Market Commentary – September 2019

The Dangers of Market Timing

December of 2018 was the worst December for U.S. stocks since the Great Depression and marked the end of a years-long period of relative calm. Except for the oil-related drawdown of 2015 and 2016, the market has been seemingly unstoppable since late 2012. The headlines in December were mostly related to interest rate uncertainty, the ongoing trade war with China and the exacerbating effects of computerized trading. The recovery was quick, however, thanks in large part to a truce in the standoff between the U.S. and China. In May we had another downturn and quick recovery, giving way to yet more all-time highs in July. Now we find ourselves once again in the midst of an uncomfortable market scenario as the trade tensions continue to be unresolved and potentially new troubles with Iran have emerged.

The recent uptick in volatility has got investors understandably worried about what's to come. Our commentary in February of this year addressed some of the reasons that these market events are so disconcerting. We expect pullbacks, corrections and even the occasional recession. Without them, there would be much less opportunity to buy low and sell high; the most important investment maxim no matter your strategy, outlook or political affiliation (more on this later). Uncertainty related to the timing, severity and duration of market downturns creates the anxiety that can lead people to make bad decisions when it comes to their investments.

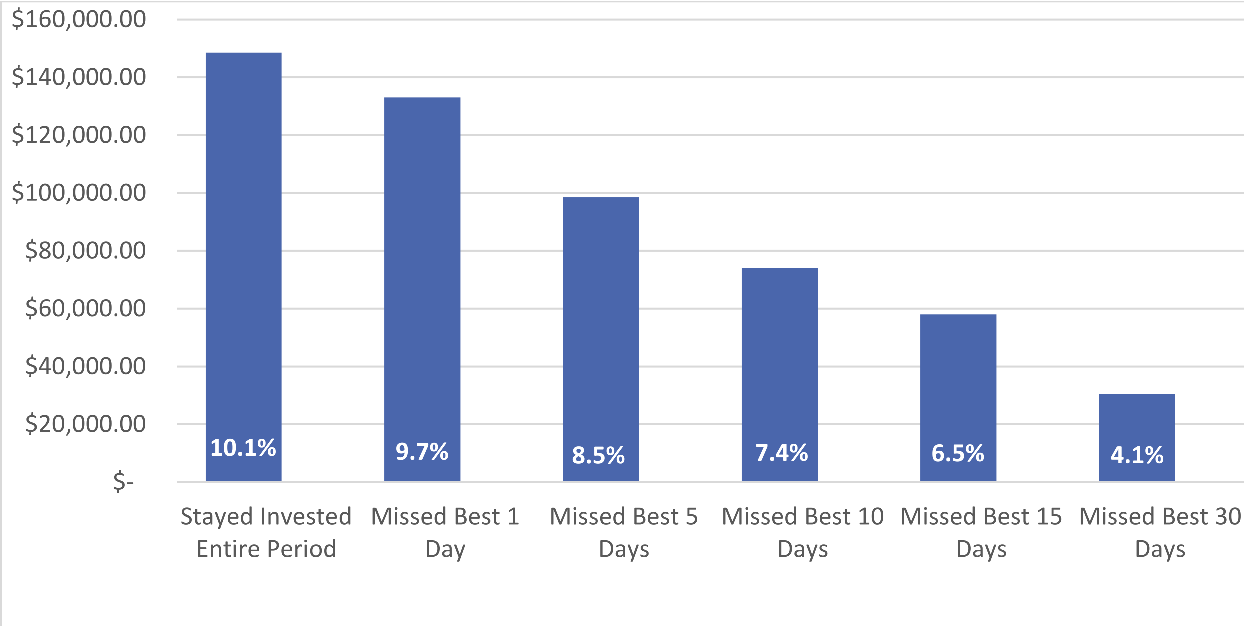
While fundamentals are still relatively strong, there are certainly areas for concern. Most notably, weakening corporate earnings, the distribution of yields on Treasuries over time and the continuing fallout from our trade dispute with China. While earnings are still in positive territory, they have softened considerably. According to Yardeni Research, Inc., single digit earnings growth rates are expected well into 2020 for the S&P 500. 2017 and 2018 earnings growth rates for the index were 11.8% and 22.7%, respectively. That's important because earnings are what companies use to fund research, hire employees, make capital improvements and pay dividends. Big trend reversals in earnings growth will inevitably have an impact on investor confidence, thereby reducing how much they are willing to pay per share.

Wavering corporate earnings and the ongoing trade deal uncertainty have pushed investors more heavily into treasuries in pursuit of quality and relative stability. The increased demand forces their prices up and their yields down. Falling yields on the 10 Yr treasury are historically associated with an economic slowdown. Couple that with the lackluster earnings projections and interest rate cuts at home and abroad, and a picture of global economic uncertainty begins to emerge.

While it's tempting to get out of a declining market, history has shown that doing so usually comes at a considerable long-term cost. Market timers have to get it right twice every time they decide to pull out of a volatile market. Remember, the number one rule for investing success is buy low, sell high. When a market timer sells their stocks, how does he or she know that they're getting the best (highest) price? Then they have to decide when to buy back into the market; will it go lower? This scenario illustrates the concept of up-capture and down-capture. In order to buy low and sell high, a market timer must own the investment and participate in as much of its runup as possible (up-capture) and miss as much of its decline as possible (down-capture) by selling at just the right time. Simply put, a market timer needs to pick precisely the right moment to buy and sell over and over again. Some occasionally get lucky, but with as many variables at play, and as quickly as the market can fall these days, most don't very often, and none do consistently. Consider the following table. Being out of the market and missing just the best 30 days over a 27-year period would have reduced an investors average annual rate of return by more than half when compared to having stayed invested for the entire period.

Cost of Being Out of the Market

Growth of $10,000; Jan 1, 1989 – Dec 31, 2016 and Average Annual Rate of Return



Source: financialengines.com

This illustration reinforces the value of a long-term perspective and avoiding the pitfalls of timing a volatile market. Having said that, however, doesn't mean there aren't times when it's sensible to make allocation adjustments in order to protect profits or prevent losses in anticipation of needing money from an investment portfolio. Most advisors don't recommend putting money into the stock market that's expected to be needed within the short term. If, for example, if you know you're going to need to pull $10,000 out of an investment account for some planned expense or project in the next 12 months or so, it wouldn't be prudent to subject that amount to swings in market values. A money market or short-term treasury fund would be a more appropriate position for those funds.

Buying and selling within an investment account should only be performed in order to maintain a target allocation or establish a new one based on changing risk tolerance levels or a shortened investment time horizon due to planned expenses. Picking and choosing when to jump in and out will almost certainly result in lower than expected long-term performance and greatly increase the likelihood of not keeping true to the all-important buy low, sell high.

We will continue to work on your behalf and in your best interest, making portfolio adjustments as market conditions and economic forecasts change. Please give our office a call if you have questions. As always, we are humbled by the trust you continue to place in us and honored by the opportunity to serve as your fiduciary advisors.

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Please be so kind as to inform us of any and all changes that may affect our ability to service your accounts. In particular, please inform us immediately if:

1) You have any changes to your financial condition or would like to reevaluate your risk tolerance.
2) You change your "mailing" or "physical" address.
3) You change banks thereby impacting a standing "MoneyLink" or other money movement instructions.

If you wish to schedule a phone conference or meeting with your advisor, please contact our office.

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In the event of a bona fide disaster or short-term interruption, we will be available via normal communication modes – email and phone.

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Schwab Alliance: 800-515-2157

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Please take note of our upcoming holiday office closures:

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Monday, November 11, 2019 (Veteran's Day)

Thursday-Friday, November 28-29, 2019 (Thanksgiving)

Wednesday, December 25, 2019 (Christmas Day)

Wednesday, January 1, 2020 (New Year's Day)

OFFICE HOURS

Please take note of our office hours:

Monday – Friday

8:00 a.m. – 4:30 p.m.

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Please contact your Advisor if there are any changes in your financial situation or investment objectives. Please contact Harold F. Grubbs, President of Financial Management, Inc. (501.227.7400), if you wish to impose, add or modify any reasonable restrictions to the management of your account by your Advisor, Financial Management, Inc. Our current disclosure statement is set forth in a written disclosure brochure based on Part II of Form ADV and is available for your review upon request.

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