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December 2018 note on recent market volatility

As we approach the end of 2018, many investors have an understandable feeling of anxiety with regards to the stock market's recent declines. During market corrections like the current one, it's important to remember that every correction in the history of U.S. stocks has been temporary, and the same will be true of the present correction. Stock returns are not linear, but they do average out over time to about 7%. While we have had some years with returns well above 7% during the past several years, 2018 currently looks to end well below that, which helps push the recent average back down towards the long-term average of 7%[(1)].

A second important point to remember is that corrections are completely normal, and in no way prevent an investor from making money investing in stocks, as long as you are properly invested and advised. In fact, corrections are simply part of the process of making money investing in stocks. The S&P 500 Index experiences an intra-year decline *every single year*. Over the past 38 years, the average annual intra-year decline equals 13.8%. As we write this note, the current intra-year decline of the S&P 500 sits at 12.7%, so very much average. Despite such an intra-year decline in stocks occurring every single year, annual stock returns were positive in 29 of the past 38 years, or 76% of the time. Investors have been spoiled in the past few years as intra-year declines have been below average, and that makes the current intra-year decline seem all the worse. But it's actually quite average[(1)(2)].

What most investors want to know during a market correction is how long will it last, and how bad will it get? No one knows. And attempts to time the market and buy and sell at the right times will not result in long-term investment success[(3)].

So then, what are we doing to deal with the current temporary market decline? A better question would be, what *have* we done? Obviously, waiting until a correction occurs is too late. Preparation must be done ahead of time. The right thing to *have done* is the strategy that our Group put in place for our clients over the past several years. That strategy is the reason why our clients have done so much better than average during the current market decline. What does that strategy consist of?

For clients living off of their assets in retirement, we have invested several years worth of living expenses in cash and bonds. This means that no matter what happens with temporary declines in the stock market, clients will have a stable source of funds to live off of. It means that even for corrections lasting several years, like the 2008 correction, clients will have liquid funds for living expenses and will not need to sell stocks at depressed prices.

Another cornerstone of our strategy of advanced preparation for market corrections consists of only investing in companies with a demonstrated track record of strong profit and cash flow generation, when they can be purchased at reasonable prices. For years, our Group has watched from a distance as the most popular investments have gone up indiscriminately, on the basis of investor momentum, and beyond underlying fundamentals. Those popular investments have lost the most during the current market correction. Because we stayed away from such speculative investments and have concentrated investment dollars in sound undervalued and reasonably priced investments, our investment strategy has held up well and performed well above average during the current market correction. This is the exact result that we expect from our strategy in times of market duress.

So, the strategy we have outlined is what investors should have done to prepare for the current and future market corrections. Let's now invert the question of what an investor should do: what should an investor *not do* in a correction? As we mentioned above, corrections occur every single year, and are always temporary. Selling in a correction is the worst decision an investor can make. A recent study has shown that the average individual investor in a blend of stocks and bonds has earned a 1.9% return over the 30 years ending 2016. The main culprit for this low return is buying and selling investments at the wrong times. We have already taken care of the buying part for our clients by not buying speculative companies that have led recent losses, and sticking to sound companies at reasonable prices. Now it's our job to keep our clients from selling at the wrong time, which includes selling during the current correction. The stock market will get past the current declines, and it will resume advancing in the future, just as it always has[(3)].

While temporary market declines are always uncomfortable, not being able to fund retirement is even more uncomfortable. Our Group's sound strategy is the right one to guide investors through the current correction and along the path of successful retirement.

Best Regards,

The Crescent Group
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Sources:

(1) S&P Dow Jones Indices LLC
(2) JP Morgan
(3) DALBAR

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