Financial Alternatives
integrated wealth management

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Quarterly Market Review Newsletter

Market returns around the world were strong in the second quarter and year to date. In addition to this newsletter be sure to read our Quarterly Market Review newsletter which contains both long and short-term investment return data from markets around the world. This quarter's market review newsletter also contains an interesting article about inflation.

This newsletter covers financial planning topics in April and October, and investment topics in January and July. In this issue we briefly discuss bull and bear markets as well as the cost and anxiety of trying to time the market.

Bull Markets vs Bear Markets

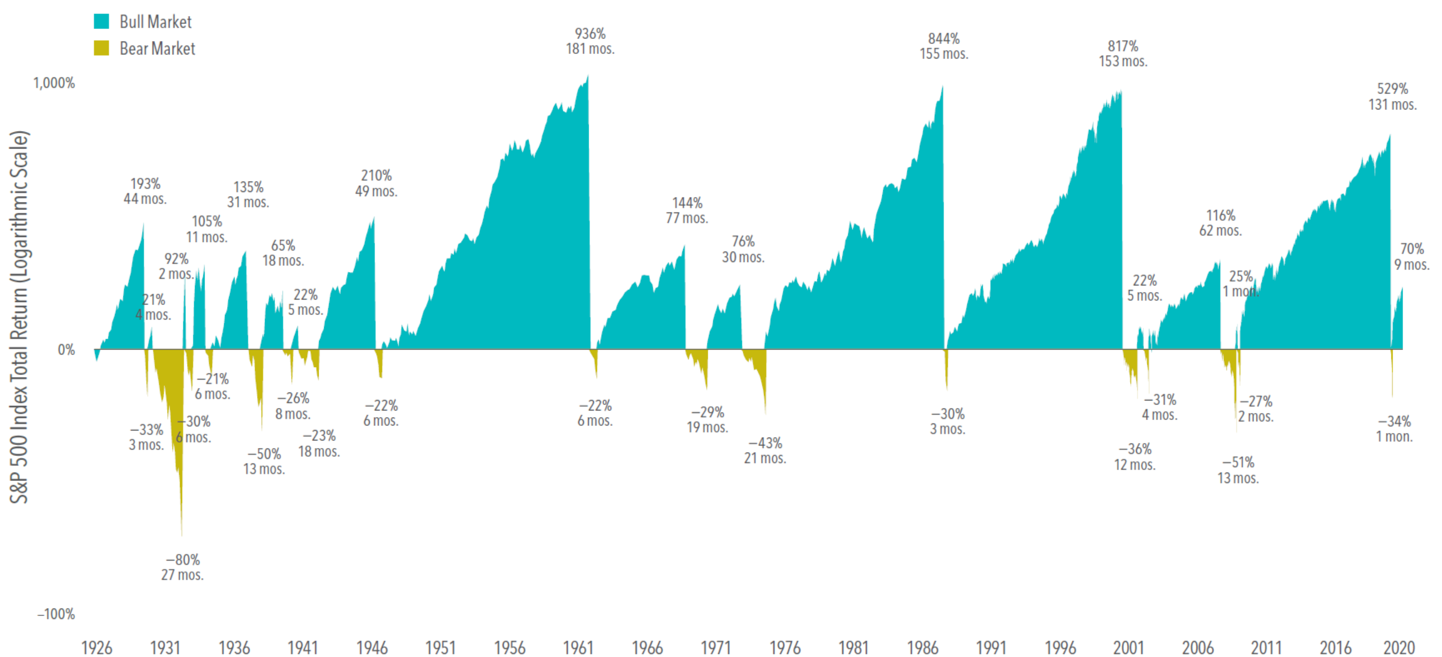
As the graph below illustrates, bull markets last much longer than bear markets. From 1926 through 2020 there were 18 bull markets or gains of at least 20% from a previous trough. They averaged 54 months in length, and advances ranged from 21% to 936%.

During this same period, the S&P 500 Index experienced 17 bear markets, or a fall of at least 20% from a

Executive Summary

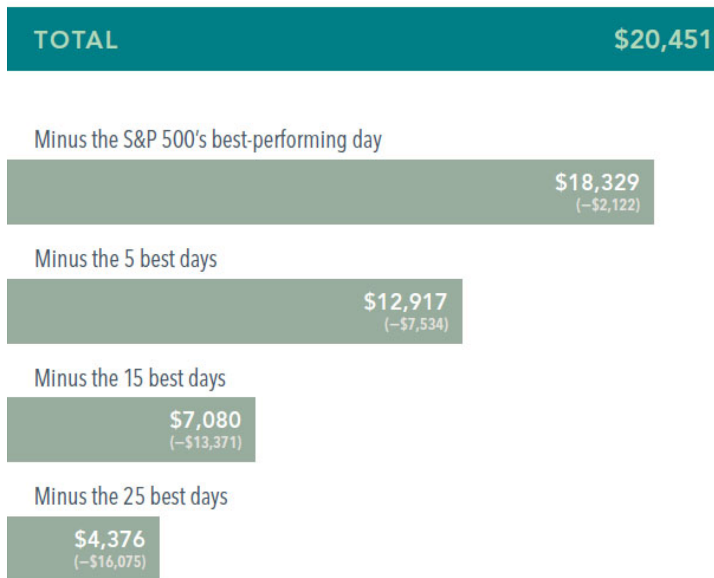
- Bear markets are a normal part of long-term investing.
- Understanding the history of bear markets and maintaining a long-term focus helps investors remain calm and take appropriate action during corrections.
- Bull markets have historically lasted much longer than bear markets.
- The desire to eliminate short-term losses tempts people to engage in market timing.
- Market timing is the attempt to own stocks when they are rising, sell them high before they fall, and buy them back at lower prices before they rise again.
- We have not seen a successful market timing strategy or fund deliver on its promise over the long term.
- Staying diversified and disciplined, avoiding market timing, and maintaining a long-term investment perspective is a better course of action.

S&P 500 INDEX TOTAL RETURNS
January 1926–December 2020



Source: Dimensional Funds, S&P

HYPOTHETICAL GROWTH OF $1,000
INVESTED IN US STOCKS IN 1990



Based on the total return of the S&P 500 Index from January 1, 1990, to December 31, 2020.

Source: Dimensional Fund Advisors

previous peak. The declines ranged from -21% to -80% across an average length of around 10 months. This translates into a bear market on average once every 5.5 years since 1926, or once every 6.5 years since 1961.

This graph helps investors see the big picture and illustrates that bear markets come and go and are shorter in duration than bull markets. But the problem with this graph is it tends to minimize the frequent drops of 5%, 10%, 15% or even 19% during bull market periods. These smaller "corrections", as they are called, cause just as much anxiety because investors never know how long the correction will last or whether it will turn into a severe bear market.

Unfortunately, all these smaller "corrections" are opportunities for investors to make the mistake of trying to time the market and sell their stock positions to avoid further losses. When you look more closely at the upward trending bull market parts of this graph, you will see many sawtooth edges that illustrate these "corrections" happening every couple of years. Investors are constantly tested to see if they are truly long-term investors.

Market Timing

If we did not have corrections and bear markets, nobody would try to time the market and investing would be easy. These often remarkable swings in stock market valuations are a part of long-term investing, and they will always cause anxiety for many investors. People often go to extremes to avoid anxiety, so it is a normal and natural reaction to want to stop the "bleeding" when you are losing money on your stock market related investments.

The only way to do this in the middle of a bear market is to remove or sell your stock positions. This would very likely relieve the anxiety temporarily - especially if the market continues to drop another 10% to 15% or more. The problem with this selling tactic is that many times a correction turns out to be minor; and it turns right around and races past the price the investor sold at.

This can lead to new anxiety about when to get back into the market and the cycle repeats itself. We would be strong proponents of market timing if there was a way to consistently get clients out of the market at a high point and back in at a lower point, but no such system exists. People claim to have formulas (we have seen many), and they often look good on paper or when back tested, but we have not seen anybody reliably implement this with clients or in investment vehicles.

The problem with market timing is that stock returns do not come in any sort of predictable pattern or range - they never have. The impact of missing just a few of the market's best days can be profound as the graph on this page illustrates. It shows that a $1,000 investment made in stocks of the S&P 500 index in 1990 would have been worth $20,451 at the end of 2020.

Now if this investor had missed only the best performing single day during this 30-year period, the investment value would have dropped to $18,329. Missing the five best days dropped the investment to $12,917, missing the 15 best days dropped it to $7,080 and missing the best 25 days dropped it all the way to $4,376!

Trying to actively time the market ends up being an expensive, anxiety-provoking proposition for most who try.

Rebalance Instead

As the graph on page one illustrates, bear markets and smaller corrections are a part of long-term investing. Make no mistake about it, there is usually one right around the corner. Although they are not to be feared they are not fun. It is never pleasant to see the value of your portfolio decline month after month sometimes for a year or more. In fact, it can be very unnerving to put it mildly.

One prudent course of action will be to rebalance your portfolio to take advantage of stock prices that are cheaper than they were before the bear market began. Discipline and fortitude are required to rebalance a portfolio after bear market losses.

If you are currently uncomfortable with the amount of your portfolio allocated to stocks, now is the time to discuss it with us – while the market is hitting all-time highs – not after we have entered a bear market. Please let us know if you would like to have this discussion.

Summary

Market returns have continued to be strong in the first half of 2021. For additional detail, be sure to read our Quarterly Market Review newsletter.

Bull markets have historically lasted much longer than bear markets, but the fact that investors do not know if smaller corrections will turn into larger bear market losses causes investor anxiety. This anxiety causes some investors to try to time the market to relieve their anxiety, which in turn often leads to subpar long-term results.

Instead, investors should expect the market corrections and bear markets that have long been a part of stock market investing, and prepare to rebalance during these times in order to take advantage of the lower prices caused by such markets.

This is always easier said than done, since one never knows how low the market will go and for how long it will stay down. Taking a longer-term view on the history of bull and bear markets can help investors to maintain their perspective and avoid making speculative market timing mistakes.

Discipline and diversification will remain critical to investment success. We are here to help you with both. If you would like to discuss your investments or any other aspect of your financial life in greater detail, please give us a call.

Past performance is no guarantee of future results. All content in this newsletter is intended as general information, not specific advice. Performance data listed is for illustrative purposes only. Portfolios are personalized and often consider many variables, including investment objectives, age, time horizon, risk tolerance, and tax variables. Information contained herein has been obtained from sources believed reliable, but not guaranteed.

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