Long-Term Investing – It's Not Always Easy! January 2019

OVERVIEW

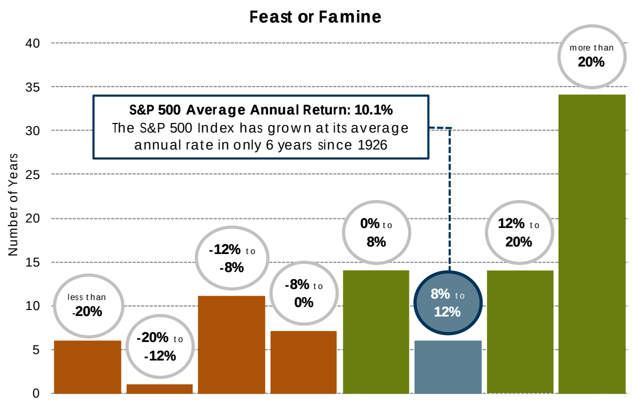
- **With the expectation of enhancing wealth through time, investing is a long-term exercise**
- **Amid market volatility and "late cycle" dynamics, the natural tendency is to shift focus shorter-term**
- **Opportunistic positioning may be warranted to some degree, but successful implementation requires discipline**

Background

Formally defined by Merriam-Webster, an investment is "the outlay of money usually for income or profit." Generally intended to meet financial objectives years into the future, the act of investing is consequently a long-term endeavor. Despite this fundamental understanding, investors of all levels of sophistication spend a great deal of time and energy focused on short-term events and outcomes. A recent blog post by *Behavioral Investment* provides a fairly exhaustive list of reasons explaining why this phenomenon persists, and argues how it often leads to emotional decisions that can make investors worse off.

Average Returns Typically Elusive

Investors today have access to a tremendous amount of data describing both real-time and historical market observations. Anchoring on the past, future expectations often approximate the trailing average annual returns of a given asset class. However, with risk being a prerequisite for higher returns, the range of possible returns around this average is often under-appreciated. The chart below illustrates how the S&P 500 has delivered calendar year returns within +/- 2% of the average in only six years since 1926. Over the past decade, investors have actually been rewarded with seven years in which this key domestic benchmark exceeded its 10.1% long-term average. When the range of potential outcomes is broad, becoming overly focused on short-term results is imprudent.



Source: FactSet, Standard & Poor's. Total returns 1926-2018.

Thoughts on Recent Market Volatility

From an investment standpoint, 2018 was a year in which many things worked, until almost nothing worked. Despite a bounce in the final days of an otherwise punishing December, risk-assets experienced a highly volatile fourth quarter that more than wiped away the gains of the first nine months of the year. The MSCI All Country World Index shed nearly 13% for the period, and many stock markets across the globe have entered "bear market" territory as they trade more than 20% below prior highs. Bond yields and the US dollar have come down, but this has offered limited solace given the magnitude of the equity market sell-off. Although identifying a specific catalyst is difficult amid the swirling headlines, it's reasonable to suggest that recent volatility may be more technical (low market liquidity, declining confidence) than fundamental (slowing global growth, uncertainty over trade) in nature.

When Cash Outperforms Everything

The Federal Reserve has hiked rates nine times in the tightening cycle that began in December 2015. While the future path/pace of monetary policy is a topic of much debate, past actions have meaningfully improved the returns for risk-averse (or perhaps opportunistic) investors holding cash. In the table below, we outline calendar years in which cash outperformed both stocks and bonds, while both were negative. These could be considered the unusual periods when diversification didn't work, and 2018 was the first time we've seen this in over 40 years. Short-termism often guides behavior toward recent winners, but few can meet their financial objectives owning just cash.

Year	S&P 500 Index	Long-Term Gov't Bonds	One-Month T-Bills
1931	-43.3%	-5.3%	1.1%
1946	-8.1%	-0.1%	0.4%
1969	-8.5%	-5.1%	6.6%
1973	-14.7%	-1.1%	6.9%
1977	-7.2%	-0.7%	5.1%
2018	-4.4%	-1.8%	1.8%

Source: Morningstar, Standard & Poor's, Barclays. Total returns 1926-2018.

ACG's Position

Even as markets remain vulnerable to exogenous shocks, economic fundamentals do not suggest a recession will occur in 2019. Staying calm during a downturn is a critical quality of any long-term investor. Behaviors drive results and performance setbacks often challenge strategic clarity. Although not always easy, adopting a genuinely long-term approach to investing is one of the few real edges any investor can hope to exploit. Periodically, it seems as if everything is conspiring against planning and discipline, but more than a century of data shows that diversified/holistic market exposure works. After confirming long-term goals and objectives, investors should consider the opportunity to rebalance into risk assets whenever pessimism is being priced into markets.

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