INVESTMENT INSIGHT
2018
FOURTH QUARTER
LEGACY WEALTH MANAGEMENT
Right by you.

Everyone I have ever seen on a roller coaster has their hands in the air and is screaming their heads off with many of them thinking "this is it – I'm going to die!" At least that was my experience a few years ago on Disney's Mt. Everest coaster going backward through a dark tunnel with a Yeti jumping out at us. I really wasn't sure I was going to survive! I think that is how the most recent quarter in the market has felt to a lot of investors. "This is it – the market is finally going to crash. I'm not sure I'm going to make it."

As always, it is important to put things in perspective. I stood in a long line for that Disney coaster and watched hundreds of people get on, scream like crazy, then get off still in perfectly good health. The coaster held up just fine and delivered me safely to the end (though a bit frazzled). Similarly, we've seen these ups and downs in the market and it is important to put them in perspective. Just since 1995, we have seen the market go from a value of just below 4,000 points on the Dow Jones Industrial Average to a closing value of 23,327 on December 31, 2018. That is a tremendous (483%) increase in value and doesn't include the value distributed in the form of dividends over those years. Yet during that period, we saw the tech bubble inflate and burst, 9/11 occur, wars in Iraq and Afghanistan, the housing bubble inflate and then burst into the Great Recession of 2008-2009, U.S. debt ratings get downgraded, debt crises around the world, and the fight over Brexit, just to name a few! At each downturn, it was completely natural to think "this one is it." But it wasn't, and this one won't be either. If you look beyond the recent downturn that started in October, the U.S. stock market has turned negative for the year but is still solidly positive over the past two years *(*see *Stock Market Returns in Perspective* next page*)*. And look at the last fifty years – the recent downturn looks completely normal *(*see *Stock Market Cycles* next page*)*.

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U.S. Stock Market

Stock Market Returns in Perspective

S&P 500 Index over different time periods, reindexed

Source: Clearnomics, Standard & Poor's, New York Times

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Market and Economic Chartbook | January 2, 2019

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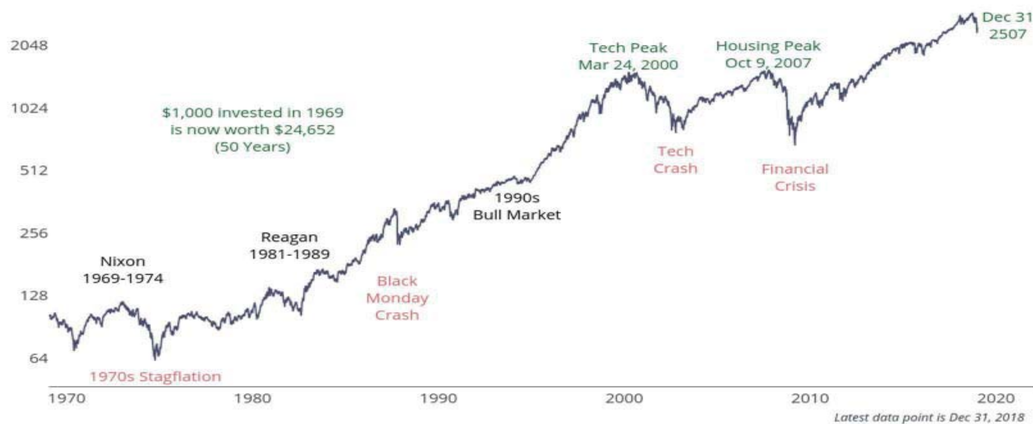
U.S. Stock Market

Stock Market Cycles

S&P 500 Index over the past 50 years (Log Scale)



Source: Standard & Poor's

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So what do we do in anticipation of, or in response to, choppy markets like we've seen this year? While we have not been trying to time our way into or out of the markets, we have been, as always, actively managing client portfolios.

Bonds

Earlier in the year, we eliminated holdings of riskier high-yield (junk) bond debt and emerging market debt for clients who held these funds. We reinvested those proceeds in a high-quality short-term bond fund that is earning a reasonable yield and is short enough in its maturity structure that its rates rise quickly as market rates rise.

International vs US Market

We recently reduced our exposure to international equity markets in favor of more U.S. equity investments. The world market is roughly divided 55% U.S. and 45% international. We target a balance of 76% U.S. and 24% international. Our recent reduction is a reflection of our research that indicates the U.S. does better in market pullbacks than its international counterparts as investors from around the world seek the safety of the U.S. market. Our change allows us to be a little more defensive as we look toward the future.

Fixed Income vs Equities

Earlier in the year, we saw our rebalancing software recommending the sale of equities that had done quite well in 2017 and the purchase of fixed income. In recent months with the fall in equity prices, we are seeing recommendations to sell fixed income and buy equities. In each of these cases, we are systematically selling high and buying low when opportunities present themselves. Actual changes that may be appropriate are unique to each client's portfolio, but our portfolio management system monitors every client account every day for such opportunities.

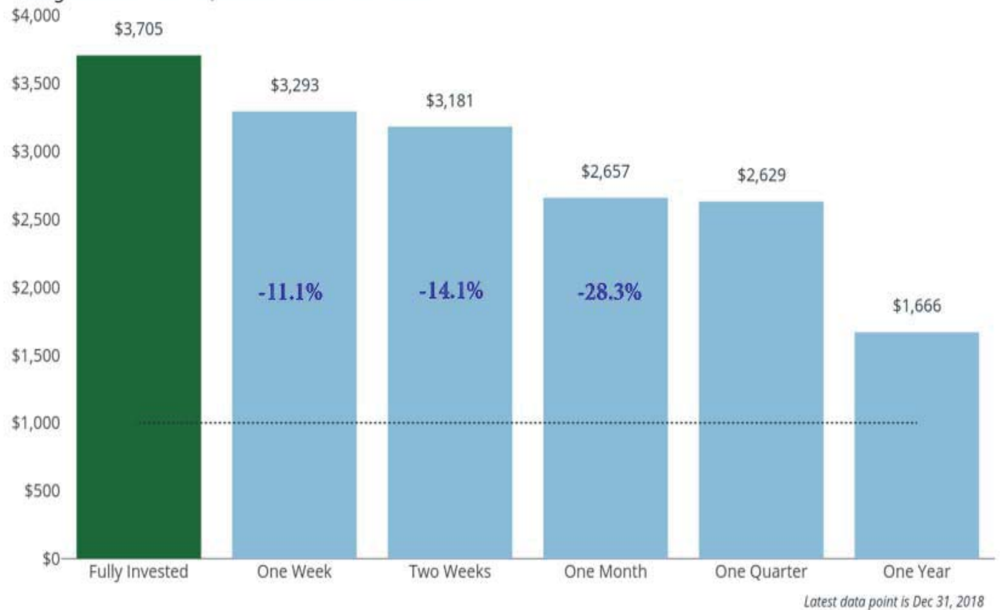
Taxes

Whenever we see downturns in the equity markets like we have in recent months, we review taxable brokerage accounts for clients to see if there are capital losses that can be taken. Clients can use realized losses to offset realized gains on their taxes, so a dollar saved in tax is just as good as a dollar earned elsewhere! If we are able to sell something at a loss, we immediately reinvest the proceeds into a substitute investment so that the portfolio remains invested.

This Fourth Quarter Investment Insight *has been written by Legacy's Managing Director Duncan Miller.*

The views of this commentary are not intended to be a forecast of future events, a guarantee of future results, or investment advice. Investors should not use this information as the sole basis for investment decisions. Past performance is no guarantee of future results. Any statistics have been obtained from sources believed to be reliable, but the accuracy and completeness of the information cannot be guaranteed.

But what if we think the market is about to move down? Shouldn't we get out and wait for things to get better? Those are completely reasonable questions but typically only involve one side of the decision – when to get out. The other side of the decision is when to get back in. As we have emphasized many times in this Insight, it is impossible for someone to predict when to get out and back in with any accuracy (see last quarter's Investment Insight). The following chart *(right)* shows us what the cost can be when trying to time the market. The green bar on the left assumes you invested $1,000 in March 2009 (market low) and stayed invested through the end of 2018. Your money would have grown to $3,705. The next bar ("One Week") assumes that an investor got out of the market after each of the twenty worst days since March 2009, stayed out for a week after each of those days, then reinvested back into the market. The investor thought "this is it – the market is finally going to crash; I better sell and I'll get back in when things have calmed down." A week later, the investor felt things had calmed down enough to get back into the market. Yet in this case, the investor's return from March 2009 to present would have been only $3,293, or 11% worse than the buy-and-hold investor. The investor who stayed out two weeks at a time fared 14% worse, while the investor who took a month to calm down and reinvest earned nearly 30% less than his/her fully invested friend! The best days in the market often come close on the heels of the worst days. Missing those recoveries is costly.



Source: Clearnomics, Standard & Poor's,
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We are also watching the news and monitoring headline items like rising interest rates, low oil prices, the possibility of an inverted yield curve, and the potential impact of the current trade dispute between the U.S. and China. One or more of these items may become a topic for future *Investment Insights*, but currently only the China trade dispute causes us near-term concern. Negotiations on that front are ongoing and more should be known in the next few months. We will continue to monitor developments.

To return to my roller coaster ride, think about your bond portfolio as the safety bar across your lap – it will keep you firmly in your seat. Our diligence in rebalancing your portfolio to its diversified allocation is our way of following the safety rule to "keep your hands and feet inside the car at all times." A solid financial plan that accounts for these ups/downs in the market is like the engineering that goes into the structure of the roller coaster that keeps you from flying off into space when you hit the next bump (call your Relationship Manager if you don't have a plan in place). If the markets continue with their roller coaster ways, understand that you have a well-diversified portfolio and a sound financial plan in place; sit back and hang on for the ride, scream like crazy when you need to, but know that you will arrive at your final destination intact, even if a bit frazzled.