



iA Wealth Research Insight

Stick with Your Plan and Keep Your Perspective

Keep calm and carry on

My team and I spend a good amount of our day monitoring the capital markets and keeping tabs on the professional money managers who run the mutual funds you support. These folks are paid to digest news and assess the ramifications, make adjustments to their financial models when appropriate, and change positioning within their funds when warranted. During times like these, when volatility becomes extreme and headlines are changing by the hour, money managers have one of the most challenging jobs around.

Our job, in some ways, becomes easier when market losses turn ugly because it allows us to focus on the tried and true messaging about maintaining a level head and focusing on long-term investment outcomes. These are anything but platitudes. There have been aggressive market selloffs before, we are in the midst of one now, and there will be many more in the future.

We aren't sure where the next days or weeks will take us, and no one can really provide complete certainty. What we are more certain about is that over the remaining time horizon of most investors, things will get better and a commitment to your investment plan is a superior approach to throwing in the towel when times get challenging for markets.

The goal of this piece is not to gloss over what we are experiencing in the markets right now – it has been painful and a lot of wealth has been destroyed. Rather, we want to offer a bit of a longer-term perspective with the hope that it will provide some relief for frayed nerves.

Outright capitulation when we witness day after day of substantial losses may feel like a catharsis, but panic selling is not a viable long-term investment strategy and more often than not leads to economically undesirable results as time passes.

What's happening

In a nutshell, we are witnessing a massive flight to quality and de-risking on the part of market participants as they attempt to complete the impossible task of discounting the economic and corporate earnings-related impacts of COVID-19. Markets had been declining rapidly since the last week of February

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and the selling hit a crescendo (at least for now) on March 9 as the S&P/TSX Composite plummeted 10.3%, marking the biggest one-day drop for the benchmark since October 1987. (Ironically, March 9 was the eleventh anniversary of the longest bull market in history.)

The historic decline in the price of oil, also on March 9 (the worst since the Gulf War in 1991) acted as fuel on the fire and escalated concerns about the state of credit markets. Credit market concerns fed into concerns around the state of the equity market and the whole thing became a downward spiral.

Recent Returns of Selected Market Benchmarks in CAD

Index	February 24 – March 10 Return	March 9 Return
S&P/TSX Composite	-16.0%	-10.3%
S&P 500	-9.9%	-6.3%
MSCI World	-10.8%	-5.9%
MSCI EAFE	-11.6%	-4.4%
FTSE Universe Index (XBB used as proxy)	2.6%	0.0%
Barclays High Yield Very Liquid Index	-2.6%	-2.7%

Source: Bloomberg

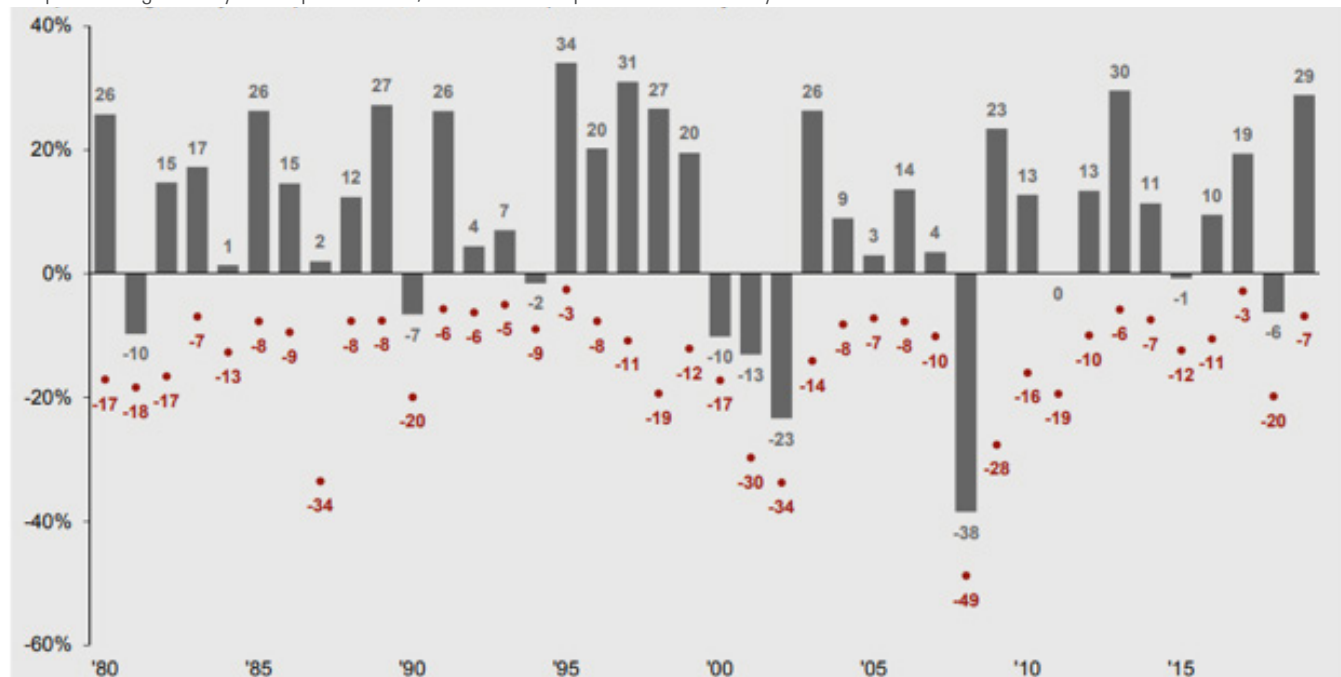
Volatility is normal

We must remember that volatility is a normal stock market dynamic. 2017 was a particularly unusual year for stocks due to the overall lack of volatility. After a pickup in 2018, volatility returned to abnormally low levels in 2019, as the S&P 500 didn't experience a single day with a loss in excess of 2%. The biggest drawdown for the index during the year was 7%, and the year-

end return for the benchmark was 29%. Markets had an almost uninterrupted winning streak from the beginning of October to the third week of February, so it is understandable that a bit of complacency entered investors' outlooks.

Chart 1: S&P 500 Intra-year declines vs, calendar year returns

Despite average intra-year drops of 13.8%, annual returns positive in 30 of 40 years



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management



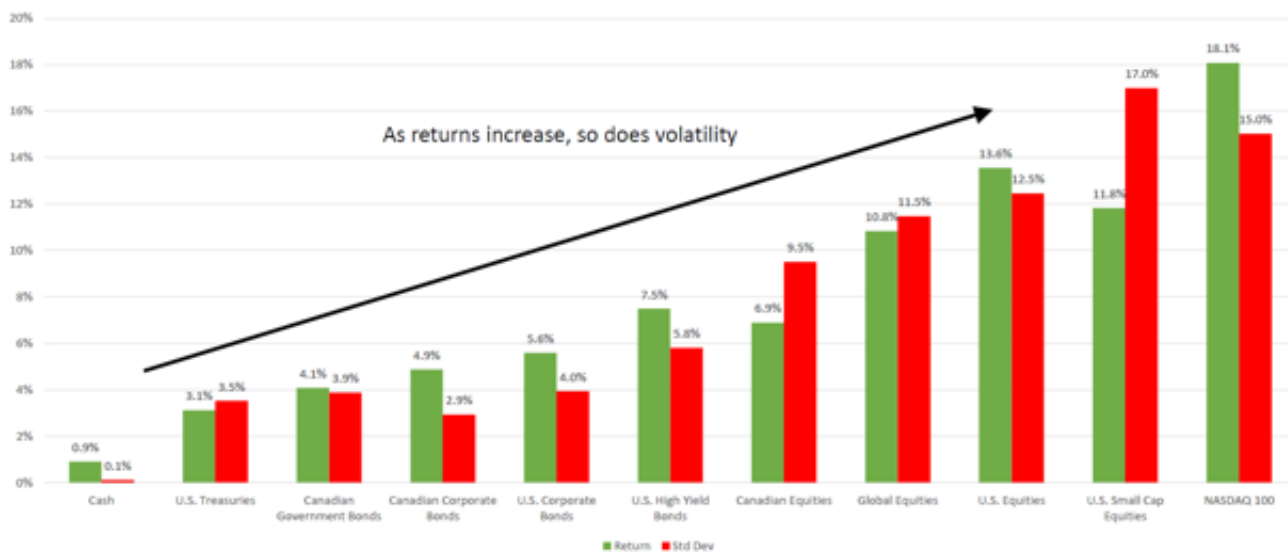
Volatility is back with a vengeance. The loss for the S&P 500 on March 9 alone was bigger than last year's maximum periodic drawdown. Then on March 10, the Dow Jones Industrial Average opened 800 points higher, it showed a midday loss of 150 points and closed the day nearly 1,200 points higher. We are still trying to find someone who can explain why things whipsawed so much.

The extraordinary volatility has been a rude wake-up call, but keep in mind that the average intra-year drawdown for the S&P 500 Index over the past 40 years was 13.8%,

and in 75% of those years, the index still managed a calendar year gain.

A higher level of volatility, with bouts that can sometimes be extreme, is an inherent trait of equity investing. In exchange for that volatility, however, comes the opportunity to participate in an asset class that has historically provided better returns than other asset classes. Chart 2 provides a sense of how various asset classes have performed, from a return and volatility standpoint, over the past decade.

Chart 2: Asset class returns & volatility – Trailing 10 years



Source: Morningstar, trailing 10 years as of December 31, 2019 using monthly returns. Returns are in base currency. Cash = FTSE Canada 91 Day Tbill; Canadian Corporate Bonds = FTSE Canada All Corp Bond; Canadian Government Bonds = FTSE Canada All Government Bond; US Treasury = Bloomberg Barclays US Treasury TR USD; U.S. High Yield Bonds; ICE Bank of America Merrill Lynch US High Yield TR USD; U.S. Corporate Bonds = ICE Bank of America Merrill Lynch US Corporate TR USD; Canadian Equities = S&P/TSX Composite; Global Equities = MSCI World; U.S. Equities = S&P 500 TR USD; NASDAQ 100 = NASDAQ 100 TR USD; U.S. Small Cap Equities = Russell 2000 TR USD.

What if the selloff gets worse?

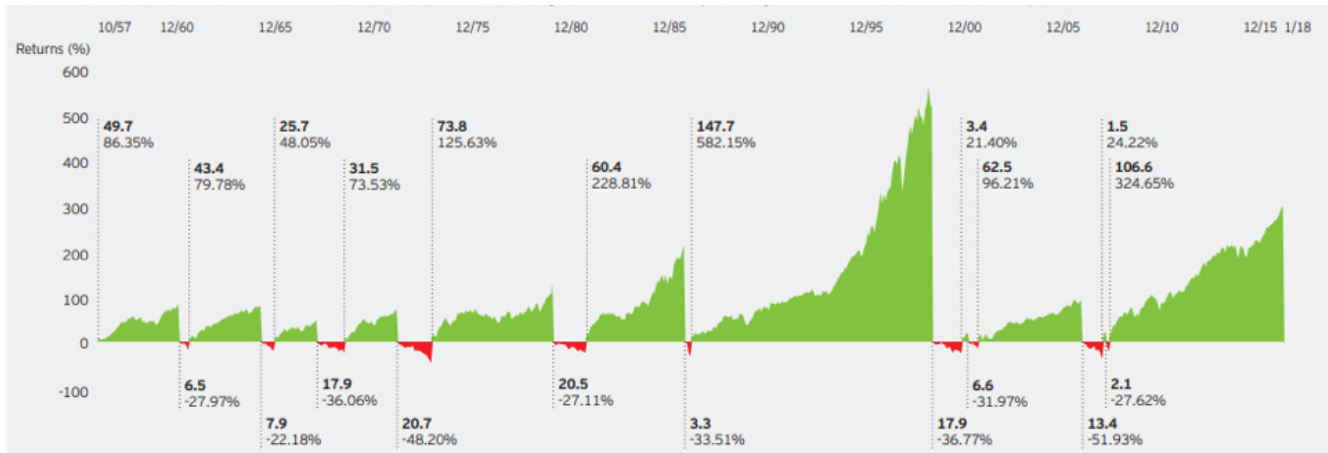
There are only a few certainties in this life: death, taxes and the fact that a bull market always follows a bear market. Perhaps that is of little consolation to investors dealing with losses, but it is the optimistic reality. A bear market is defined as a loss of 20% or more for stocks. As of market close on March 10, we were well on our way for the major North American indices. The problem with a bear market is that you never know how severe it will be, nor do you know how long it will last.

There have been 10 bear markets for the S&P 500 in the last 60 years or so, with the average slide being 34.3% and an average duration of close to 12 months. For perspective, the bull markets coming out of those downturns have averaged 55 months with an average gain of 160%.



Chart 3: The historical performance of the S&P 500 Index during the US bull and bear markets

The bold numbers calculate the duration of months for the market either being bull or bear and the percentages cover the total return for the time period.¹



In the chart above, the green time periods indicate bull markets, when the S&P 500 rose 20% or more from its previous low. The red time periods indicate bear markets, when the S&P 500 declined 20% or more from its previous high.

The bold numbers calculate the duration of months for the market either being bull or bear and the percentages cover the total return for the time period. Data shown is as of the last bull market, which ended on 1/25/2018.

1 Source: Bloomberg L.P. Returns from 10/22/1957-12/31/18.

2 Source: Invesco

So yes, it could get worse, but we do know that investors who have held for a full market cycle have typically ended up in good shape. Investors who have had the

patience to hold for multiple market cycles have profited nicely, despite taking numerous gut punches along the way in the form of market corrections and bear markets.

Everyone talks about the long term, but I can't take this anymore!

Investors who work with financial advisors have the benefit of a portfolio built around their risk tolerance, return expectations, time horizon and other specific needs. If you have a very long-term time horizon and are willing to take on more risk with the expectation of higher returns, there is a good chance that most, or maybe all of your portfolio is exposed to stocks.

As the Chart 4 illustrates, a pure stock portfolio, based on the performance of the S&P 500 in local currency returns going all the way back to 1950, would have lost as much as 39% over any 12-month period. Hopefully that's the level of risk you bargained for. On the flipside,

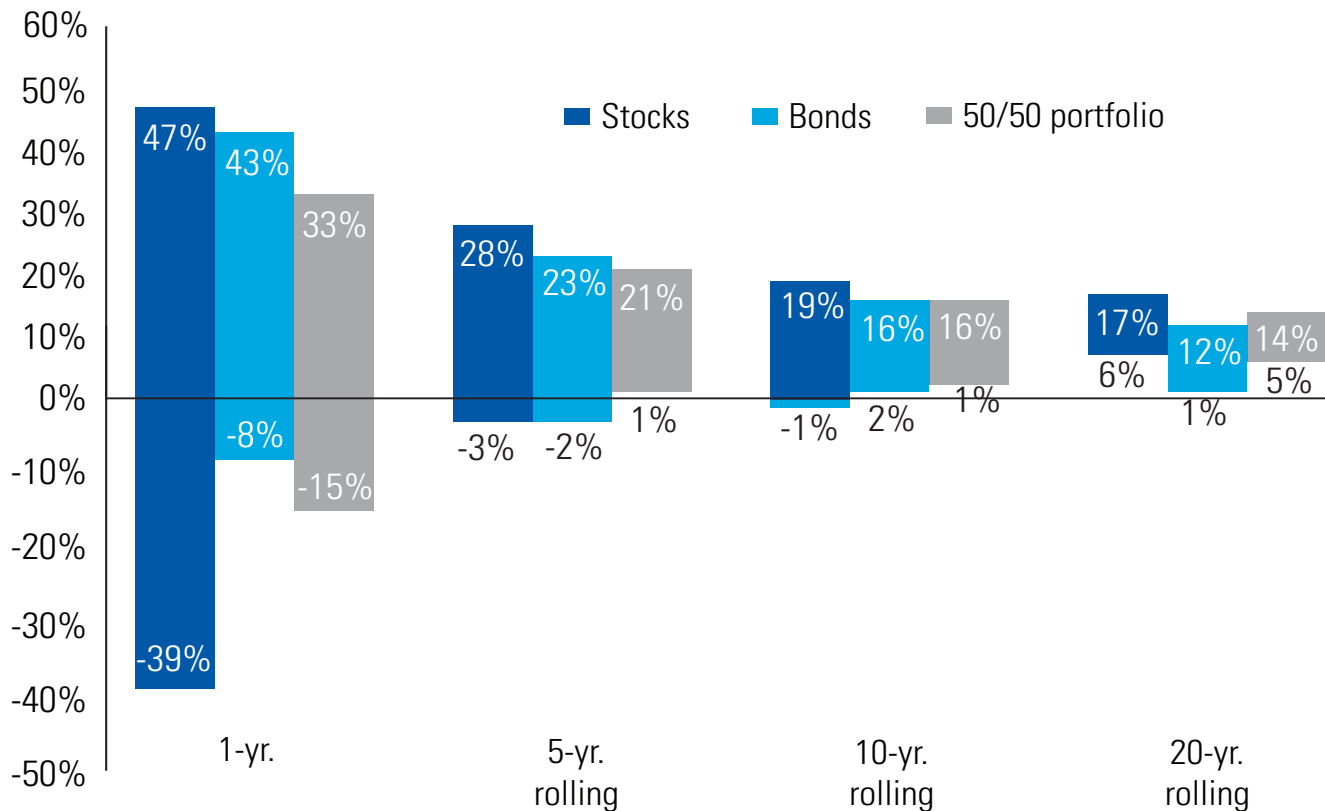
the best 12-month return for every 12-month period going back to 1950 was 47%.

When you start increasing the time horizon, however, you see a fascinating thing happen. The return variation between the best and worst historical outcomes begins to narrow as the holding period increases. When extending things out as far as 20 years, the minimum historical return annualized for stocks was 6%. In other words, you could have invested in the equity market at the most inopportune time of the past 70 years (based on month-end levels) and still made a 6% annualized return in stocks. This is why patience matters.



Chart 4: Range of stock, bond and blended total returns

Annual total returns, 1950-2019



Source: Barclays, Bloomberg, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management. Returns shown are based on calendar year returns from 1950 to 2019. Stocks represent the S&P 500 Shiller Composite and Bonds represent Strategas/Ibbotson for periods from 1950 to 2010 and Bloomberg Barclays Aggregate thereafter. Growth of \$100,000 is based on annual average total returns from 1950 to 2019.

Investors with less tolerance for risk and shorter time horizons most likely hold a portfolio comprised of a combination of stock and bond exposures. Chart 4 also shows that the variability between the best and worst performance over all time periods measured for portfolios of this nature is less than that of a pure stock portfolio. That really is the point of

positioning a portfolio in a more conservative fashion, and the numbers illustrate that a balanced portfolio has tended to be more resilient over shorter time periods. Just be aware that returns on the upside will tend to be lower over time when the portfolio is positioned more conservatively.

I bought at the top of the market – I’m doomed

Not really, although this is where long-term thinking becomes especially important. To underscore the point of the previous section, we looked at data for the S&P 500 back to 1928. This means the period considered includes the Great Depression, which was the worst period for stock markets in history.

Let’s assume we identify an investor who is the worst market timer of all time and moved all in as they were peaking as the Roaring Twenties came to a close. In other words, this investor was looking at the Depression down the barrel of a gun. The investor would have lost more than 80% of his money in three-and-a-half years



if his returns matched those of the S&P 500. That's probably the level at which despondency sets in. This particular investor would have seen World War II come and go and witnessed the beginning of the baby boom while still being under water. But by late 1954, he would be back to the break-even point. This is an example of patience to the extreme. If this very patient investor elected to hold for an additional 10 years however,

In closing

The best way to build wealth over the long-term is to first develop an investment plan with the help of your financial advisor. The next step is to stick with that plan, even when the clouds look the most ominous. It is this step where the advice and guidance of a professional advisor can be most invaluable. Market corrections happen, and so do bear markets, but patience and discipline are generally rewarded in the long term.

We like to reflect on the wisdom of some of history's greatest investors when market conditions go pear shaped. It can bring comfort and is useful in helping restore perspective. Here are some of our favourite insights:

"Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years." – *Warren Buffett*

"The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell." – *Sir John Templeton*

"Forecasts may tell you a great deal about the forecaster; they tell you nothing about the future." – *Warren Buffett*

"In investing, what is comfortable is rarely profitable." – *Robert Arnott*

"Opportunities come infrequently. When it rains gold, put out the bucket, not the thimble." – *Warren Buffett*

his return would have been almost 170%. Keep in mind that all of these numbers are before dividends.

To summarize this scenario, this particular investor put all of his eggs into one basket and bought stocks at the worst possible time in modern history, did not add another dime to his investment portfolio, and still ended up with a half-decent return over a time period (35 years) that is long, but in line with most people's investment lifespans.

Buy when there's blood in the streets, even if the blood is your own." – *Baron Rothschild*

"The idea that a bell rings to signal when investors should get into or out of the market is simply not credible. After nearly 50 years in this business, I do not know of anybody who has done it successfully and consistently." – *John Bogle*

"I will tell you how to become rich. Close the doors. Be fearful when others are greedy. Be greedy when others are fearful." – *Warren Buffett*

"If you have trouble imagining a 20% loss in the stock market, you shouldn't be in stocks." – *John Bogle*

"The investor's chief problem – even his worst enemy – likely to be himself." – *Benjamin Graham*

"Sometimes buying early on the way down looks like being wrong, but it isn't." – *Seth Klarman*

"Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it." – *Warren Buffett*

"You want to take risk when others are fleeing from it, not when they're competing with you to do so." – *Howard Marks*

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Recommended List: The list presents a selection of funds that we believe are among the best of their peers and offer unique characteristics that can add value when used in a well-diversified investment portfolio tailored to a client's investment objectives.

Hold: The fund remains on the Recommended List, but is not recommended for adding to or selling from client's portfolios.

Sell: The fund is no longer on recommended list.

Under Review: The fund's participation on the Recommended List is under review.

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