SUMMIT FINANCIAL

(Another) Test in Staying the Course

Quick take:

- Recent market volatility is yet another painful reminder of what happens to risk assets during challenging times for the world and economy.
- Market volatility is a natural aspect of investing, and the S&P 500 has had an average intra-year max drawdown of 14% over the past 40+ years. Recently, market volatility has been suppressed by significant government monetary intervention but is returning to more normalized levels.
- Over periods of market stress, it's essential to stay focused on long-term goals. These times reaffirm the need to maintain diversified portfolios aligned with individual risk tolerances.
- Uncertainty is likely to remain high in the coming months – or even years – but the best path is often to stay the course, assuming all near- and medium-term liquidity needs are met. There may also be opportunities to take advantage of as market dislocations occur.

If the past few years weren't hard enough, the world is now enduring another crisis in the form of war in Eastern Europe. Decades of attempts to maintain peace in the region were quickly shattered when Russia invaded Ukraine in late February 2022. First, it's important to acknowledge the direct consequences for the people of Ukraine who face the true burden of this unnecessary act of aggression. In addition to the saddening impact on the people of the region, financial markets quickly moved to price in diminished geopolitical stability and slower growth. With many major equity indexes crossing into correction or bear market territory, it's easy to get anxious seeing your account balance dramatically rise and fall each day.

Although the combination of factors we face today is unique (geopolitical instability in Eastern Europe, dramatic global inflation, reduction of global monetary policy) and it always will be, the current risk-off market environment playbook isn't. We take comfort in knowing that we've been here before and that these bumpy periods eventually pass. For well-prepared, long-term investors now is a time to stay the course while evaluating potential opportunities as assets become oversold. Below we offer a series of charts detailing historical parallels that support the case for diversified portfolios and staying focused on remaining invested.

With countless fear-invoking headlines, it's important to keep things in perspective. The table below details the last several bear (or close to it) market drawdowns dating back to Black Monday in 1987. While you often hear about the magnitude of the drawdown, what's less discussed is the results over the next 12-months. This was particularly true for the period following the coronavirus pandemic. Many of the best all-time trading days come within a month of the worst trading days and sitting out from these best days can have a material impact on long-term performance.

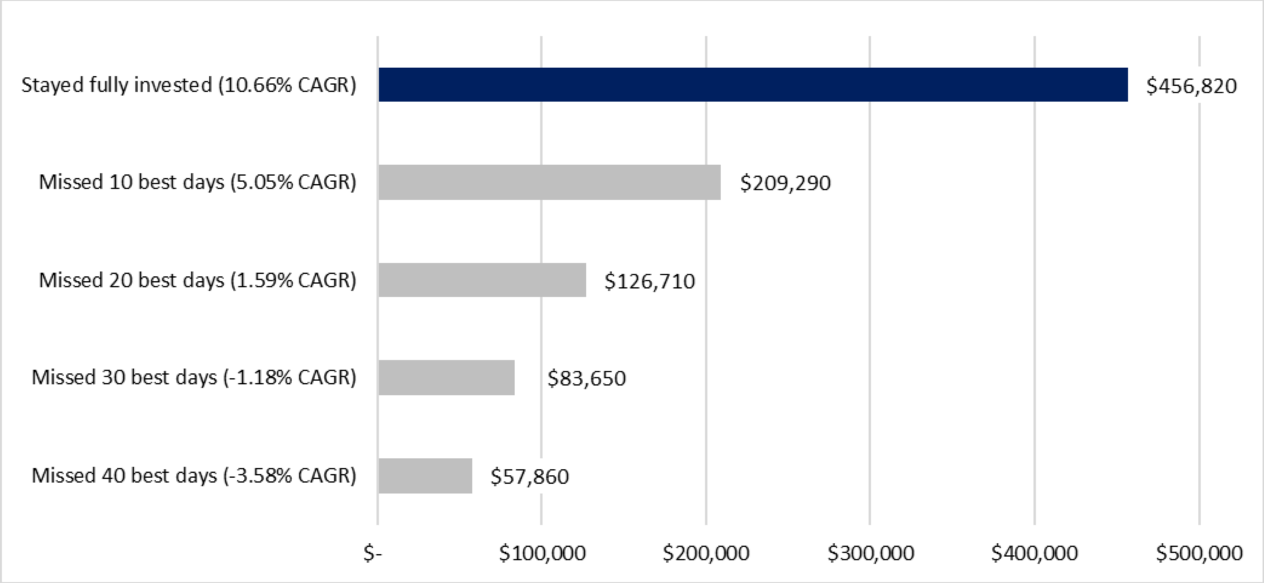
S&P 500 Biggest Declines and Following 12-Month Performance

Dates of the S&P 500's biggest declines	Black Monday	Gulf War	Asia Monetary Crisis	Tech Bubble	Financial Crisis	U.S. Credit Downgrade	Trade War	COVID-19 Pandemic
Start Date	8/25/1987	7/16/1990	7/17/1998	3/27/2000	10/9/2007	3/10/2011	10/3/2018	2/19/2020
End Date	12/6/1987	10/11/1990	8/31/1998	10/9/2002	3/9/2009	10/3/2011	12/24/2018	3/23/2020
Next 12 Months	12/6/1988	10/11/1991	8/31/1999	10/9/2003	3/9/2010	10/3/2012	12/24/2019	3/23/2021
U.S. Stocks	-32.8%	-19.2%	-19.2%	-47.3%	-55.2%	-14.2%	-19.3%	-33.8%
Next 12 Months	28.7%	33.5%	39.8%	36.1%	72.3%	35.0%	39.9%	77.8%

Source: Bloomberg

With this in mind, it may be tempting to try to time the market. The problem is that this is a notoriously challenging exercise that requires two important decisions – when to sell and when to buy. A few small miscalculations of either move can have a significant impact on results. As seen below, missing out on the 30 best days over the past 15 years would have converted a positive annualized return of over 10% to a negative return. Missing out on just the 10 best days would more than cut your return in half.

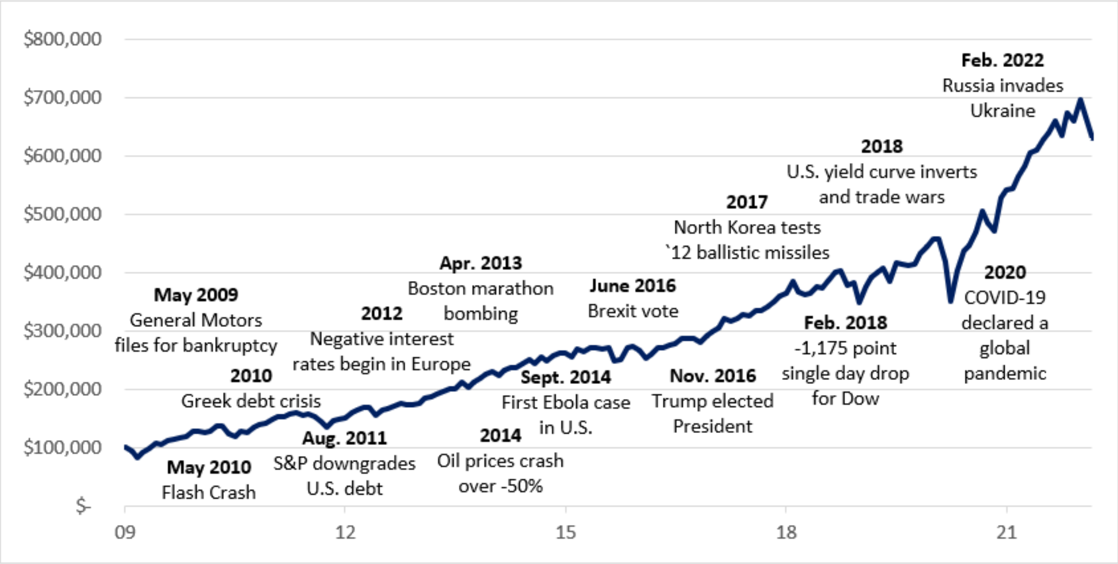
$100,000 invested in the S&P 500 (12/31/06 – 12/31/21)



Source: Morningstar. CAGR is an abbreviation for the compound annual growth rate or annualized return.

Looking back over the past decade, or century for that matter, there have been plenty of excuses to sell risk assets. Just over the past bull market, we've had the Greek Debt Crisis, more expansive use of negative interest rates, an Ebola outbreak, Brexit, a global trade war, and the worst global pandemic in over a century – just to name a few. Amongst all of this, stock markets have still managed to produce impressive gains.

Growth of $100,000 over the Cycle



Source: Morningstar as of 3/1/2022

Many will offer opinions, but our view is that it's nearly impossible to predict how this crisis will unfold. What's perhaps more likely, is that volatility will remain elevated in the coming months and maybe even years. Given this framework, our conviction in diversified portfolios remains. While this approach can often result in remorse of some form (I lost money, I didn't make as much, etc.), the result is winning by not losing. The below 60/40 stock/bond mix has produced a better return than a globally diversified, all equity portfolio with dramatically less volatility.

The Case for Diversification: MSCI All-Country World Index vs. Diversified 60/40 Stock/Bond Portfolio

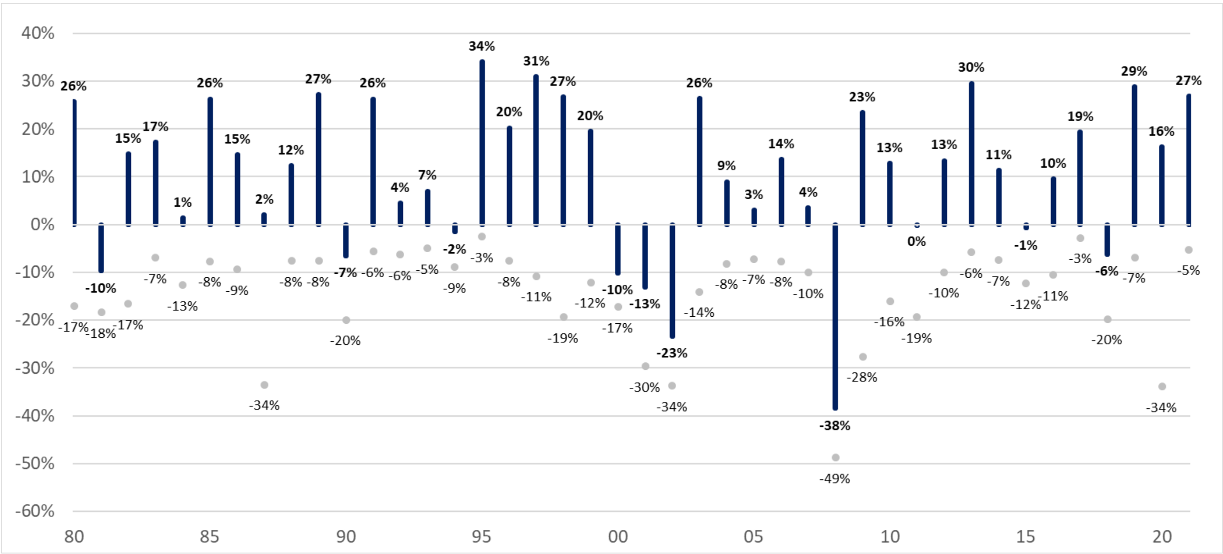
	MSCI ACWI		Diversified Portfolio		
Period	Return	Standard Deviation	Return	Standard Deviation	Sentiment
2000 - 2002	-41.4%	17.1%	-17.0%	10.9%	➔ ☹ "I lost money"
2003 - 2007	136.6%	9.5%	81.3%	6.0%	➔ 😐 "I didn't make as much"
2008	-41.8%	25.1%	-26.9%	17.3%	➔ ☹ "I lost money"
2009 - 2019	231.6%	14.5%	184.9%	9.1%	➔ 😐 "I didn't make as much"
2020 - YTD 2022	27.1%	19.0%	19.0%	13.0%	➔ 😐 "I didn't make as much"
2000 - YTD 2022	248.4%	15.6%	272.9%	10.0%	➔ 😊 "I generated a strong return with less risk"

Growth of $100,000	**$ 348,390**	**$ 372,921**

Source: Morningstar as of 3/1/2022. The Diversified Portfolio consists of 40% Russell 3000 Index, 20% MSCI ACWI ex. USA Index, 30% Bloomberg U.S. Aggregate Bond Index, and 10% Bloomberg U.S. Corporate High Yield Index.

Volatility will always be an inevitable part of equity market investing. While this period may feel unique, the S&P 500 Index had an average intra-year max drawdown of 14% since 1980 despite generating a positive annualized return of over 12% during the same period. With index declines so far in the low-to-mid double-digits during this crisis, the decline is near the historical average.

S&P 500 Intra-year Declines Versus Calendar Year Returns



Source: Bloomberg as of 12/31/21, price return only

Living through these periods of market uncertainty is rarely an enjoyable exercise but they are likely to occur every few years. It's important to remain calm and stay focused on the long-term. While it can feel like you're missing out on better opportunities, staying the course, and maintaining a diversified portfolio often wins over extended periods. There also may be opportunities to use volatility to your advantage. This can include investing excess cash in compelling opportunities that arise and harvesting losses to offset future gains or to facilitate repositioning your portfolio.

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