Keep Calm and Carry On

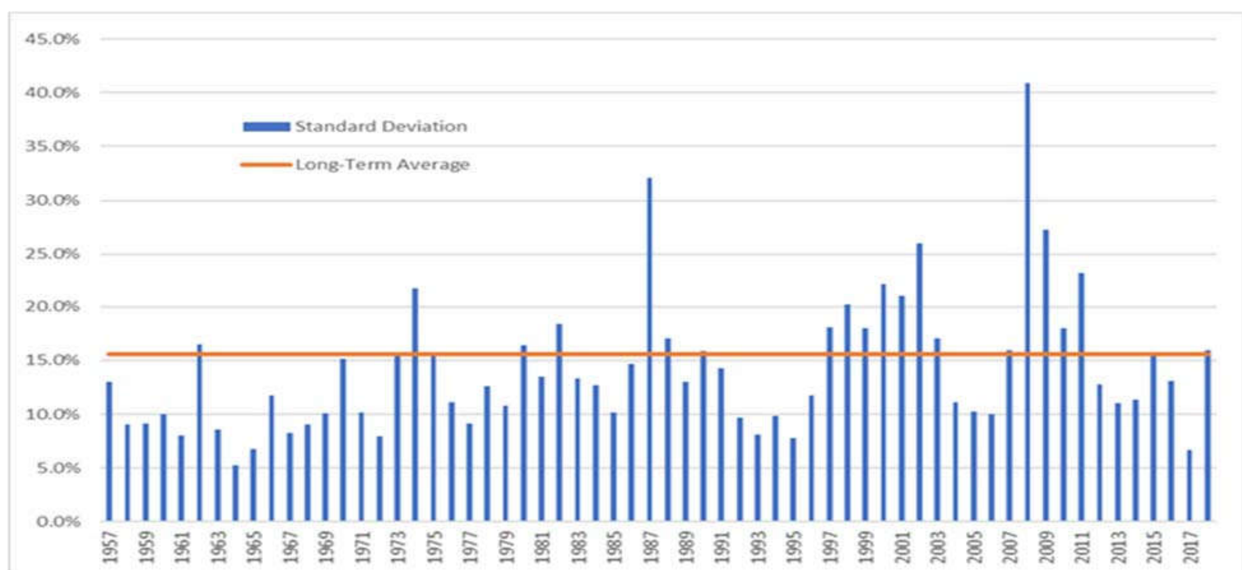
Global Financial Private Capital

- The one certainty of investing is that your portfolio will experience volatility. The recent market turbulence is not as abnormal as headlines would have you believe. In fact, markets have returned to a more normal level of volatility in 2018 after an unusually calm 2017.
- While volatility can often lead to irrational decisions, such as exiting markets prematurely, evidence shows that market timing is a poor investment strategy. An investor who exited the market and subsequently missed just 10 of the best-performing days in the past 38 years would have lost out on more than half of the gains.
- For long-term equity investors, the most powerful factor is time. An investor's time horizon is directly correlated with the likelihood that his or her portfolio will experience a positive return.

As 2018 comes to an end, investors naturally begin to anticipate what the next year will bring, whether it's progress on the trade discussions, the future of Brexit, or what will happen with the Federal Reserve (Fed) monetary policy. While it is important to think about the future, it is hard to predict or know with certainty how any individual calendar year will play out. Certainly 2018 proved to be full of surprises so far. The past, however, is accessible to us, and institutional investors typically spend ample time studying the past to help them make better decisions for the future. To that end, there are three important lessons we can learn from the past.

Lesson #1: We are back to normal volatility

The volatility in the markets throughout 2018 was enough to give all of us whiplash. Large wild swings have been commonplace this year, and headlines on market volatility have been a dime a dozen. Everything from the Fed raising interest rates to Brexit and trade wars have roiled the markets. However, this recent market turbulence isn't as abnormal as the headlines would have you believe. In fact, the markets returned to a more normal level of volatility in 2018 after an unusually calm 2017. Since 1957, the long-term average standard deviation, a measure of volatility for the S&P 500, is 15.6%. The standard deviation of the S&P 500 in 2017 was just 6.7%, the second-lowest year on record after 1964. To date in 2018, the standard deviation has averaged a total of 15.9%. While volatility is certainly back, 2018 has not been substantially more volatile than an average year.



Source: Bloomberg.

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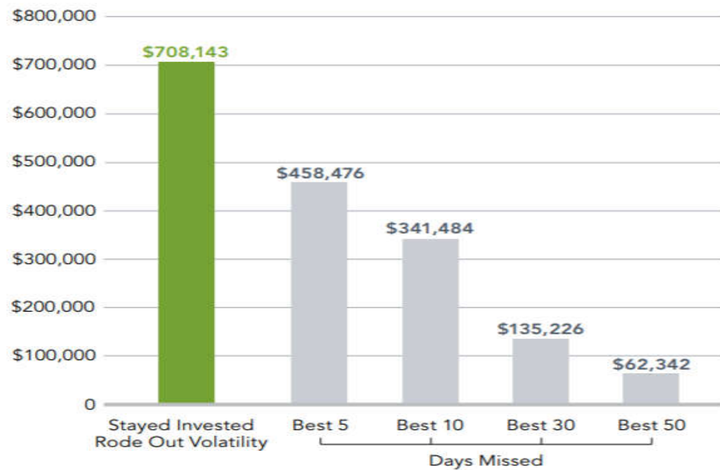
Lesson #2: Staying invested matters

Many investors get nervous and look to exit the equity markets during periods of volatility. However, research shows that the results of doing so are less than optimal. A study by Fidelity evaluated a hypothetical portfolio of a $10,000 investment in an S&P 500 index fund from 1980 to June 2018. Simply missing the five best days while otherwise fully invested drops the overall return by 35%. The results only get worse as more good days are lost: Missing the 10 best days drops the return by more than 50%. The study tracks a 38-year period, or roughly 10,000 days of stock trading. Trying to time the market without missing the top five days requires surgical precision, to say the least. As you can probably sense, we're not keen on market-timing – evidence suggests that it just doesn't work. A far better course would be to stay in the market with the knowledge that volatility is normal, and that missed upside can dramatically cut into the long-term returns required to maintain your individual goals.

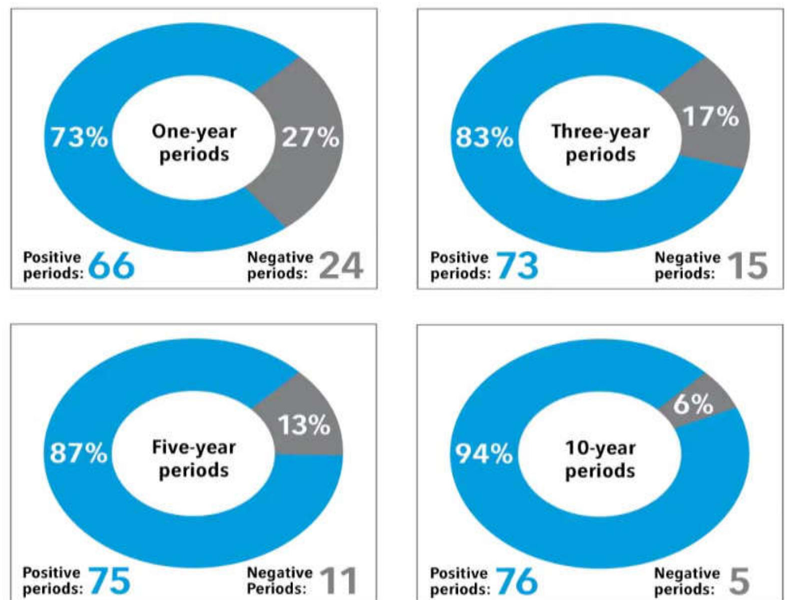


Past performance is not a guarantee of future results. The hypothetical example assumes an investment that tracks the returns of the S&P 500 Index and includes dividend reinvestment but does not reflect the impact of taxes, which would lower these figures. There is volatility in the market and a sale at any point in time could result in a gain or loss. Your own investment experience will differ, including the possibility of losing money. You cannot invest directly in an index.

Source: FMR Co., Fidelity AART, as of 6/29/18.

Lesson #3: The risk of stock market losses diminishes over time

For long-term equity investors, the most powerful factor is time. An investor's time horizon is directly correlated with the likelihood that his or her portfolio will experience a positive return. A study by Capital Group looks at the past S&P 500 performance for the 90-year period from 1927 through 2017. The study found that one-year investments produced negative results more often than investments held for longer periods. If those short-term one-year investors had held on for just two more years, they would have only experienced about half as many negative periods. As the time period rose to 10 years, the study found 94% of 10-year periods generated positive returns. As you can see, staying the course is the most critical investment strategy for long-term investors.



Sources: Thomson Reuters and S&P 500

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Conclusion

The famous motivational slogan "Keep Calm and Carry On" was produced by the British Government in 1939 in preparation for World War II. It was intended to raise the morale of the public as citizens faced threats of mass air attacks. While we are not facing war, investing during periods of volatility can certainly cause us to lose our calm. Today's investors are subject to a daily barrage of negative headlines and it is equally important to keep calm and carry on with decisions relating to one's investment portfolio. When emotions and investing cross paths, it can lead to costly decisions in the long run. It's critical that investors look beyond volatility, focus on their financial goals and time horizons, and, most importantly, identify their appropriate tolerance for risk to remain invested.

The Standard & Poor's 500, often abbreviated as the S&P 500, or just the S&P, is an American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. All indexes are unmanaged and an individual cannot invest directly in an index. Index returns do not include fees or expenses.

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