ENRICHING YOUR CROSS-BORDER LIFESTYLE

June 30th 2015

# REVIEW OF THE SECOND QUARTER

## <u>Investing During Troubled Times</u>

Recently, developments in Greece that have been brewing for years seem to be boiling over. China's stock market has become frothy after dramatic increases over the past year. It is difficult to remain committed to a long-term investment strategy with so much uncertainty.

If we look back at the past six years we see a long time period where markets have risen. But memories are short. We don't readily recall the periods during that time when doubts hit the financial markets and caused widespread concern like we have seen recently. There was a debt ceiling crisis, an Arab Spring and an Asian Tsunami, just to name a few. We don't remember these as causing historic financial havoc because they didn't cause a lengthy economic downturn.

We do, however, recall periods of significant loss, like the Great Recession of 2008. It is instructive to look at how long-term investors fared during this time and other recent downturns, because they help inform us about the possibilities in the future.

<u>A Stock Market History Lesson</u>
We have had several market downturns in the past 30 years but three really stand out from the crowd as notable. These periods were the crash of 1987, the "tech wreck" of 2000-2002, and the Great Recession of 2008.

In October 1987 the stock market went down over 20% on one day. This day is now known as Black Monday. But the market was up higher at the end of the year than where it started the year! After that event, guardrails were put in place so that large losses automatically shut down US stock markets to give investors and traders an opportunity to breathe instead of heading straight down.

The second time period was the tech wreck of 2000-2002. In the late 1990s the stock market was on an upward trajectory so strong people called it a "new era" in investing. Companies that simply added a ".com" onto their name jumped up in value overnight. Credible professional investors appeared on financial news networks and talked about a new era of investing. Anyone that tried to explain traditional valuation measures like price-to-earnings and book value were laughed at because they just didn't understand that these new companies were being judged by entirely new metrics like "clicks" – (clicks measured traffic to the company website.)

The S&P 500 reached a high of 1,527 on March 24, 2000. This signaled the end of the tech upswing. The market then took a two and a half year downturn, eventually reaching a low of 777 on October 9, 2002.

The next five years saw a strong rebound as investors realized that even in the new era, companies that actually had earnings and not just clicks should be worth something. The S&P 500 stock index reached its next peak exactly five years later on October 9, 2007. The new high was 1,565. It took five years to get back to roughly the same level it was at the height of the tech rally in March of 2000.

Then the stock market again took a downturn, which everyone still remembers as the Great Recession of 2008. In this case the market dropped from its high of 1,565 on October 9, 2007 to a low of 677 in March of 2009. At that point we were even lower than where we were at the end of the "tech wreck" in 2002.

But then the market started up again and has generally had strong performance for the past six years. On June 30, 2015, the S&P 500 closed at 2,063, considerably higher than either of the other two highs of the recent past.

Investors who reduced exposure to risky assets during 2008 and early 2009 did not reap the benefit of one of the strongest bull markets of all time (2009-2015). So investors that got out of stocks after the drop were considerably worse off than investors that kept true to their long-term allocation. In an ideal world investors would be able to time their exit to be at the top but it rarely works that way. Investors only become pessimistic after a long drop and there is strong evidence that investors' timing decisions do more harm than good.

The shorter term picture is also full of times when it looked like the market was going to drop, only to do a head fake, and continue to rise. If you had been so uncomfortable with the stock market that you stayed in cash for the past six years, you would have missed out on a 200% return in the stock market! (The S&P 500 advanced 205% from its low on March 9, 2009 to its value on June 30, 2015 per JP Morgan Guide to Markets, June 30, 2015 and that doesn't even include dividends!)

<u>Diversified Portfolio Returns</u>

The last few paragraphs just took you through a roller-coaster ride of recent stock market performance. But the real question is … How have diversified portfolios fared through these recent market downturns?

Diversified portfolios that have stayed the course during times of market stress have generally done better than the average investor that has tried to get in and out of markets at the right time. A graph we reviewed with many investors earlier this year looked at "The Market's Response to Crisis." This graph looked at the returns of a portfolio constructed with market indices. It showed the compound return of the portfolio during periods of time of 1 year, 3 years, and 5 years after crises. We have included this graph on the next page.

What this simple graph shows is that even in the worst market events of the most recent 30 years, the diversified portfolio was up 44% or more after five years!

The message here is not that you shouldn't be concerned about your investment portfolio. The message is that by keeping invested in a long-term strategic allocation, you are more likely to have a successful investing experience than if you stay in cash or time markets.

This is how we invest for clients. We choose asset classes wisely, and construct portfolios with a long-term outlook. This approach has served investors well over time.

Sincerely yours,

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