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.

Staying on Track with Portfolio Rebalancing

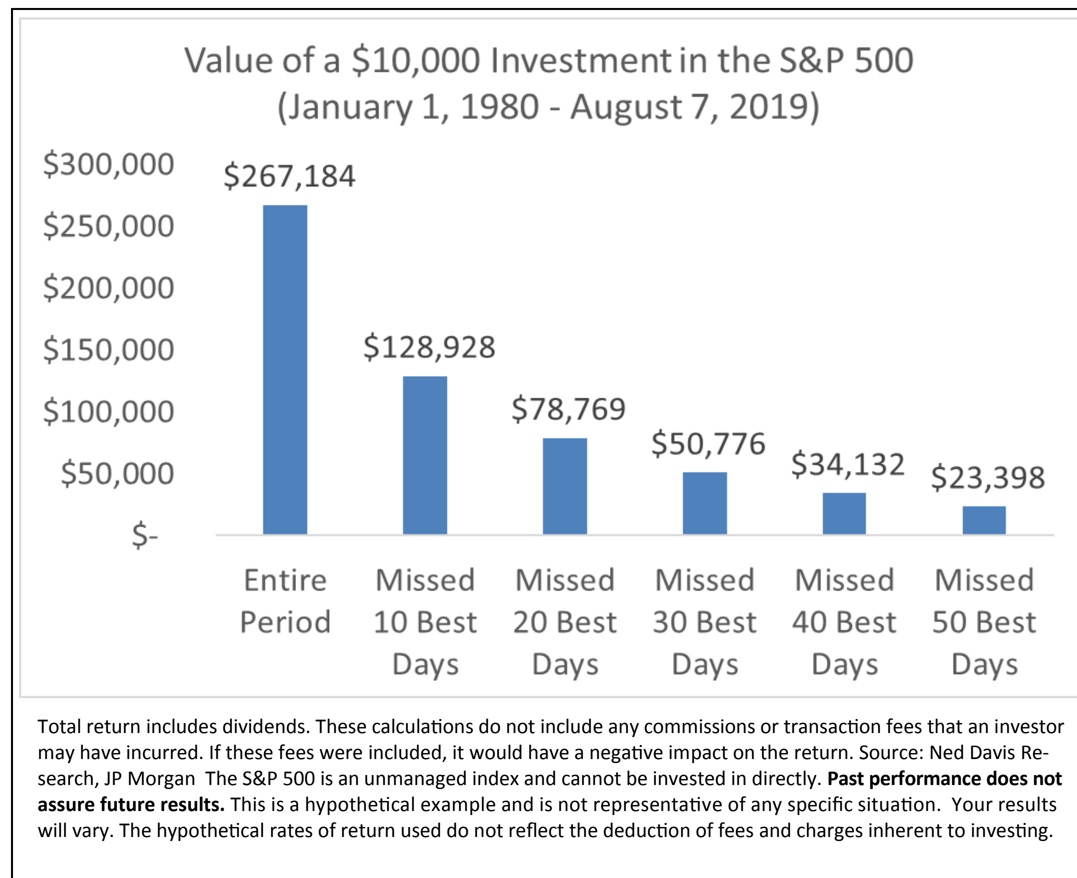
- Study after study shows that jumping in and out of the stock market is almost always a bad idea.
- Professional portfolio rebalancing is a strategy for maintaining a consistent level of risk in your investment portfolio.
- When the portfolio is rebalanced, the investment manager trims stock holdings after a large rise in the stock market. The manager adds to stock investments after a significant market decline.
- This strategy is designed to limit the tendency many investors have to "buy high, sell low".
- Rebalancing may improve returns modestly, but the primary purpose is to reduce risk.

Why do investors hit the panic button?

It is a basic primal instinct to flee when faced with danger. This instinct is primarily responsible for humans avoiding extinction as a result of attacks from saber-toothed tigers, wooly mammoths and other dangerous animals.

But study after study shows that selling investments when the market declines is almost always a bad idea for two reasons. First, it's nearly impossible to know whether or not a small dip in the stock market will turn into a full-fledged market rout. Second, it's also nearly impossible to know when to get back in. Even if an investor is almost perfect in

knowing when to get in and out of the stock market, his results can be disastrous. The study alongside shows the value of a $10,000 investment in the S&P 500 compared to an investor who missed the best 10, 20, 30, 40 or 50 days in the stock market since January 1, 1980. As you can see, an investor who missed just the 10 best days over the past 39 years would have fared much worse than an investor who simply bought and held over the same time period.



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: Ned Davis Research, JP Morgan 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.

Rebalancing: how it works

Imagine it's the first day of your investment experience. After your advisor gets to know you, the two of you discuss your investment goals including your risk tolerance, your desire for income, and your investment time horizon. Your advisor recommends an appropriate allocation to the major asset classes: stocks, bonds, cash.

Then time passes. As the markets shift around, your investments stray from their original weightings in your portfolio, even though you've done nothing at all. This means you are no longer invested according to your original plan, and may be taking more risk than you originally intended.

This is why it is necessary to rebalance your portfolio: to shift your assets back to their intended, long-term allocations.

Let's take a look at a hypothetical example. In this illustration, we compare the results of a $100,000 portfolio using a 70 percent allocation to equities (S&P 500) and a 30 percent allocation to fixed income (represented by the Bloomberg Barclays Aggregate Bond Index). In the table, we compare the portfolio that is immediately rebalanced at a 10 percent threshold (a portfolio with a 70 percent weighting in equity is rebalanced when it reaches 77 percent equity), a portfolio that experiences no rebalancing, and a portfolio that is sold out of the stock market after a 20 percent drop in the S&P 500, then reinvested 12 months later. The last example is meant to be a proxy for those investors who panic and sell when the stock market declines. Over a long period of time, the total return experienced by the rebalanced portfolio is just modestly lower than the portfolio that was not rebalanced. But both portfolios had significantly greater ending values than the portfolio managed by the "panic-and-sell" investor.

1/1/1974—12/31/2018 (1)	Rebalance @ 10% Thresholds	No Rebalancing	Panic and Sell when S&P 500 falls >20%
Ending Value	$7,498,949	$7,416,743	$3,919,714
Annual Total Return	10.1%	10.0%	8.5%

The same result is true over a shorter period of time, from 1989-2018. As you can see, the panic-and-sell investor has significantly less wealth at the end of the study period. In this illustration, the cost of panicking is $463,706 (the difference between ending wealth of $1,371,158 for the rebalanced portfolio versus $907,452 for the "panic-and-sell" portfolio).

1/1/1989—12/31/2018 (1)	Rebalance @ 10% Thresholds	No Rebalancing	Panic and Sell when S&P 500 falls >20%
Ending Value	$1,371,158	$1,370,954	$907,452
Annual Total Return	9.1%	9.1%	7.6%

Rebalancing to limit risk

But why should an investor rebalance if the ending value is roughly the same as the portfolio that was not rebalanced? The answer is simple: the primary value of rebalancing is to reduce risk. The five worst stock market periods since 1976 are depicted in the table below. As you can see, the rebalanced portfolio since 1976 fell much less than the portfolio that was not rebalanced:

5 Worst Periods for S&P 500 Since 1/1/78 (1)	Rebalance @ 10% Thresholds	No Rebalancing
8/31/1987-11/30/87	-20.8%	-24.0%
7/31/1998-8/31/1998	-10.5%	-12.7%
8/31/2000-9/30/2002	-27.5%	-38.9%
10/31/2007-2/28/2009	-35.6%	-44.2%
4/30/2011-9/30/2011	-9.4%	-13.1%

Invest now or wait for a pullback?

A common concern that often prevents investors from getting in the market is the fear of investing at the wrong time. What if the investor gets in the stock market just in time for a real tumble?

To show the impact of terrible market timing, we compare the same three investors (rebalanced, no rebalancing, panic-and-sell, buy back in 12 months) and an initial investment of $100,000, but change the starting year to 2000, just in time for a drop in the S&P 500 of about 50 percent.

1/1/2000—12/31/2018 (1)	Rebalance @ 10% Thresholds	No Rebalancing	Panic and Sell when S&P 500 falls >20%
Ending Value	$263,317	$242,022	$198,993
Annual Total Return	5.2%	4.76%	3.69%

A similar result is shown for an investor who starts in 2007 with an initial investment of $100,000 and just in time for another approximately 50% drop in the S&P 500:

1/1/2007—12/31/2018(1)	Rebalance @ 10% Thresholds	No Rebalancing	Panic and Sell when S&P 500 falls >20%
Ending Value	$217,917	$205,283	$173,575
Annual Total Return	6.7%	6.18%	4.70%

(1) Source: Morningstar Direct. Using monthly data for periods ended 2018 with semi annual rebalancing and a 20% decline in the S&P 500 on an annual basis. S&P 500 and Barclays Capital Aggregate are unmanaged indices and do not include fees and taxes. Past performance is not an indication of future results. Hypothetical examples shown above are 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. Dividends are reinvested.

As you can see, the rebalanced portfolio actually performed better than the portfolio that wasn't rebalanced, because more money was allocated to stocks at lower prices, when the stock market declined.

The trade-offs

Be aware that there are trade-offs. Frequently rebalanced portfolios may incur expenses (transactions charges and taxes) that could reduce the benefit. A study published by Vanguard shows that rebalancing at a 10 percent threshold with annual monitoring frequency is sufficient to balance benefits with the costs.[2] Also, higher risk asset classes tend to produce higher returns over time, so rebalancing tends to reduce their weighting in the portfolio. Thus, while rebalancing may improve returns, its primary purpose is to control risk.

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.

To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. Content in this report is for general information only and not intended to provide specific advice or recommendations for any individual. Economic forecasts set forth may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

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.

Securities offered through LPL Financial, Member FINRA/SIPC.

The Model Wealth Program: how we rebalance

The Model Wealth Program uses a 10 percent threshold to rebalance the portfolios we manage. In addition, we also carefully manage cash generated by the portfolio in an effort to maintain proper balance. These steps should help keep the portfolios we manage in-line with the investor's appetite for risk.

Professional investment management is an attempt to earn competitive returns, while managing risk. In our view, investors who ignore risk may not wind up earning a competitive return. Rebalancing portfolios to maintain a level of risk consistent with the investor's goals is an important investment principle and a key component in our investment philosophy.

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.

Cornerstone
WEALTH MANAGEMENT LLC
A Registered Investment Advisor

(2) Reference: Best practices for portfolio rebalancing, page 16, Yan Zilbering, Colleen M. Jaconetti, and Francis M. Kinniry Jr., November 2015.