# Investment Insights

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## The Model Wealth Program
## Principle-Based Investing

***"Principle-based investing means we focus on investment principles that have stood the test of time rather than basing our decisions on short-term market predictions. Our goal is to identify a small number of experienced managers who offer the potential to outperform their peers over a long period of time. Our approach is to combine a well-defined quantitative and qualitative due diligence process with proprietary construction tools to build, manage and monitor our client's portfolios."***

***The Model Wealth Program is a managed fee-based investment program, available through Cornerstone Wealth Management, LLC. The MWP investment team has developed sophisticated long-term strategies in an effort to manage and control risk, to help investors pursue their financial goals. For more information about the program, contact your Cornerstone Wealth Management representative.***

## How Chasing Market Benchmarks Hurt Investment Performance

- As the stock market climbs, investors are becoming increasingly fixated on how their portfolio returns compare to the benchmark returns.
- Fear of "underperformance" is unhealthy because benchmark returns have nothing to do with investment objectives, and can lead to harmful decision-making.
- The Dalbar study concludes that investors who don't have clear investment objectives are more likely to abandon their investment strategy and are more likely to underperform investors who do.
- Successful investors are grounded by their investment strategy and long-term goals.

### Chasing the Benchmark

As the stock market continues its relentless climb, I'm finding that investors are becoming increasingly fixated on how their portfolio returns compare to the benchmark returns. It seems that it's not enough that the stock market has delivered double-digit returns over the last couple of years. Investors now seem to be focused on the market benchmarks, such as the S&P 500, concerned whether their own returns measure up. This fear of underperformance is unhealthy because benchmark returns have nothing to do with their own investment objectives, yet it often leads to harmful investment decisions.

## Benchmarking Can Lead to Underperformance

Benchmarking – that is, using market benchmarks to track how well your investments are performing – is not necessarily a bad thing, but it can distract investors from what is really important, which is their own investment objectives. Dalbar Inc., which conducts an annual study of investor behavior, found that investors who make investment decisions based on the short-term fluctuations of the market are more likely to make behavioral mistakes that can hurt the long-term performance of their portfolio.

The study found that typical behavioral mistakes, such as trying to time the market or chasing performance, consistently increase risk as well as investing costs, leading to underperformance. And, investors who look to past performance as a basis for their investment decisions tend to underperform the market.

The study also revealed that investors who spend too much time reviewing their account statements tend to be more obsessed with the market benchmarks, wondering more often if they should be making changes to their portfolios. It is well established that, when investors make frequent changes to their portfolio, they tend to underperform the market. Investors who closely follow financial media are more likely to react with the herd to short-term market of economic events. And history has clearly shown that the herd is rarely right.

| | Average Equity Investor | Average Fixed Income Investor | Average Asset Allocation Investor | S&P 500 | Bloomberg-Barclays Aggregate Bond Index | Inflation |
|---|---|---|---|---|---|---|
| 20 Year | 3.88% | 0.22% | 1.87% | 5.62% | 4.55% | 2.17% |
| 10 Year | 9.66% | 0.70% | 4.53% | 13.12% | 3.48% | 1.82% |
| 5 Year | 3.96% | -0.40% | 1.50% | 8.49% | 2.52% | 1.56% |
| 3 Year | 5.58% | -0.11% | 1.84% | 9.26% | 2.06% | 2.04% |
| 12 Month | -9.42% | -2.84% | -6.97% | -4.38% | 0.01% | 1.93% |

Total return includes dividends. These calculations do not include any commissions or transaction fees that an investor may have incurred. If these fees were included, it would have a negative impact on the return. Source: Dalbar, Quantitative Analysis of Investor Behavior, for the period ending December 31, 2018. The S&P 500 is an unmanaged index and cannot be invested in directly. **Past performance does not assure future results.** This is a hypothetical example and is not representative of any specific situation. Your results will vary. The hypothetical rates of return used do not reflect the deduction of fees and charges inherent to investing.

Consider the fact that investors who jump in and out of the market to avoid big declines are likely to miss out on the biggest gains in the market, which often occur near market bottoms. During the investment period 1997 to 2017, if you stayed in the market the entire time your annualized return would have been 7.2 percent. However, if you managed to miss the 10 best days of the market, your return would have been halved to 3.5 percent and halved again to 1.2 percent if you missed the 20 best days. So much for following market benchmarks.

Investors who have lived through major stock market declines or economic malaise should know that, while they may be consequential at the moment, they have very little, if any, impact on their portfolios over the long-term. In today's market, a 3,000 point decline in the stock market will be reflected as a tiny blip on their long-term portfolio performance.

## Investors Need to Fixate on Their Own Objectives

Investors must first understand that the more critical benchmarks are their own investment objectives established through a thoughtful planning process. Individual planning benchmarks are more meaningful than market benchmarks that have nothing to do with whether you achieve your personal financial goals. By focusing instead on your own planning benchmarks, you will find that you can aim to achieve more stable and consistent returns over time.

Consider the following example: You have a goal to retire in 20 years, requiring an average annual return of 8 percent. So, you construct your portfolio around a risk-return profile that strives to achieve that annual return and put you on target to your goal. The first year the S&P 500 gains 20 percent and the second year it loses 4 percent. Should that matter to you?

Your portfolio works to achieve a required return of 8 percent, not to match a market benchmark over which you have no control. If your portfolio goes on to achieve your personal investment objective, why distract yourself with the random, short-term fluctuations of the market?

## Successful Investors Are Grounded by Their Investment Strategy

Studies have also shown that investors who don't have a well-conceived investment strategy tend to be easily distracted by short-term market fluctuations. That's because their investment decisions tend to be market- or risk-driven rather than goals-driven. Investors who are more reactive than proactive in their investment approach are susceptible to second-guessing and hesitation, which invariably leads to underperforming the market.

The Dalbar study concludes that investors who don't have clear investment objectives are more likely to abandon their investment strategy and are more likely to underperform investors who do. Investors who develop the patience and discipline to adhere to their investment strategy are less likely to make typical behavioral mistakes.

Investors who have a thoughtful, well-conceived investment strategy tend to keep their long-term investment objectives front and center even during the most turbulent markets. The strategy is what keeps them grounded in sound investment principles that guide their decisions. It's what enables them to ignore the irrational behavior of the herd as it scampers off a cliff.

## Why You Need an Investment Coach

A good financial advisor will tell you that benchmarks can't fund your financial goals, but a well-conceived investment strategy can. An investment strategy that is based on proven principles and managed with sound practices can keep you from succumbing to your emotions, which never mix well with investing.

It starts with establishing clear goals with definitive time frames so you can know what it will take to achieve them. An experienced, objective financial advisor can guide you through the process and work with you to match your objectives and investment profile to an asset allocation that strives to achieve your required returns.

All things considered, developing the investment strategy, is the easy part. The true value of a financial advisor is to instill the discipline and confidence you need to block out all the noise and stay laser-focused on your long-term strategy. In other words, the key role of your financial advisor is to keep you from making typical behavioral mistakes that lead to underperformance.

## Advisor Alpha

In fact, a Vanguard study found that, by helping you make smart investment decisions, a good financial advisor can improve your long-term returns by as much as three percentage points annually. The study breaks it down further:

- 1.5 percentage points for helping clients stick to their strategy
- 0.75 percentage points for developing a sensible asset allocation
- 0.45 percentage points for guiding clients to low-cost investment options

Over a 20- to 30-year period that kind of return enhancement can translate to tens or hundreds of thousands of dollars added to your portfolio.

Legendary investor and mentor to Warren Buffett, Ben Graham, once said, "The investor's chief problem – even his worst enemy – is likely to be himself." When you realize that it's your investment behavior that has the greatest impact on your investment performance, you can understand the importance of having someone coaching you along the way, helping you to keep your emotions in check while providing clarity around your investment objectives.

## The Model Wealth Program: Benchmarking

For the portfolios we manage in the Model Wealth Program, we avoid attempting to beat a benchmark on a short-term basis. Focusing too much on benchmarks can lead to an overconcentration in asset classes with recent strong performance, and not enough exposure to asset classes that are temporarily out-of-favor. Our goal is to help investors earn a competitive return, while managing risk over the long-term.

*Do you want your portfolio to be invested, or do you want it to be professionally managed? We believe the Model Wealth Program is well-positioned to take advantage of the opportunities in the market. For information about the program, contact your investment advisor.*

### Important Disclosures

The information contained in this report is as of Aug 08, 2019 and was taken from sources believed to be reliable. It is intended only for personal use. To obtain additional information, contact Cornerstone Wealth Management. This report was prepared by Cornerstone Wealth Management. The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual.

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Investing involves risk including the potential loss of principal. No strategy can assure success or protection against loss. Past performance is no guarantee of future results. Asset allocation does not ensure a profit or protect against a loss.

**Stock** investing involves risk including loss of principal. The payments of **dividends** is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time.

**The Standard & Poor's 500 Index** is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

**Bonds** are subject to credit, market, and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

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