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A QUARTERLY PUBLICATION OF SIENA WEALTH ADVISORS

Keep Calm And Step Forward

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Words from our colleague and nationally recognized author, Larry Swedroe:

2016's Grim Beginning

As you may already have observed, 2016 got off to a bad start for equity markets around the globe. In fact, for the S&P 500 Index, the first five trading days were the worst-ever start to a year, with a loss of 6%.

Combined with the weak performance of global equities in 2015, and all the geopolitical turmoil in the world, the stomachs of many investors started to rumble, especially upon hearing pronouncements from market "gurus" forecasting doom and gloom.

For example, *George Soros is predicting* a crisis similar to the one we had in 2008, with problems in China being the trigger. And it certainly doesn't help when respected investors such as Jeremy Grantham and Carl Icahn are proclaiming that the market is vastly overvalued.

Over the 20 years that I've been providing investment advice, I've learned that when we have situations like the one we're in now, *many investors begin to "catastrophize."* They begin to focus solely on the negative news—such as ignoring the 292,000 increase in employment, along with an upward revision of

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50,000 to the prior month's gains, reported on the fifth day of trading in 2016. These investors begin to anticipate everything that could possibly go wrong, and end up in a loop of worry and anxiety that leads at best to indecisiveness and at worst to panicked selling.

Just as when a kite starts to plunge earthward and the natural, panicky reaction is to yank backward on the lines, the natural, panicky reaction to a dive in your portfolio's value is to pull back (sell). In both cases, pulling back is the wrong strategy. The right strategy is the less intuitive one. It involves the choice to remain calm and step forward (actually buying stocks to rebalance your portfolio back to your desired asset allocation).

Buffett's Advice

Warren Buffett is probably the most highly regarded investor of our era. Read his statements carefully regarding efforts to time the market:

- "Inactivity strikes us as intelligent behavior."
- "The only value of stock forecasters is to make fortune-tellers look good."
- "We continue to make more money when snoring than when active."
- "Our stay-put behavior reflects our view that the stock market serves as a relocation center at which money is moved from the active to the patient."

And finally, Buffett recommends that if you simply cannot resist the temptation to time the market, then you "should try to be fearful when others are greedy and greedy only when others are fearful."

While it is tempting to believe that there are those who can predict bear markets and, therefore, sell before they arrive, there is no evidence of the persistent ability to do so. On the other hand, there is a large body of evidence suggesting that trying to time the markets is highly likely to lead to poor results.

For example, a study on the performance of 100 pension plans that engaged in tactical asset allocation (a fancy term for "market timing," allowing the purveyors of such strategies to charge high fees) found that not one single plan benefited from their efforts. That is an amazing result, as even random chance would lead us to expect at least some to benefit.

Avoiding Investment Depression

If you're prone to investment depression, one way to help avoid the downward spiral that many investors experience (which can lead to panicked selling) is to envision good outcomes.

To help you do just that, I have gone to my trusty videotape and come up with some data that should not only be of interest, but should also enable you to envision positive outcomes. My thanks to my colleague, Dan Campbell, for producing the data, which covers the 89-year period from 1926 through 2014.

- There were 33 years (or 37% of them) in which the S&P 500 Index produced a loss during the first quarter. By the end of 18 of those years (or 55%), the S&P 500 had produced a gain. Of those 18 years, the highest return occurred in 1933, when the S&P 500 returned 54%. The best performance during the last three quarters in each of those years was also in 1933, when the S&P 500 returned 79.2%. The last time the first quarter ended in negative territory but full-year returns turned positive was just recently, when in 2009, the first quarter finished with a return of -11% and went on to recover for full-year gains of 26%.
- There were 31 years (or 35% of them) in which the S&P 500 Index produced a loss during the first six months. By the end of 11 of those years (or 35%), the S&P 500

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had produced a gain. Of those 11 years, the highest return occurred in 1982, when the S&P 500 returned 21.4%. The best performance over the last half in each of those years was also in 1982, when the S&P 500 returned 31.7%.

- There were 24 years (or 27% of them) in which the S&P 500 Index produced a loss during the first nine months. By the end of four of those years (or 17%), the S&P 500 had produced a gain. Of those four years, the highest return occurred in 1982, when the S&P 500 returned 4.0%. The best performance over the last quarter in each of those years occurred just recently, when in 2011, the S&P 500 returned 11.8% over the last three months.

Summary

Warren Buffett has accurately stated that "investing is simple, but not easy." The simple part is that the winning strategy is to act like the lowly postage stamp, which adheres to its letter until it reaches its destination. Similarly, investors should stick to their asset allocation until they reach their financial goals.

The reason investing is hard is that it can be difficult for many individuals to control their emotions (greed and envy in bull markets, and fear and panic in bear markets). In fact, I've come to believe that bear markets are the mechanism by which assets are transferred from those with weak stomachs and without an investment plan to those with well-thought-out plans—meaning they anticipate bear markets—and the discipline to follow those plans.

A necessary condition for staying disciplined is to have a plan to which you can adhere. But that's not sufficient. The sufficient condition is that you must be sure your plan avoids taking more risk than you have the ability, willingness and need to take. If you exceed any of those, you just might find your stomach taking over. The bottom line: If you don't have a plan, develop one. If you do have one, and it's well-thought-out, stick to it.

Market Returns During Election Years

Market returns reflect the aggregate expectations of market participants. Their various risk aversion, investors' tastes and preferences, and expectations about future profits are a few inputs that affect aggregate expectations. Election years are filled with uncertainty, adding more inputs into the expectations of market participants. Who will be the next president? How will his or her views affect business, taxes, and policy? What can we expect of market returns during election years?

The long and short answer; it's difficult to find a systematic return pattern in the data during election years. Market expectations of election outcomes are embedded into security prices. However, based on the research, market returns have been positive in both election years and the year following an election year on average. One might expect these election expectations to affect the US stock markets more so than international, emerging, or US bond markets. An evidence-based investor knows not to follow what they might expect, but rather what the academic research proves. In addition, a prudent,

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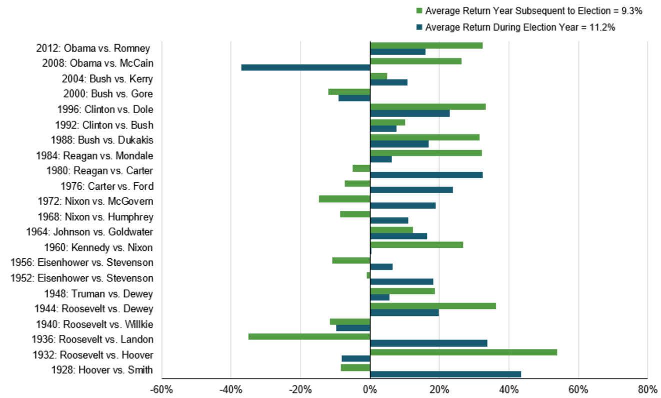
evidence-based investor knows that they invest in a globally diversified portfolio of asset classes. Thus, it's important to not only focus on one stock market index such as the S&P 500, but rather break down the affects of presidential election across various asset classes.

U.S Large-Cap: S&P 500 Index

Returns During and After Election Years

S&P 500 Index: 1928–2013

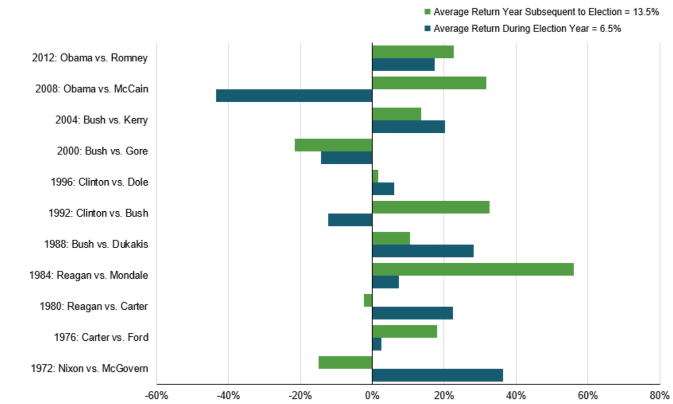


Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. Actual returns may be lower. Source: The S&P data is provided by Standard & Poor's Index Services Group.

International Developed Markets: MSCI EAFE Index

Returns During and After Election Years

MSCI EAFE Index: 1972–2013



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The US stock market often performed better in election years on average than the other asset classes. Would you have guessed that outcome? Although January has been a rough start for 2016, this research gives us yet another reason why trying to time short term market fluctuations is often a mistake. Investor's should follow a long-term plan based on academic research.

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