Wealth Management

The Crescent Group

RBC Wealth Management

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Carsten Frederiksen, CFP®
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
Direct: 214-775-6401
The Crescent Group website

Paul Hendershot
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus

Nick Weege
Financial Advisor
214-775-6408

Lindsey Wood, MBA
Client Service Associate
214-775-6458

January 2019 Investment Commentary

U.S. stocks started 2019 with their best January performance in 30 years. Our Group was not surprised to see this. We counseled our investors to remain invested during the depths of the downturn in December, and we're happy that client accounts have rebounded very nicely to start the year. There's no question that what happened at the end of the year was ugly. The S&P 500 ended up declining 20% from peak to bottom, which is the definition of a bear market. Over the past 71 years, there have only been 9 worse stock market declines than we experienced last fall. Yet for properly advised investors, last fall had no impact on your long-term retirement success. As typically happens, only those investors who panicked and sold became victims of the correction, and we made sure that didn't happen to our clients[1][2].

Let's stop and think more deeply about panicking and selling when the stock market declines, since this is one of the most important lessons of last year's bear market. A 2017 report by DALBAR revealed that the average investor in a blend of stock and bond mutual funds earned a 1.9% annual return for the thirty years ending 12/31/2016. This abysmal result compares to a return of 8.3% for investors who simply bought and held over that time period (as calculated from the S&P 500 and Barclays Aggregate). The study attributed the dismal result achieved by investors to poor behavior. For all of the attention and discussion given to long-term investing and buy and hold, it turns out that almost no one has the discipline to do it. Preliminary data show that the average investor continued their streak of poor behavior during the 2018 correction. For instance, Charles Schwab reported that customers shifted assets to cash toward the end of last year, but especially in December, at the peak of the panic. This of course is the exact opposite of what most people should have done[3][4].

It's understandable why investors panic and want to sell when the market tumbles. It's a scary time, and the instinct is to sell to "protect" what hasn't declined. The problem with this instinct is that to make money investing over time, an investor needs to buy low and sell high, not buy high and sell low. Panicking and selling when the market declines is the very definition of buying high and selling low. A big part of our Group's job is to make sure our clients don't become the victims of corrections. When the market tumbles we do everything we can to keep our clients invested and make sure they don't become part of the 1.9% statistic we

cited above. A major problem for many investors is that their financial advisors have no more confidence or emotional control then they do, and panic and sell just as much as their clients do during market corrections. It's critical that you find an advisor who has confidence in their investment process, and who has the right mindset to lead you successfully through market corrections, rather than helping you become part of the 1.9% return statistic.

Another crucial lesson learned during last year's correction is the danger of following the crowd with investments. For years, investors flocked to high tech companies such as Amazon.com and Netflix, which in many cases had lots of growth potential but not necessarily profit and cash flow potential. During the bear market last fall, these companies led the market declines, as investors adopted a more defensive posture and moved into companies with sound, proven profits and cash flows. What's particularly noteworthy is that the U.S. economy remained strong during last fall's stock market decline. What do you think will happen to such overvalued growth companies when our economy actually experiences a recession? Last fall was just a preview of the damage such growth companies will experience. When an actual recession hits, the carnage from owning the most popular investments will be far worse[(5)].

The fact that Amazon and Netflix fell so much last fall poses a big problem for the average investor. Why? Because the most popular and potentially overvalued companies make up the biggest portion of the S&P 500 and NASDAQ indexes. When sentiment changes on these companies it decimates the indexes, just as it has in the past. There are historical examples of this that we can look to. Warren Buffett gives the example of overenthusiasm for auto and airline companies in the past. These companies were the Amazon and Netflix of their era – the hot new technology companies that promised to transform the world. They had rapidly growing revenue. And they did transform the world. The problem is they ended up not making profits over the long-term. Buffett cites overenthusiasm for auto and airline companies as a main reason why the Dow Jones index was flat from 1964 to 1981. Investors in the index saw no share price appreciation over a 17-year period. Similarly, the S&P 500 was flat from 2000 to 2013 as a result of overenthusiasm for technology companies. Over that thirteen year period, passive investors in the S&P 500 index saw no share price appreciation. How many investors have a retirement plan that allows for no return over thirteen to seventeen years[(5)(6)]?

While stock market declines are always uncomfortable, the worst thing an investor can do is panic during a correction and abandon a sound investment process with a long-term track record of success. Our investment process has been used by the world's most eminent investors for nearly one hundred years. We have the utmost confidence in our investment strategy, and would never consider abandoning it due to a short-term market decline. We will continue to invest in businesses with sound profits and cash flows at reasonable and cheap prices, and keep our clients invested during the hard times, to prevent them from becoming part of the 1.9% annual return statistic and keep them on track with their financial and retirement goals.

Best Regards,

The Crescent Group
Carsten Frederiksen, CFP® | Paul Hendershot | Nick Weege | Andrew Ielmini | Lindsey Wood, MBA

Sources:

(1) CNBC
(2) JP Morgan
(3) DALBAR
(4) The Wall Street Journal
(5) S&P Dow Jones Indices LLC
(6) Fortune

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