INVESTING INSIGHTS

High Probability ADVISORS

No Time Like the Present

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INTRODUCTION

In the last several years of the US stock market's long bull run, people have often asked "should I lower my risk?" My response usually included an acknowledgment of the concerns of the day (stretched market valuations, Fed policy changes, political upheaval, length of time since the last downturn, etc.), but also highlighted the reality that trying to time the end of a bull market is a fool's errand that rarely results in success. Instead of focusing on the ***short-term***, I would advise that there is no time like the present to review and reaffirm your ***long-term*** allocation strategy to ensure it is right for your objectives.

Now that the stock market is more than 25% below its highs, we are beginning to get the "should I lower my risk?" question from investors wanting to pull out of stocks and wait for the dust to settle. Once again, our response is that market timing does not deliver a high probability of success, but there is no time like the present to return allocations back to the levels that are consistent with your long-term allocation strategy. If the allocation strategy made sense before the volatility, then the best decision is to stay with your long-term plan.

However, you may be like many investors who have watched some or all of the last bull market from the sidelines. You may have been underinvested in stocks since the Credit Crisis waiting for what you perceived to be a safe reentry point, or possibly you had a liquidity event like the sale of a business and are looking for the right time to put the money back to work in stocks. If you have a long-term time horizon for your money and are hoping for the right time to invest, then I believe there is truly no time like the present. The following discussion will summarize why now is an excellent time to bring your stock allocation back up to a level that is appropriate for your long-term goals and objectives.

DISCUSSION

Stocks are volatile. This point is academic until our money is invested in stocks and their values drop, albeit temporarily. If we put aside the Great Depression and just focus on the past 80 years since the 1930s, the stock market has seen declines worse than -25%:

- Once in both the 1940s and 1980s; and,
- Twice in both the 1970s and 2000s.

We are now experiencing our seventh decline of 25% or more in the past eighty years, even though stocks have compounded at nearly +10% annually over that time period. However, if we have a longer time horizon, then the ***volatility*** of the stock market is just that: volatility. That's because few of the bear markets in history resulted in sustained losses when we stretch our vision past a few years.

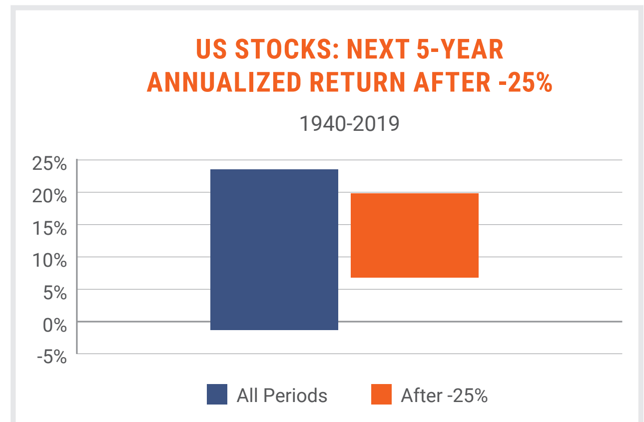
As an example, despite six previous bear markets of -25% or more:

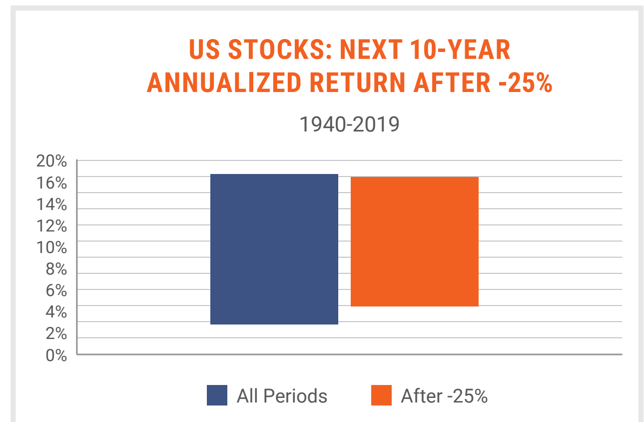
- Only three of those six periods resulted in losses that extended over a full 5 years (1973-74 Recession, 2000-02 Tech Bubble and 2008-09 Credit Crisis); and,
- Only the combined Tech Bubble/Credit Crisis resulted in a 10-year loss in stocks.

The saying "time heals all wounds" has been true for the stock market at least!

Yet, we are not investing in a bull market if we are investing our capital in the stock market today. We are investing after a market drop of more than 25%. What is the experience of stocks following such a 25% decline (even if the bear market continued to lower lows)?

- If your time horizon is only one year, then volatility from here is still a clear possibility. For a worst case outlook, the lowest 5% of returns after a big drop in the market was -13.4% in the rolling 12-month periods since 1/1/1940, while the lowest 5% of returns over the entire time period was -14.0%. Not much of a difference.
- However, if you look over 5-year periods, then the ***lowest*** 5% of returns was ***+6.9%*** on an annualized basis after more than a 25% decline, which contrasts favorably to the -0.9% annualized return for the lowest 5% of returns over all rolling 5-year periods.
- Likewise, the lowest 5% of 10-year returns following declines of 25% or more was +4.7% annualized versus +2.8% over all rolling 10-year periods. These results are illustrated in the charts to the right.





CONCLUSIONS

Because we are human, taking the first step to get invested is difficult in times like these even when the evidence supports moving forward. Behavioral Finance studies have noted the existence of Loss Aversion (the tendency to focus more on avoiding losses than pursuing gains after having experienced losses) and Herding (following what other investors are doing rather than your independent analysis), which are challenging to push against in the face of the bad news that we are reading on the front page of every media outlet. Yet, pushing past Behavioral Biases and making objective decisions is an important part of a successful long-term investment program.

We do not know whether the bear market's bottom is here or ahead of us, but there are plenty of studies that have shown the damage to your ability to grow your wealth as a result of staying on the sidelines and missing just a few days of strong stock market returns. Rather than try to guess the future, the charts we have provided illustrate the importance for long-term investors of taking advantage of the past. There will always be some looming cloud that serves as a reason to not invest. However, the high probability strategy is to put your liquid capital to work after the type of decline we have experienced over the past few weeks.

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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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