Commentary

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Falling Stock Prices and the Risks of Market Timing

By: Kevin Barr, Head of SEI Investment Management Unit

- The extended period of market calm that investors have enjoyed in recent years has come to an end.
- While market declines can be disconcerting, they are normal. Endlessly rising markets are not.
- The volatility serves as a reminder of the value of focusing on achieving goals rather than on daily stock price movements and trying to time the market.

Stock market declines in recent days have put many investors on edge. While economists and professional investors debate whether this is merely a short pause in the market's long upward trajectory or the beginning of an extended downturn, investors worry about losses in their portfolios. We have said for some time that a market pullback would not be unexpected given the notable gains in stock prices in recent years. We do not think the pullback means that the U.S. economy is heading into recession.

What's Moving the Market?

Following an extended period in which the U.S. Federal Reserve (Fed) supported economic recovery by maintaining historically low benchmark interest rates, the U.S. economy has regained strength and the labor market has tightened to levels consistent with full employment. The introduction of tax cuts, coupled with increasing wage gains, raised concerns over higher inflation expectations and the possibility that the Fed would be forced to raise interest rates more quickly than expected—causing the first notable market contraction in about two years to take place on Friday, February 2. The selloff continued on Monday, February 05, erasing year-to-date gains for major equity indices.

Our View

Investors have enjoyed a long period of relative calm in financial markets, making the return of market volatility an unwelcome interruption. Although volatility can be unsettling, we've seen it before. Market movements of 2% or more have been frequent occurrences at various periods in the past, and declines of 10% or more have historically occurred about every two years.

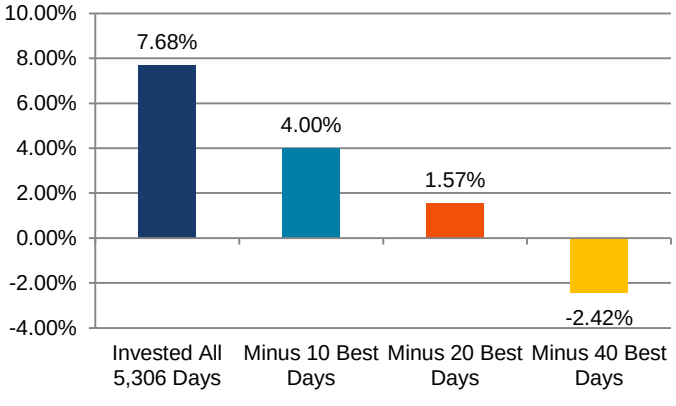
U.S. corrections generally last around three months and, despite their regularity, the average annual return for the S&P 500 Index over the last 50 years has been 10.05% (as of 12/31/2017)[1]. Whether or not the current decline will become a correction is anyone's guess.

Predicting the direction of short-term market movements is, at best, more art than science.

When you witness the market making big point swings, it can be tempting to try "timing" the market – attempting to buy or sell based on the direction the market may be headed. Choosing the ideal moment to buy or sell is difficult and, as you can see below, investors who attempt to time the market may end up missing periods of greater returns.

Two Potential Keys to Success: Patience and Commitment[2]

Average Annual Total Return: (12/31/01-12/31/16)



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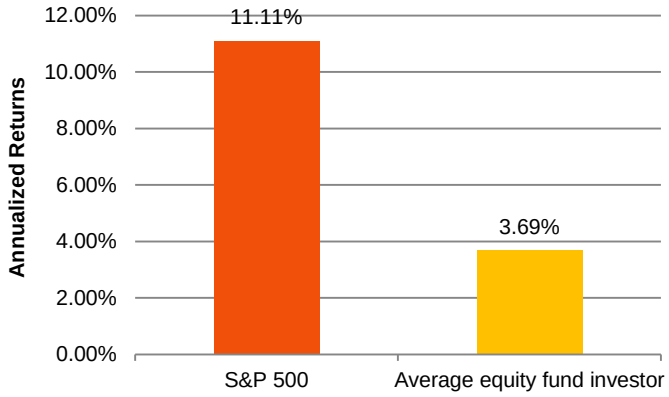
[1]Source: Professor Aswath Damoradan, NYU Stern School, http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

Average equity fund investor (shown below) underperforms a simple buy-and-hold strategy (S&P 500, shown below) by an overwhelming percentage.

Average Investor Trails the Market[3]



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In our view, putting energy into developing and maintaining an investment plan that is designed to help you achieve your goals within a timeframe and level of risk of your choosing is a more prudent approach. This is the foundation of SEI's goals-based investment strategy. The objective is to create diversified portfolios.

In summary, market environments like today's serve to remind us how important it is to have a disciplined and well-designed approach. While day-to-day movement in stock prices (both up and down) are par for the course, investors are well served by remembering that daily, weekly, monthly, even quarterly market movements are often little more than noise for a portfolio that has a time horizon measured in years or decades.

[2]*This chart is for illustrative purposes only and does not represent the performance of any investment or group of investments.*
Source: J.P. Morgan Asset management analysis using data from Bloomberg. Returns are based on the S%P 500 Total Return Index, an unmanaged capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Past performance is not indicative of future returns. An individual cannot invest directly in an index. Data as of December 31, 2016.

[3]*Source: Dalbar, March 2017. Note: The average equity investor refers to the universe of all mutual fund investors whose actions and financial results are restated to represent a single investor. Index returns are for illustrative purposes only and do not represent actual fund performance. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results. The S&P 500 Index is an unmanaged, market-weighted index that consists of the 500 largest publicly traded U.S. companies and is considered representative of the broad U.S. stock market.*

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