Sharing our thoughts on the recent stock market volatility – November 2018

October has brought a return to volatility in the stock market. The S&P 500 is down 6.9%, representing the worst month since August 2011. Primary reasons for the October sell-off are fear of higher interest rates, expectations of slower global growth, uncertainty over US/China trade relations and political turmoil.

Keep calm and carry on

Investing is a long-term process, and our emotional instincts sometimes lead to poorly timed investment decisions, based on short-term market moves. Warren Buffett, one of the greatest investors of all time has told us to "be fearful when others are greedy and greedy when others are fearful". Our fight-or-flight instinct causes us to want to sell stocks after the market goes down. Alternatively, after stocks have a long winning streak we feel euphoric and don't want to miss out on further gains so we buy near the highs. Both of those emotional reactions lead us to break Mr. Buffett's good advice.

Dalbar Inc's research of investor behavior consistently shows that the average investor earns below market returns. Underperformance is caused by poor timing of buying or selling. Studies of mutual fund flows show that when stock markets go up, more money is invested and when stock markets go down money is withdrawn. We don't want to be the investors who act emotionally; we want to be the ones that follow Warren Buffet's advice.

The Stock Market rewards long-term investors

As you can see with the following chart, for the past hundred years the market has rewarded investors who stayed for the long run. The graph shows some ups and downs, as we just experienced in October yet after every downturn, the market not only came back but increased to a higher level.

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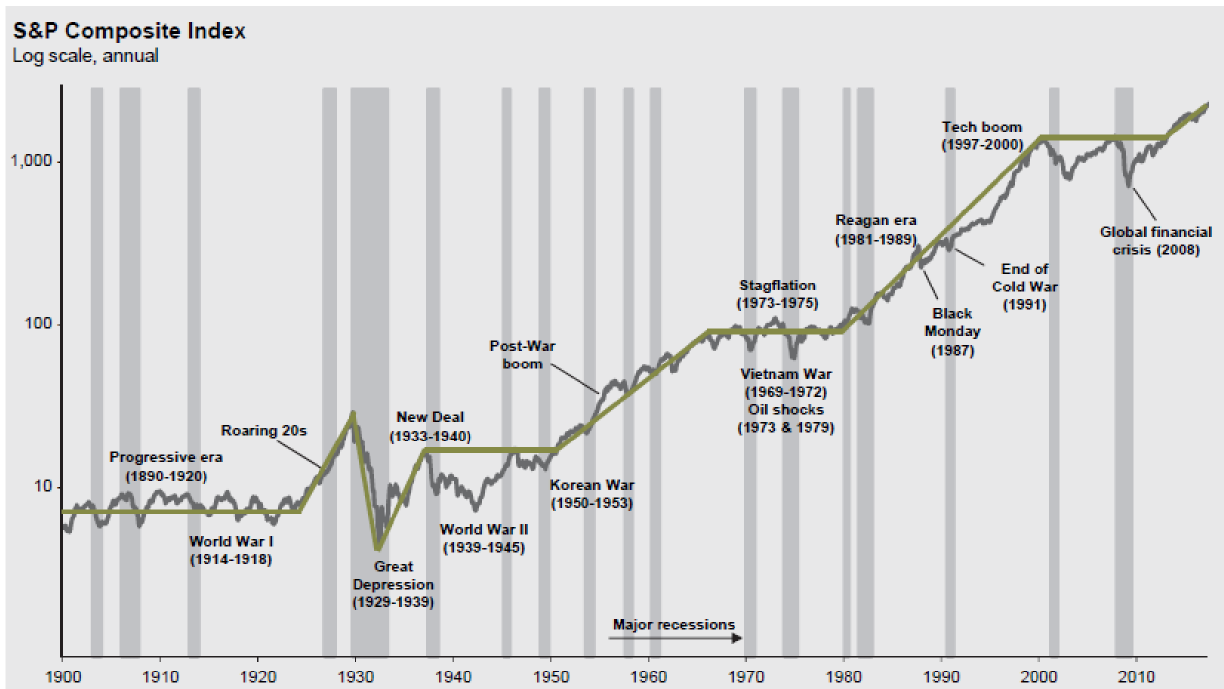

Source: FactSet, NBER, Robert Shiller, J.P. Morgan Asset Management.
Data shown in log scale to best illustrate long-term index patterns. Past performance is not indicative of future returns. Chart is for illustrative purposes only.
Guide to the Markets – U.S. Data are as of September 30, 2018.

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Our wealth does not grow in a straight line

In a balanced portfolio of stocks and bonds, every monthly statement will not show higher balances every time. That's because of volatility in stock and bond prices. As we saw in the previous chart, stocks reward long term investors and the path higher follows a jagged line – some months up and some months down. For us to be rewarded as investors over the long-run, we need to tolerate some month to month price fluctuations.

We like the following chart which shows a different view on stock market returns. The bars are S&P 500 returns per year while the red dots show the largest peak-to-trough drop in the market during the year. For example in 2016, even though the S&P 500 ended the year up 10%, there was a period during the year when the market dropped 11%. As you can see from the data which goes back to 1980, what we lived through in October is a normal level of volatility.

Here's our advice which we believe is appropriate at all times:

1.Have a plan which establishes your investment objectives

2.Set a diversified asset allocation to best meet those objectives

3.Look for returns over appropriate time frames and be patient even when our emotions tell us to act

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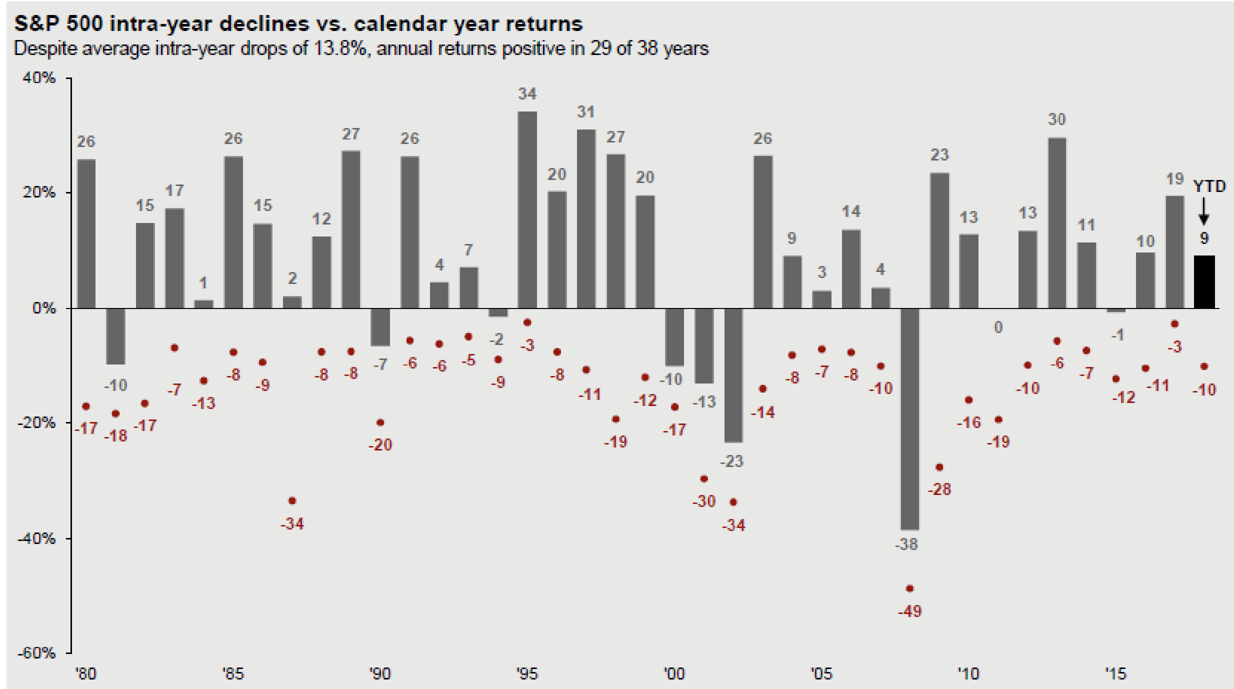

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2017, over which time period the average annual return was 8.8%.
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J.P.Morgan
Asset Management

Invest for the long run with the right portfolio allocation
With the advent of faster communication we can look at our mobile devices and see stock prices and portfolio values change instantaneously throughout the day. This causes our emotions to come into play more frequently, possibly making us conflate long term investment returns with daily stock prices. We all need to be mindful that the timeframe for investing is usually years and not days. Working together with our clients, we set an asset allocation which balances stocks, bonds and cash to fit your investment objectives. We would have a different allocation for a college savings fund for a high school senior than we would have for a couple in their early 50's saving for retirement. If life changes have impacted your investment objectives or you want to revisit your portfolio allocation, let's have a conversation. We want to make sure that we have the right plan in place so that you can meet your long term financial goals. We are always available for this or any conversation.

All the best from your Lucas Team,

Ralf, Rob, Brett, Bruce, Kathleen

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