ADVISER
INVESTMENTS

SPECIAL REPORT

The 5 Steps to Thriving in Volatile Markets

Whenever the U.S. stock market hits a rough patch, it's hard to escape the relentless reports of doom and gloom. Turn on the television or radio, or surf the web and you're confronted with worrisome headlines that bemoan every dip and dive in the markets. The constant drone of bad news, stoked by an endless 24-hour news cycle, creates a high level of worry and anxiety that is simply hard to withstand. Right now, those worries are in overdrive thanks to the coronavirus.

Once such force-fed fear sets in, it's natural to want to sell your investments that are declining in value and park your portfolio in "risk-free" money markets. But if you pull out of stocks when they are falling, you put yourself in the crosshairs of another risk—being left behind when the markets inevitably rebound.

At Adviser Investments, we recognize that sitting tight and "staying the course" is far easier said than done. We also know that learning how to manage your emotions in rough markets is the key to long-term success. We want to share evidence that will help you practice one of the most important investing rules: Patience, not panic, wins the day.

We have distilled our philosophy for navigating rough markets into five key steps. Knowing how wealth is created over the long term will give you the confidence and insight to make wise decisions during periods of market volatility.

STEP 1

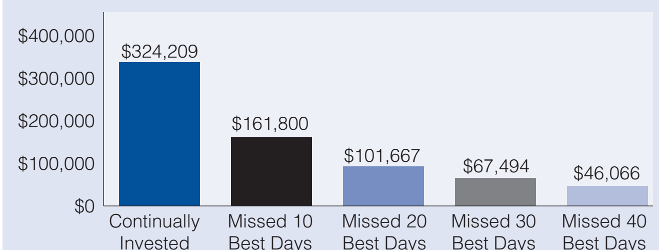
Time in the Market, Not Market-Timing®

In a perfect world, we would all possess a crystal ball that would tell us when to get out of stocks before a market correction, and when to buy stocks ahead of a bull run. Unfortunately, no such mechanism exists. Sure, there's always someone out there who manages to make one nice market call. But the problem is that one right move isn't enough. Even if you manage to make the right call and exit the stock market before a major decline, your work is just half done. You need to get your money back into the stock market before the next rebound if you want a shot at inflation-beating gains. It is hard enough to make one right market call; making two is even more difficult.

In the 40 years through 2019, the S&P 500 stock index had an annualized gain of 12.0%. Yet, the average stock fund investor earned returns significantly less than that. Investors' main weakness? Bad timing that kept them out of the market for just a few critical days here and there.

It takes very few missed days to sabotage a portfolio. As the chart below illustrates, being out of the market for the 10 best days over the past 20 years resulted in a return that was more than 50% less than the gain from staying fully invested during that stretch. Those that missed greater numbers of the best days saw their returns suffer even more. That's one of the reasons why Adviser Investments believes in time in the market, not market timing. We are confident that by remain-

Missing the S&P 500's Best Days (2000–2019)
Hypothetical value of $100,000 invested in the S&P 500 index



Data Source: Morningstar, YCharts; Analysis: Adviser Investments.

ing patiently invested in tough times we keep our portfolios positioned to do well when the markets do well.

STEP 2

Stick With Stocks

When stocks hit a down period, the safety of bank certificates of deposit (CDs) and money market accounts look more attractive. Who wouldn't prefer having their money in cash investments where there is virtually no risk?

That's why Adviser Investments recommends you keep a portion of your assets in cash. This way, you know you will always have a backup fund to cover emergencies or unexpected expenses. But beyond your emergency stash, having too much cash in your long-term investment portfolio can hurt returns. It also adds another kind of risk: Historically, cash has failed to keep pace with inflation.

DESPITE PERIODS OF MAJOR DECLINES DURING THE LAST 40 YEARS, THE S&P 500 GAINED 12.0% A YEAR

Over the past 40 years, the average annualized gain of a 3-month U.S. Treasury bill—a good proxy for cash—was just one percentage point more than the 3.3% rate of inflation. And that's before taking taxes into account. Assuming that you paid a 22% tax on your income, that 4.3% return falls to 3.4%—putting you just 0.1% ahead of inflation on an annualized basis. At the top federal tax rate of 37%, you would have actually fallen *behind* inflation each year.

Roaring Back: S&P 500 Bear-Market Recoveries Since 1957

Start Date	End Date	Total Loss	3 Years Later: Cum. Change
Jul. 1957	Oct. 1957	-21%	39%
Dec. 1961	Jun. 1962	-28%	83%
Feb. 1966	Oct. 1966	-22%	27%
Nov. 1968	May 1970	-36%	56%
Jan. 1973	Oct. 1974	-48%	55%
Nov. 1980	Aug. 1982	-27%	83%
Aug. 1987	Dec. 1987	-34%	46%
Mar. 2000	Dec. 2002	-49%	54%
Oct. 2007	Mar. 2009	-57%	103%

Source: Standard & Poor's.

If you want to generate inflation-beating returns (typically the goal for most investors), cash is not the answer. Stocks are still your best bet. Over long periods, stocks have produced returns more than double those earned by cash. Moreover, current tax law levies a top capital gains tax rate of 20% on investments held more than one year. For high-income investors, that's a lot better than the 37% tax charged on the interest from money market or short-term bond holdings.

Now of course we all know that stocks do not go up every year. There are months, and even years in which stocks lose value.

Still, remember that despite periods of major declines during the past 40 years, the S&P 500's long-term annualized gain was 12.0%. If you managed to sit tight throughout the volatile markets, you were rewarded with an annualized gain that significantly outpaced inflation and cash.

That's why Adviser Investments believes stock funds are a critical component in the portfolios we build to help our clients meet their long-term investing goals.

STEP 3

Diversify Your Holdings

Adviser Investments' confidence in stocks over the long term stems from our core discipline of managing market risk. Reducing losses by actively managing risk improves long-term performance for our clients.

We recognize that we can't avoid losses entirely. But our goal is to keep losses within a reasonable framework so that when markets rebound, we recover those losses quicker, moving on to further gains ahead of broad-based market indexes.

We like to say that there is tyranny in the mathematics of loss: Lose 10% and you need only an 11% gain to get even; lose 20% and you need a 25% gain. But lose 50%, as the S&P 500 index did during the 2007–2009 bear market, and you need to double your remaining assets to get back to where you were. It took the index, with dividends reinvested, almost four years to recover the losses suffered in the 2007–2009 bear market.

WHAT IS DIVERSIFICATION?

Diversification is at the heart of successful risk management. The basic premise is to build a portfolio to include a variety of different assets that react differently to market conditions.

When one piece of the portfolio pie is faltering, another piece may be holding on better, or even gaining ground.

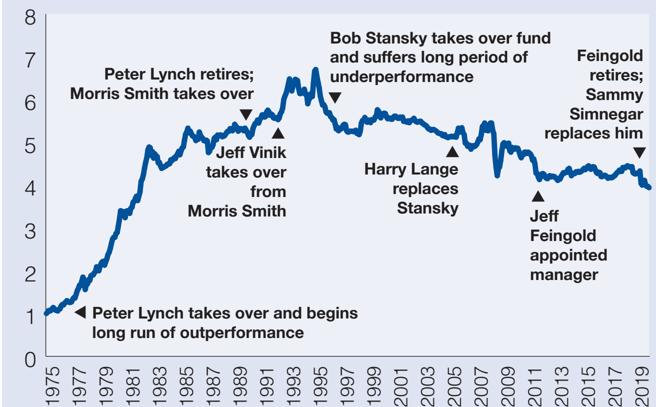
Adviser Investments employs a variety of diversification tools to manage portfolio risk:

Asset Diversification: While stocks offer the best long-term prospects for inflation-beating gains, adding bonds to a portfolio can decrease the overall volatility of your portfolio without greatly reducing return.

- **A 100% stock portfolio** gained 12.0% on an annualized basis over the 40 years through 2019; during that stretch there were seven years where the portfolio lost value. The worst calendar-year drop was a 37.0% loss.
- **A portfolio that invested 80%** in stocks and 20% in bonds posted an 11.2% annualized return. In seven down years, the single worst annual loss was a 28.6% decline.
- **Increasing the bond portion** to 30% (70% stocks) produced a 10.8% annual return and in six down years, the worst year was a 24.3% loss.

Magellan vs. S&P 500

When line is rising, Magellan is outperforming



Note: When line is rising, Magellan is outperforming the index. Presented for informational purposes only; not a recommendation to buy, sell or hold any investment product. Sources: Morningstar, YCharts.

Geographic Diversification: Fewer than half of the public stocks traded worldwide are based in the U.S. Moreover, the U.S. economy does not move in lockstep with foreign economies; when there is a recession here, a foreign economy—and its markets—may be doing quite well. Investing around the globe gives your portfolio exposure to stocks and economies beyond the United States.

Style, Size and Market-Segment Diversification: References to a singular "market" belie the fact that the stock and bond markets are in fact comprised of many distinct parts that do not move in sync with one another. Growth stocks behave differently from value stocks. Large-cap stocks and small-cap stocks each have their own characteristics. Each stock falls into one of dozens of industry and sector classifications; each industry reacts differently to market and economic conditions. Within the bond universe, investment choices vary by issuer (federal government, municipal, corporate), maturity (short-term, medium-term and long-term) and credit quality (investment-grade to junk). Spreading a portfolio among the different segments of the stock and bond markets provides more diversification than a portfolio focused on just one or two areas.

STEP 4

Buy the Manager, Not the Fund®

Making money in bull markets is relatively easy. Making money over an entire economic cycle of both up and down markets tests every manager's talent. Adviser Investments invests with managers who have a proven record of producing strong risk-adjusted performance over a full market cycle.

Our emphasis on the manager, not the fund, is so fundamental to our investment philosophy that we trademarked it! As you know, managers come and go from a fund—just look at the record for Fidelity Magellan above.

Adviser Investments' research team scrutinizes managers' track records across funds over their careers. This takes much of the guesswork out of buying funds or finding the best substitute for a closed fund.

Eating Our Own Cooking

The principals at Adviser Investments (and their families) invest their liquid assets alongside our clients—in fact, we manage more than 100 portfolios for friends and family members. Our 401(k) plan, which is available to all employees, also invests in many of the same funds we purchase for our clients.

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We also personally interview fund managers so we can get a solid sense of their investment philosophy. It is always a plus when we find a manager who has some of his or her own money invested in the fund. When managers are also fund shareholders, it gives us extra confidence that they are highly motivated to do well.

STEP 5

Find an Investment Adviser Who Listens to You

The challenge in volatile markets is to resist the urge to make portfolio decisions that calm your nerves in the short-term but prohibit you from achieving your long-term objectives. That's where an independent, fee-only investment adviser that gets paid to provide advice that is in your best interest—not to sell you something new—can provide tremendous value.

Being able to pick up the phone or send an email to share your concerns and get professional advice is one of the best remedies for remaining informed and calm while others are overreacting to a falling stock market.

A telltale sign of a quality adviser is a talent for listening. A good adviser doesn't automatically tell you not to worry when the markets are falling or insult you with cookie-cutter advice. A top-notch adviser takes the time to find out exactly what you are worried about and then addresses your specific concerns.

Ideally, that two-way communication is the cornerstone of your relationship with an adviser, no matter what the current conditions of the markets are. It starts with the first conversation. You want to work with an adviser who wants to know about you and your life goals. That is the only way to devise, and stay with, an investment plan that best serves your specific needs.

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ADVISER INVESTMENTS IS *AN INVESTMENT ADVISER YOU CAN TALK TO.*® We are an independent, professional wealth management firm with expertise in actively managed mutual funds, ETFs, fixed-income investing, tactical strategies and financial planning. We advise more than 3,000 clients with over $5 billion under our care. Our team focuses on helping individual investors, trusts, foundations and institutions meet their long-term investment goals.

Our risk-aware investment approach and highly personalized client services are designed to help you expertly weather stormy markets with confidence.

*For more information, please contact Adviser Investments at **800-492-6868** or **info@adviserinvestments.com***

Sample portfolio returns in the "Asset Diversification" section of Step 3 use total returns of the S&P 500 index and Bloomberg Barclays U.S. Aggregate Bond index and are presented to illustrate the impact of holding bonds in a portfolio over time. Indexes cannot be invested in directly. Sample portfolios not intended as representative of actual client portfolios or returns; nor do they account for any fees associated with purchase or holding of investment products or advisory fees.

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