Equity Investing

Know the Game You’re Playing

December 2023

Phillips & Company

Wealth Strategies | Vested

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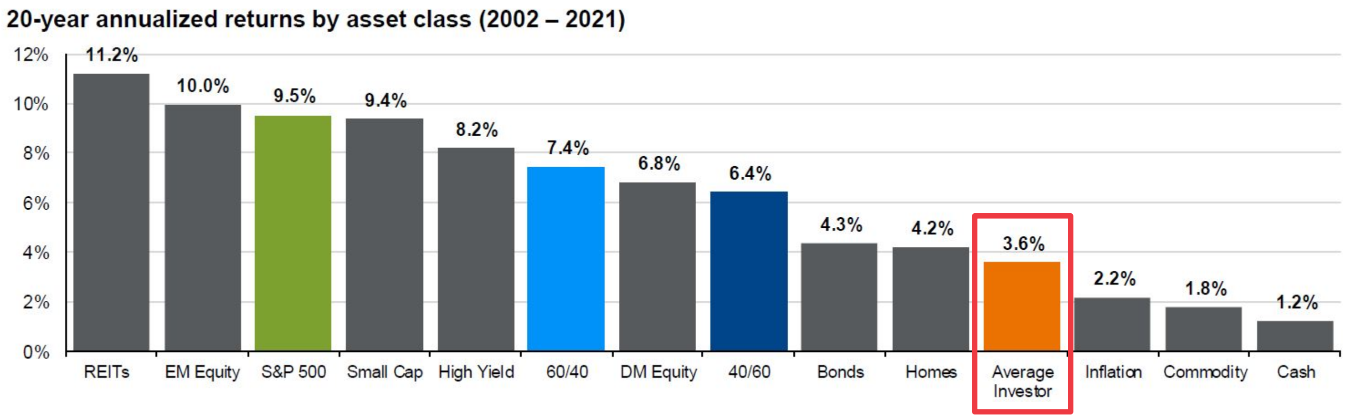
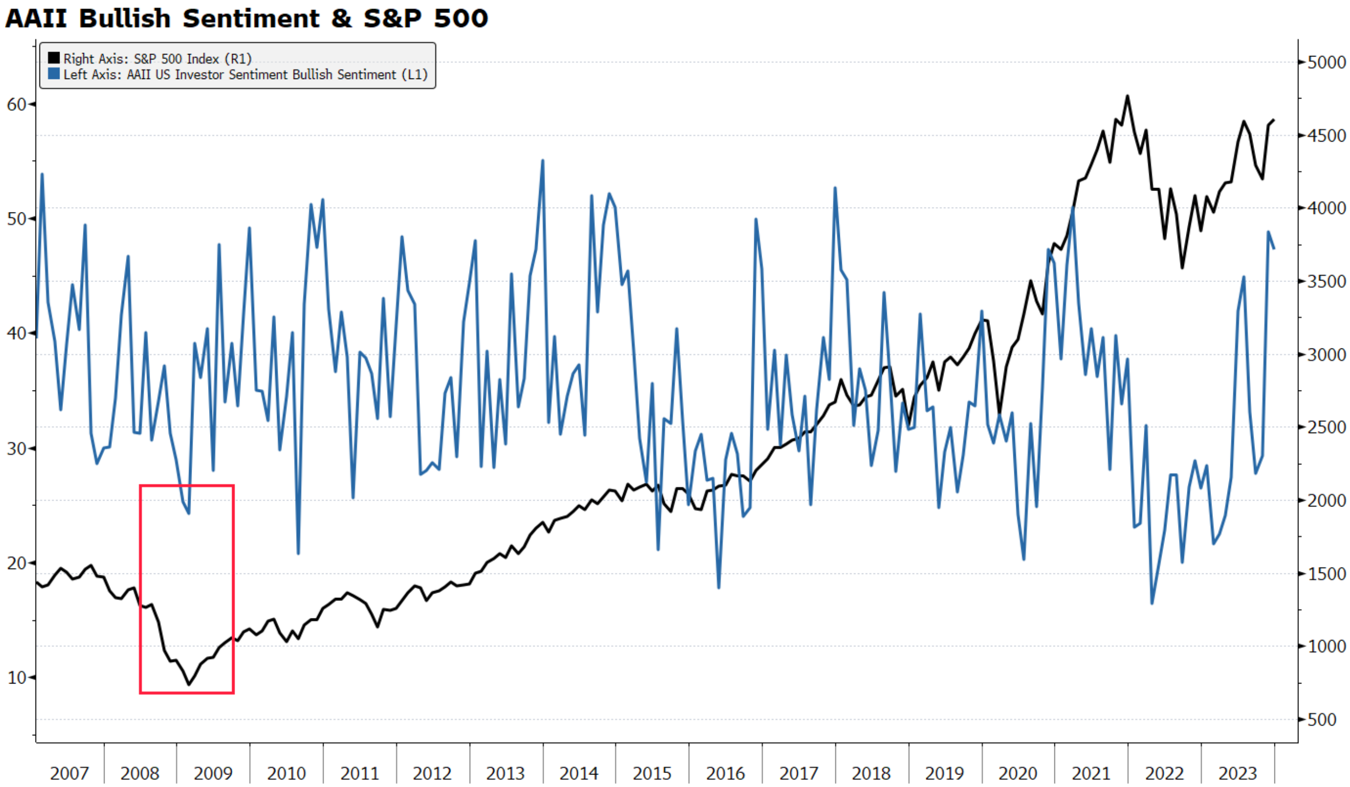
Individual Investors Tend to Underperform



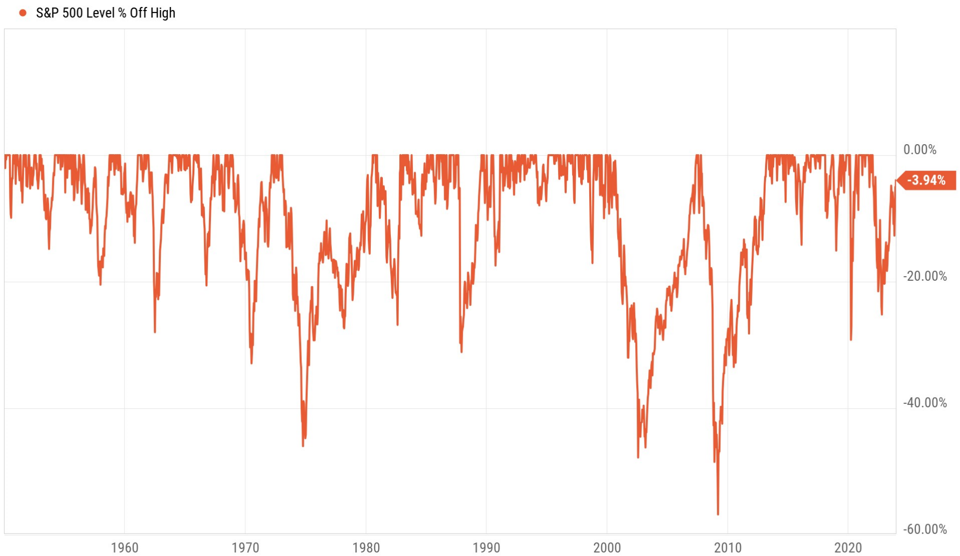


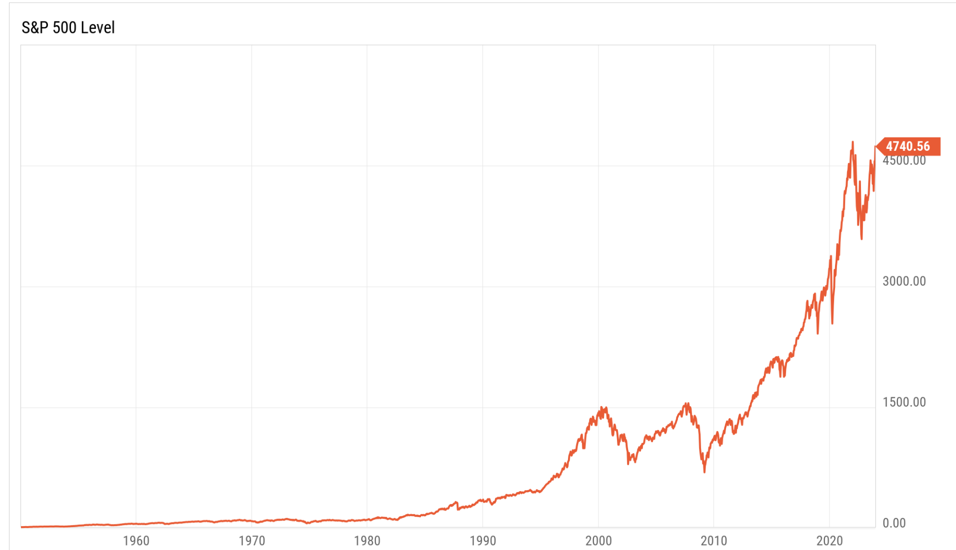
- ☐ As you can see, individual investors generally post weaker returns compared to those of both the broader market asset classes and balanced asset allocation portfolios.

- ☐ Generally speaking, those same investors tend to sell when they should buy and react when they should not. Just look at individual investor sentiment at the worst part of the financial crisis. Using the AAII Index, you can see individual investor sentiment is at its worst exactly when the market bottoms out, and then proceeds to take off on the historic bull market that we're still in today.

Sources: J.P. Morgan, Bloomberg

Investing in a Drawdown





- Since 1928, the S&P 500 has been in a drawdown over 71% of the time using monthly total return data. Which means drawdowns are the norm rather than the exception; most of your time as an investor will be spent in a drawdown.

Average Cumulative S&P 500 Forward Total Returns (Monthly Data Since 1928)							
Drawdown	**% of Time**	**1-Year**	**3-Year**	**5-Year**	**10-Year**	**15-Year**	**20-Year**
0% (All-Time High)	29%	13%	38%	78%	185%	376%	634%
<10%	34%	11%	41%	79%	217%	431%	793%
10-20%	12%	13%	43%	75%	258%	486%	980%
20-40%	10%	11%	28%	54%	200%	444%	903%
>40%	15%	10%	35%	61%	170%	509%	1130%

Average Annualized S&P 500 Forward Total Returns (Monthly Data Since 1928)							
Drawdown	**% of Time**	**1-Year**	**3-Year**	**5-Year**	**10-Year**	**15-Year**	**20-Year**
0% (All-Time High)	29%	13%	11%	12%	11%	11%	10%
<10%	34%	11%	12%	12%	12%	12%	12%
10-20%	12%	13%	13%	12%	14%	13%	13%
20-40%	10%	11%	9%	9%	12%	12%	12%
>40%	15%	10%	10%	10%	10%	13%	13%

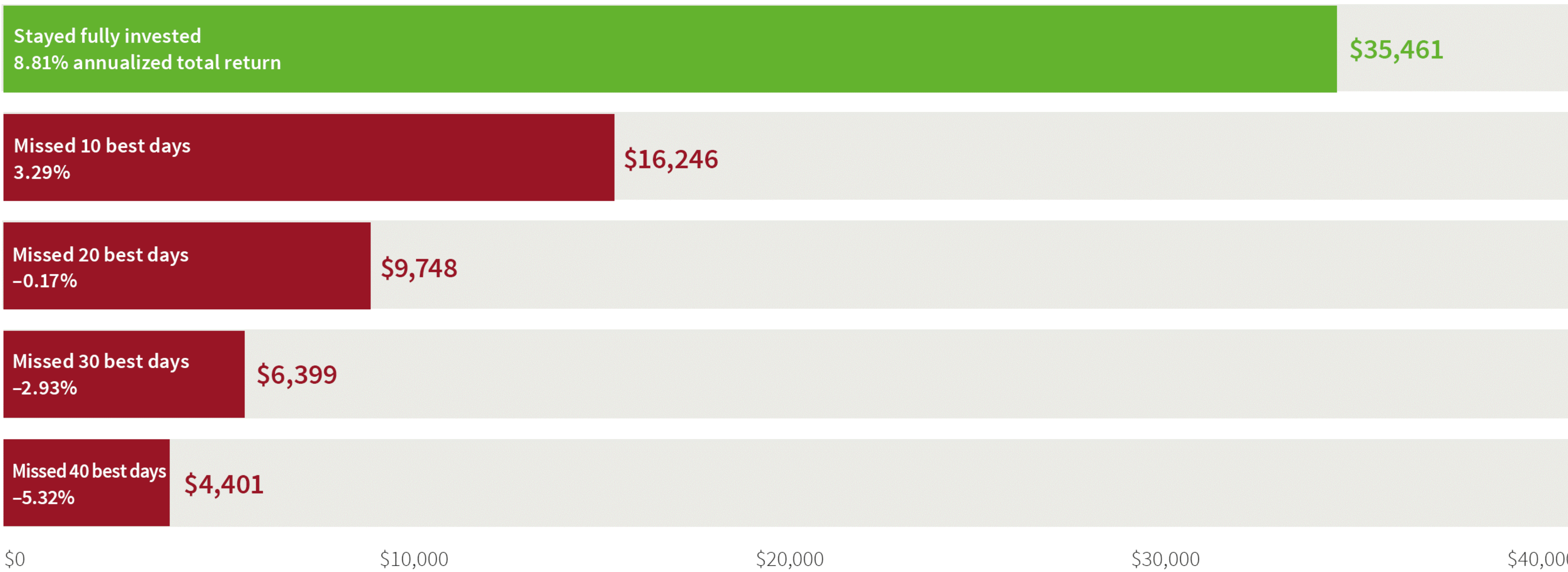
- When will it end? No one can tell you that. But the stock market tends to be higher over the next year regardless of whether it's in a drawdown or not.
- The biggest drawdowns historically (>40%) have actually been followed by the highest long-term (20-year) returns. Which means that if you have a long time horizon and are still adding new money to stocks, drawdowns should be embraced, not feared.

Source: YCharts, Creative Planning

Markets Move In Brief Bursts

Miss Just a Few Days & You Lose All the Advantage

$10,000 invested in the S&P 500 (12/31/07–12/31/22)



☐ Over a 15-year period of market returns, a portfolio fully invested in the S&P 500 generates, on average, a return of approximately 8.81% annually. But if you missed the ten best days during that 15-year period, your returns would be cut by over one-half.

☐ So, what percentage of trading days do those ten best days amount to over a fifteen-year period? Let me explain. There are approximately 252 trading days in a given year, so multiply that number by fifteen years and you have 3,780 days. And that means those ten days amount about a quarter of one percent (0.26 percent) of that time total. That's an incredibly small number. In other words, missing out on only 0.26 percent of trading days costs you more than 20 times that in return potential.

Source: Putnam

Pain is Part of the Process

The Key is Not Minding

Standard & Poor's 500 Composite Index (1951-2020)

Size of decline	–5% or more	–10% or more	–15% or more	–20% or more
Average frequency*	About three times per year	About once per year	About once every three years	About once every six years
Average length†	43 days	110 days	251 days	370 days
Last occurrence	October 2020	September 2020	March 2020	March 2020

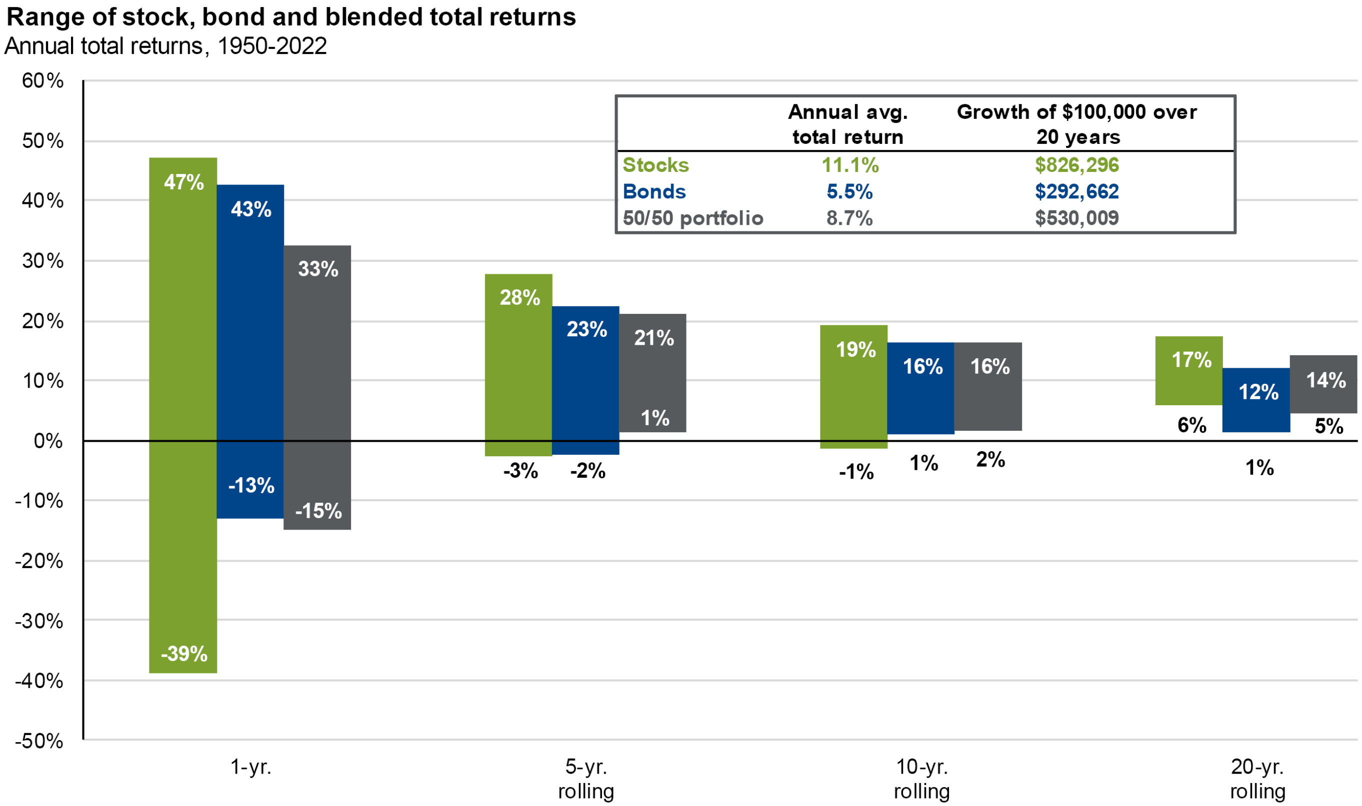
* Assumes 50% recovery of lost value.
† Measures market high to market low.

- ☐ While you wait for your returns, you are likely to experience some difficult times. That is apparent when you consider the frequency and longevity of corrections and bear markets.

- ☐ Investors often can become downright desperate while they wait. Most of the time, your best bet – beyond rebalancing and dollar-cost averaging – is to remain patient.

Source: Putnam

Time Shapes Risk



- Exposing your portfolio to equity markets requires tremendous patience. In the short run, markets can be extremely volatile. I probably don't need to tell you that because you experienced the first few weeks of 2020. But long-term equity investing can produce reliable return averages for investors.

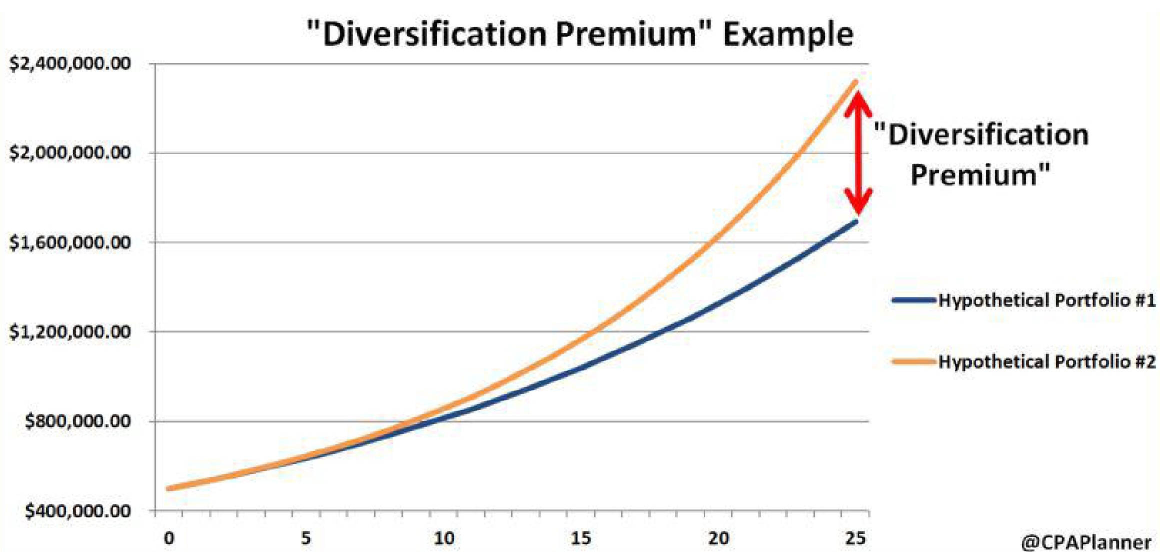
- If you examine the one-year range of returns for the S&P 500 since 1950, you will see a wide range of return outcomes, from a negative 39 percent to a positive 47 percent. As an investor, if you're tempted to time the market, I refer you back to the first two charts to see what your likely outcome could be.

- With that said, if your time horizon is long, you can see how the risk of negative equity returns is shaped out, providing investors with long-range risk and returns that they can depend on for retirement.

Diversification: The Only Free Lunch in Finance

2008 - 2022																	
Ann.	Vol.	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	YTD
Large Cap 8.8%	REITs 23.4%	Fixed Income 5.2%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Small Cap 20.0%	REITs 41.3%	Comdty. 16.1%	Large Cap 20.8%
Small Cap 7.2%	Small Cap 23.2%	Cash 1.8%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	EM Equity 18.7%	Large Cap 28.7%	Cash 1.5%	DM Equity 12.8%
REITs 6.6%	EM Equity 23.0%	Asset Alloc. -25.4%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap 18.4%	Comdty. 27.1%	High Yield -12.7%	High Yield 9.6%
Asset Alloc. 6.1%	Comdty. 20.2%	High Yield -26.9%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. 10.6%	Small Cap 14.8%	Fixed Income -13.0%	Asset Alloc. 8.8%
High Yield 5.4%	DM Equity 20.0%	Small Cap -33.8%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Large Cap -4.4%	Asset Alloc. 19.5%	DM Equity 8.3%	Asset Alloc. 13.5%	Asset Alloc. -13.9%	EM Equity 6.1%
Fixed Income 2.7%	Large Cap 17.7%	Comdty. -35.6%	Large Cap 26.5%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	Fixed Income 7.5%	DM Equity 11.8%	DM Equity -14.0%	Cash 4.6%
DM Equity 2.3%	High Yield 13.0%	Large Cap -37.0%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	High Yield 7.0%	High Yield 1.0%	Large Cap -18.1%	Small Cap 4.2%
EM Equity 1.0%	Asset Alloc. 12.4%	REITs -37.7%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Cash 0.5%	Cash 0.0%	EM Equity -19.7%	REITs 2.3%
Cash 0.6%	Fixed Income 4.2%	DM Equity -43.1%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	Comdty. -3.1%	Fixed Income -1.5%	Small Cap -20.4%	Fixed Income 1.6%
Comdty. -2.6%	Cash 0.4%	EM Equity -53.2%	Cash 0.1%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -14.2%	Cash 2.2%	REITs -5.1%	EM Equity -2.2%	REITs -24.9%	Comdty. -5.4%

- ☐ You can see from the table to the left, no asset class, on a year-over-year basis, has consistently dominated the markets. During some years, small company stocks lead. During other years, it's the large company stocks, and at other points, it might be emerging markets or real estate.



- ☐ In addition, there is almost no cost attached to smart diversification. If done properly, investors can even reduce risk while maintaining their return targets, and in some cases, expand the growth potential of their portfolios.

Source: J.P. Morgan