These are the times……to remain disciplined

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These are certainly troubling times, but here is a brief video from DFA that I think brings a bit of perspective about the importance of staying calm. Additionally, here is a recent article from Vanguard concerning markets and covid-19 that you might find useful.

To give some long-term return/volatility perspective, below is a chart of the S&P500 (using the Vanguard Admiral S&P500 Fund since inception with dividends reinvested) which shows the growth of $10k since August 31, 1976. Over this time period there were market pullbacks and concerns of differing variety (I have just highlighted some major ones from the recent past), but publicly traded companies continued to produce earnings and profits which is ultimately the underpinning of stock value. This time is really no different. Though there may be a hiccup in corporate earnings (which ultimately drives stock prices), this event will cause companies to seek new ways of conducting business (e.g., many employees are telecommuting that never did before) and many of these trials will lead toward leaner and more efficient operations and higher productivity across the board.

Source: Morningstar

What *is* different is that this event not only caused our portfolios to lose value (because investors have re-evaluated future corporate earnings), it also has brought concerns about our health and that of our loved ones; while the "madness of crowds" has left shelves empty, further heightening our sense of anxious panic. Whoever would have predicted the hot commodity during a pandemic would be toilet paper?!? It is certainly excusable for people to want to do SOMETHING during such times! It's only natural. What we must contain, however, is wanting to do something rash with our investment portfolio.

You might recall from past discussions that when it comes to portfolio management there are only 4 things you can control. Those are:

1. Diversification/allocation
2. Minimizing taxes
3. Minimizing costs
4. **Remain disciplined**

Staying disciplined is incredibly difficult. As markets are rising and those around us are seemingly getting rich it's hard to hold back the urge to increase our stock allocation, while as markets fall it's hard to maintain them. It's simply not natural to stay put during times of crisis (after all, it's totally understandable for someone to run away from a burning building and not toward it), but this is not how proper portfolio management works. Come what may, you must remain disciplined during both up and down markets.

Below is a slide from a DFA presentation which you are sure to recognize. Over and over again investors seem to commit the same mistakes. As the market cycle brings new highs investors tend to get comfortable and pile into stocks (even though they have become more expensive). The market then turns downward causing investors to become nervous. The market then goes quite low and investors get fearful and bail out of stocks (even though they are more of a bargain). Rinse and repeat. Instead of staying the course most individual investors "skate to where the puck was" and get clobbered by those more disciplined. It seems many individuals are now entering the "fear phase".

Many Investors Follow Their Emotions

People may struggle to separate their emotions from their investment decisions.

Following a reactive cycle of excessive optimism and fear may lead to poor decisions at the worst times.

So why has "The Market" gone down? The answer is quite simple: Institutional investors collectively agree that the future profitability of companies will go down. Why has the market been so erratic? This is also an easy answer: As new information arrives institutional investors collectively reassess future profitability. As things begin to look either better or worse the institutional investors react immediately and this is reflected in the second by second valuation changes. This valuation whipsaw phenomenon is simply the trade-off we get for having extremely liquid markets (unlike real estate, for instance, which is only priced upon the sale of a particular property). To put the liquidity into perspective, buyers for your stock holdings can be found in under a second (!!); while it might take weeks or even months to sell a piece of real estate. Simply put, if The Market didn't pull back with news of the pandemic something in the system would be broken.

So, what do we do? I could go into various strategies to either bet against institutional investors (you will not outguess these professionals unless you are abundantly lucky) or hedge by buying, for instance, Puts (which over time will be very expensive and a losing strategy); but I'll spare you. The best strategy is to assume a broadly diversified portfolio of stocks and (high quality) bonds and *stay the course*. Otherwise you are nearly

certain to have a less rewarding (and probably more painful) investment experience over the long term. After all, if one sells thinking the market will go down, they then need to precisely define the trigger for eventual re-entry into the market….and must also have a trigger for re-entry if they were wrong. In reality the best time to "buy the market" is when things look at their worst, but exceedingly rare is the individual investor with the courage to do this.

At the end of the day market timing is an act of futility which brings us back to the 4 things we can control. Come what may in the markets, adhering to the "4 things" has and will continue to pay off for investors. Depending upon the era in which they live the adherence has produced different outcomes, but all outcomes are optimized considering the era in which they existed. Simply put, nothing is guaranteed (except death and taxes) but we can optimize our situation given the hand we happen to be dealt.

As Thomas Paine wrote in perhaps more uncertain times, "THESE are the times that try men's souls." Throughout my career I've talked with clients about past stock market episodes (both up and down) and the importance of stock/bond mix and remaining disciplined regardless of what may come. During more stable times I am generally met with an abundance of confidence, but when we actually enter either a really good or bad time we find out who can really stay the course.

When markets experience sudden and violent shocks, almost without fail there's talk of how "it's different this time". Fundamentally, it isn't. We will make it through this episode, company profits will normalize, companies will find new and more efficient ways of conducting business, and markets will eventually resume their march upward.

Make no mistake, there *will* be an uptick in company failures; but this is why we own over 10,000 companies. There *will* also be bond defaults, but this is why we sacrificed higher-yielding lower-quality bonds for lower-yielding higher-quality ones. In essence, we knew rough seas would occur at some point and this is why we built our portfolios as we have. Afterall, if it was possible to time the market why would we hold bonds at all? Why would we hold thousands of different companies around the globe? Now that seas have gotten rough, we must stay the course come what may because not doing so would expose us to many *other* risks. Know that things will eventually normalize and companies will emerge more efficient than ever. Staying the course will keep you from missing that opportunity.

In the meantime, keep yourself and your loved ones healthy! Follow hygiene and social distancing guidelines laid out by health authorities. Use this opportunity to reflect upon your own disaster preparedness (we do live in an earthquake zone!!!) and determine whether or not you were adequately prepared this time around.