

## INSIGHTS

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### CHANGE DOESN'T MEAN GO A DIFFERENT DIRECTION

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Change is a constant in life and it is no different in the investment world. Fluctuations create opportunities in our markets as well as risks. Some of the evolution can be attributed to advancements in technology. This particular change, increasing the immediacy of information, helps bring the ever-evolving economy and markets to the forefront of our lives, and with it more volatility, shifting our attitude, expectations, and our approach to managing our wealth. Some of these variations require that things be viewed through a different lens altogether and encourage a more diversified global allocation in a portfolio.

One of the primary sources of change, as a society, is that the developed world is more and more dependent on other countries to help produce the goods we use on a daily basis. As a result, global markets have become highly interconnected and more volatile than ever before. That does not mean we should lose sight of the fundamentals of investing. The desire to try to catch the next big investment trend and allocate assets accordingly is virtually impossible to accomplish consistently. It simply means that we need to enhance our diversification and keep a watchful eye on this ever-changing landscape. Short sightedness and emotion continue to make irrational companions in investing.

This constant volatility, however, has encouraged investors to expect returns in dramatically shortened time frames. Instant information has resulted in investors reacting more quickly and in a purely emotional fashion to intense short-term moves in the market more than ever. This immediate expectation for information and answers more often creates a desire to change direction when things aren't gaining ground. The faster information travels, the faster it seems assets are traded. That is not in an investor's best interest.

Holding firm to an investment discipline is imperative to a portfolio's long-term return. The average holding period of a stock in the US today is roughly 1.8 years. Two decades ago, that same period was over 8 years. This is not to say that one's asset selection will not change over time. In reality, it is simply the ability to stick with a disciplined allocation through rebalancing so it delivers the greatest benefit. Asset selection is just one part of that discipline.

Another modification adopted by many investors is the idea that their position along the risk spectrum (from conservative to aggressive) is largely based on their age and time horizon. A more important factor is risk tolerance (whether that is financial or emotional risk). There are plenty of retirees that desire the risk of an all equity portfolio. In contrast, plenty of young investors can't stomach the thought of their portfolio declining in value at all. Too often, investors use the generic age-based approach to allocation. Each person has a unique set of circumstances—risk tolerance, time horizon, income needs—which should help define goals, and, in turn, those goals should be the driving factor in determining an asset allocation.

It has been proven that over the long term a more aggressive allocation historically reaps higher rewards in terms of returns. However, higher historical returns in more aggressive portfolios have had a much wider range of returns and, most importantly, have generated these returns through a discipline to stay the course in times of volatility. Too many investors have learned the hard way that their tolerance for a big loss in the short term was less than they thought, and they reallocate to a more conservative portfolio at these downturns. A conservative portfolio may have lower historical returns but with significantly less drawdown and volatility. For some, it's worth the lower return for a better night's rest. The reality remains, however, that many investors want all of the upside when markets are performing well—but none of the downside when they are not. We can all agree that is an unrealistic expectation. Making the decision to add to underperforming asset classes and selling outperforming asset classes—in an ongoing, disciplined attempt to rebalance—goes against the emotions of fear and greed that often drive the short-term markets. If we use our brains over our hearts and look at our portfolios as rebalancing guides, we can expect a more successful investment.

It is true that the long term is really just a series of short-term fluctuations, but it's how we react to these short-term changes that decide our ultimate fate. Reacting to these short-term changes by adjusting our allocation is detrimental to the long-term success of the portfolio. In other words, change in an asset allocation should not be a function of short-term market movements, but should be tied to the risk tolerance and long-term goals of the portfolio. Developing and maintaining the right long-term asset mix is by far the most important set of decisions an investor will ever make.

In summary, the change that we see in money management is in the how, where and why we invest—not in the fundamentals or the need to have a strict disciplined approach. Therefore, the development of a long-term strategic asset allocation plan is still imperative. Sticking to that plan during market changes often becomes the real challenge. Rebalancing forces us to do what we know we're supposed to do: buy low, sell high. Embrace technology and information, be diligent in your research, use the right strategy, and be aware that not all fluctuations in the markets need a refocus of your approach.

No matter how much our world changes, ultimately the basics of the economy do not, and we hold true to the following facts: markets move from emotions on the short run and turn back to fundamentals in the long run. In the end, maintaining risk-tolerant-appropriate allocations is the best way to generate healthy long-term returns.



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