address your questions or provide you further insight into our investing strategies.

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