FACTORS IN FOCUS

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TIME For a Different Approach?

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By the time I meet with a prospective client, they have often spent time reading about and learning that trying to beat the market through stock picking and market timing are not the best ways to achieve their financial goals. They've either tried it themselves or worked with an advisor or broker who took that approach and achieved predictably bad results. They know that there has to be a better way, or are open to hearing about a different investment approach that isn't predicated on forecasting short-term market movements.

It can be frustrating, however, when clients try to have a conversation with friends and family about investing. After seeing the light, clients want others that they see struggling to experience a similar epiphany. Sometimes it works out; other times the conversation falls on deaf ears.

Many people we know still cling to the hopes or false belief that they can pick stocks that will beat the market, or find a professional who can accomplish that goal. Others are still scarred from the 40% decline on stocks from 2000-2002 and almost -60% drop from 2007-2009. They plan to liquidate some or all of their investments the next time it appears that we're heading for a plunge. The fact that they probably bailed out during the 2010, 2011, and 2016 corrections (temporary declines of about 20% in each case) and only got back in after prices were higher, or that they hold too much cash and low returning short-term investments is of little consequence. They have selective memory or instead view this as collateral damage in the mission to avoid getting walloped by another steep decline.

It never resonates that a few episodes of missing 10% or 20% gains by getting out and back in at the wrong time results in the same loss of wealth as participating in a bear market. There is an important difference—losing money in a bear market has always been *temporary*. Incorrectly timing the market has usually led to a *permanent* loss of wealth because markets go up more often than they go down and typically never revisit previous levels.

Some investors simply don't know the truth about active management or the long odds against being able to successfully time the market—for them, our insights can be transformative. But many do know, those who have spent the last 10 or 20 years saving or investing and have heard "you can't beat the market" or "market timing is a fool's errand." They just don't believe it. And why should they? We are inundated with false information about investing and bombarded by negative news every day, about politics, about the economy, about individual companies, etc. There always seems to be a reason not to be invested, and when stocks start to decline, these headlines become particularly poignant and worrisome. Doing something—anything—seems like the best approach. It's one thing to cast these claims aside when you examine your investment portfolio and see that the negativity narrative is counterbalanced by rising portfolio values. When headlines are depressing and stocks are also declining, fear and panic can overtake rationality and investors start looking to make changes that can shield them from further declines. "This too shall pass" is irrelevant, because their only concern is "how much worse will it get before it does get better?"

More often than not, it does get worse—***for the headlines***. A look at the last two serious bear markets and a sample of *Time* magazine headlines reveal that there was bad news all the way down, convincing the nervous investor that the correct policy was to sit on the sidelines until the dust settled. But surprisingly, we also find that the bad news never abates. Even as stocks recovered, climbing

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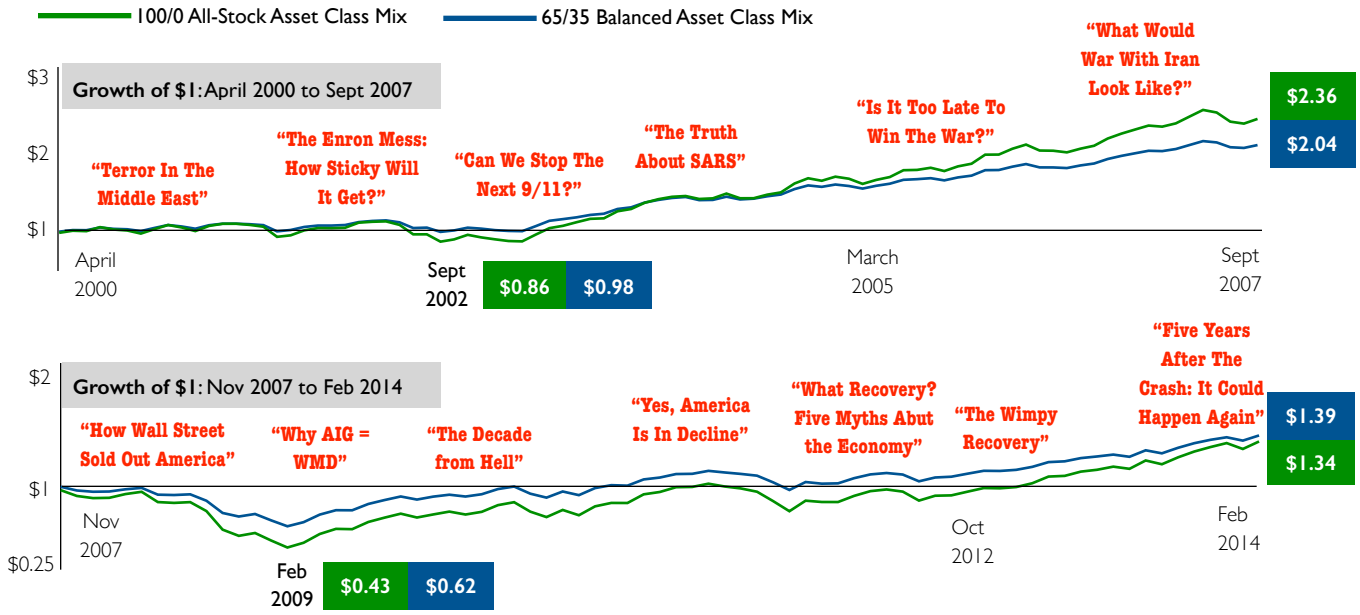
back from the temporary hole they had fallen into and then surpassing old highs, the headlines mostly stayed negative, pointing out new worries and planting the seed that a near-term recovery was only temporary.

investing and your philosophy. Narratives make for great lessons and we remember stories and experiences more clearly than numbers and data. Knowing that stocks do occasionally go down, will in all likelihood recover fully



100/0 All-Stock Asset Class Mix *= 21% DFA US Large Company Fund, 21% DFA US Large Value Fund, 28% DFA US Small Value Fund, 18% DFA Int'l Value Fund, 12% DFA Int'l Small Value Fund.* ***65/35 Balanced Asset Class Mix*** *= 65% All-Stock Asset Class Mix, 35% DFA Five-Year Global Bond Fund. Both mixes rebalanced annually.*

The charts above are illuminating because they remind us that diversified stock portfolios (see the 100/0 Mix) can decline substantially. Adding short-term bonds (see the 65/35 Mix) can minimize the declines but not offset them completely. We also find that balanced portfolios have historically recovered much more quickly than expected.

By layering over selective *Time* cover story titles, we are reminded of how difficult the bear markets are to endure and the recoveries are to achieve. We're inundated daily with negative news and predictions of why conditions will continue to deteriorate and why any near-term recovery will be short lived. Investing success doesn't just require a well-designed portfolio that is appropriate for your long-term goals and in line with your risk tolerance, it is also essential that you stay the course when it seems obvious that you should head for the hills.

Seeing market declines and recoveries through this lens can help reinforce your investment decisions and our underlying principles, but it could also change the perspectives for those people with whom you discuss

and sooner than you expect, and that you will be fighting a negativity narrative the whole way, you can be better prepared for the future. You are free to dismiss a short-term, edge-of-your-seat mindset without fear of costly consequences. You can appreciate that being patient and doing nothing (other than rebalancing back to your target allocation) is often the most profitable decision of all.

Putting less faith in financial headlines and placing more emphasis on your long-term plan, the resiliency of the global stock market, our "Asset Class" philosophy, and the importance of personal responsibility and actions can have a significant impact on your long-term wealth and your overall wellbeing. Being more in control with a time-tested approach might help you worry less about your finances and lead to greater happiness and add free time for you to pursue more rewarding aspects of life.

If you know someone whom you think might find these perspectives and reminders helpful, feel free to provide them a copy of the newsletter. It might be time that they explored a different investment approach.

Contact Eric Nelson, CFA at eric@servowealth.com with any questions, comments, thoughts, or to discuss your personal financial situation.