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S. Harris Financial Group

INNOVATIVE STRATEGIES + PERSONAL FOCUS

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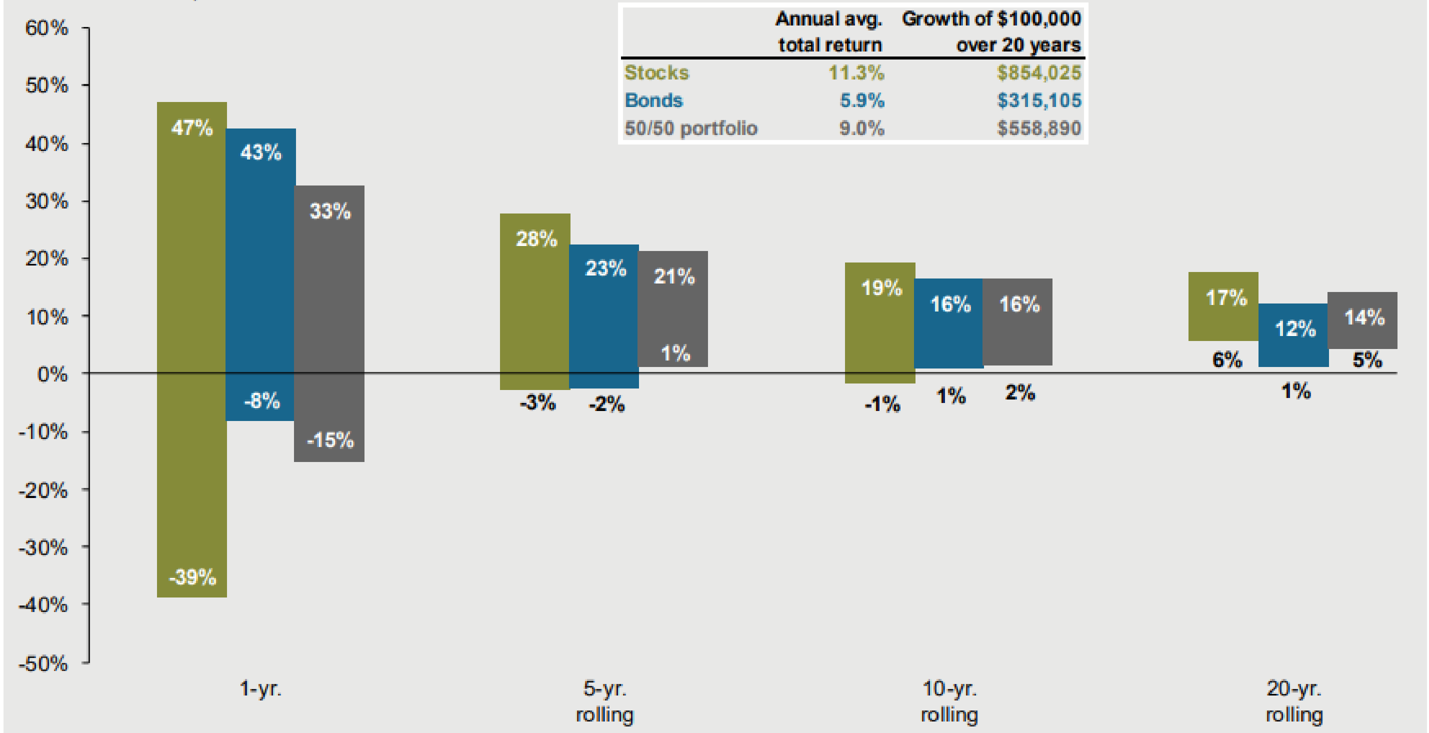
A Quick Investment Lesson From 2020

Covid-19 and fears about the election, among other events of 2020, disrupted the U.S. economy and brought the longest bull market run in history to an end. If the volatility driven by continued disheartening news caused you to lose sleep, you would not be alone. Even more surprising for many is that almost a year later we find the market hitting new highs and there is talk of a potential economic recovery in 2021.

Many investors experienced their first bear market, or their first one in a while. As a reminder, bear markets are defined as declines of 20% or more from the most recent high, while bull markets are increases of 20% or more from the bear market low. So, what lessons can investors learn from 2020 and the global pandemic?

Lesson 1: Keep your long-term goals in mind to avoid emotion-based decisions

The events of last year had many investors feeling nervous and liquidating their positions in the market, as there was a rush to "safety." Money flowed out of the stock market and into either the bond market or, more likely, bank accounts. Unfortunately, this is a common occurrence in times of fear, and the reality is that many people missed some of the best market days in the last decade. Instead, we remind clients that the only monies we typically have invested in the stock market are funds we anticipate them using in 5+ years, so keeping a long-term focus is important. For example, as the chart below illustrates, a portfolio of 50% stocks and 50% bonds had positive returns in every rolling 5-year period dating back to 1950. Therefore, if your allocation is in line with your risk tolerance and you can remember that the stock market is for your longer-term needs, it can help you stay focused on the importance of staying invested.



	Annual avg. total return	Growth of $100,000 over 20 years
Stocks	11.3%	$854,025
Bonds	5.9%	$315,105
50/50 portfolio	9.0%	$558,890

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Lesson 2: Make sure your portfolio matches your risk tolerance

The chart below illustrates investment returns in the market each year from 2006 to 2020, ranking the best performing parts of the market from top to bottom. In addition, the last two columns on the right show the annualized return and volatility/risk (respectively) of the different parts of the market between 2006 and 2020. Remember that there was a flight to "safety" in the first quarter of 2020, when many investors got out of the stock market and moved their money to cash or bonds? Note that cash was the 3rd worst performing asset class in 2020, followed by commodities and real estate. In other words, if investors did not reinvest their funds rather quickly back into the stock market, they likely missed significant upside in the second through fourth quarters.

															2006 - 2020	
2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Ann.	Vol.
REITs 35.1%	EM Equity 39.8%	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%	Large Cap 9.8%	EM Equity 23.3%
EM Equity 32.6%	Comdty. 16.2%	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%	Small Cap 8.9%	REITs 23.1%
DM Equity 26.9%	DM Equity 11.6%	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%	High Yield 7.5%	Small Cap 22.6%
Small Cap 18.4%	Asset Alloc. 7.1%	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%	REITs 7.1%	DM Equity 19.1%
Large Cap 15.8%	Fixed Income 7.0%	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%	EM Equity 6.9%	Comdty. 18.8%
Asset Alloc. 15.3%	Large Cap 5.5%	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%	Asset Alloc. 6.7%	Large Cap 16.7%
High Yield 13.7%	Cash 4.8%	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%	DM Equity 5.0%	High Yield 12.2%
Cash 4.8%	High Yield 3.2%	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%	Fixed Income 4.5%	Asset Alloc. 11.8%
Fixed Income 4.3%	Small Cap -1.6%	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%	Cash 1.2%	Fixed Income 3.2%
Comdty. 2.1%	REITs -15.7%	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%	Comdty. -4.0%	Cash 0.8%

See Disclosure #2

Instead, we utilize the concept of diversification to build a portfolio for clients that is in line with their risk tolerance. You can see from this chart that a diversified ("Asset Allocated") portfolio, represented by the light gray squares, reduces the roller coaster ride of returns, and therefore increases an investors chance of being able to ride out the storm when the markets get volatile.

Lesson 3: Avoid the temptation to time the market

The desire to liquidate holdings or invest funds when you believe something is going to happen in the short-term rarely proves to be an effective strategy. There are many times in history that headlines could make one weary of investing, but hindsight shows us that people sitting out of the market experienced significant opportunity cost during many of those times. To successfully "time the market" you must make two great calls; when to sell and when to buy back in. Individuals rarely make both those calls correctly. One reason it is so hard to get back in is that many of the best days in the market occur amongst the worst times in the market and missing those days can have devastating impacts on investor returns over time.

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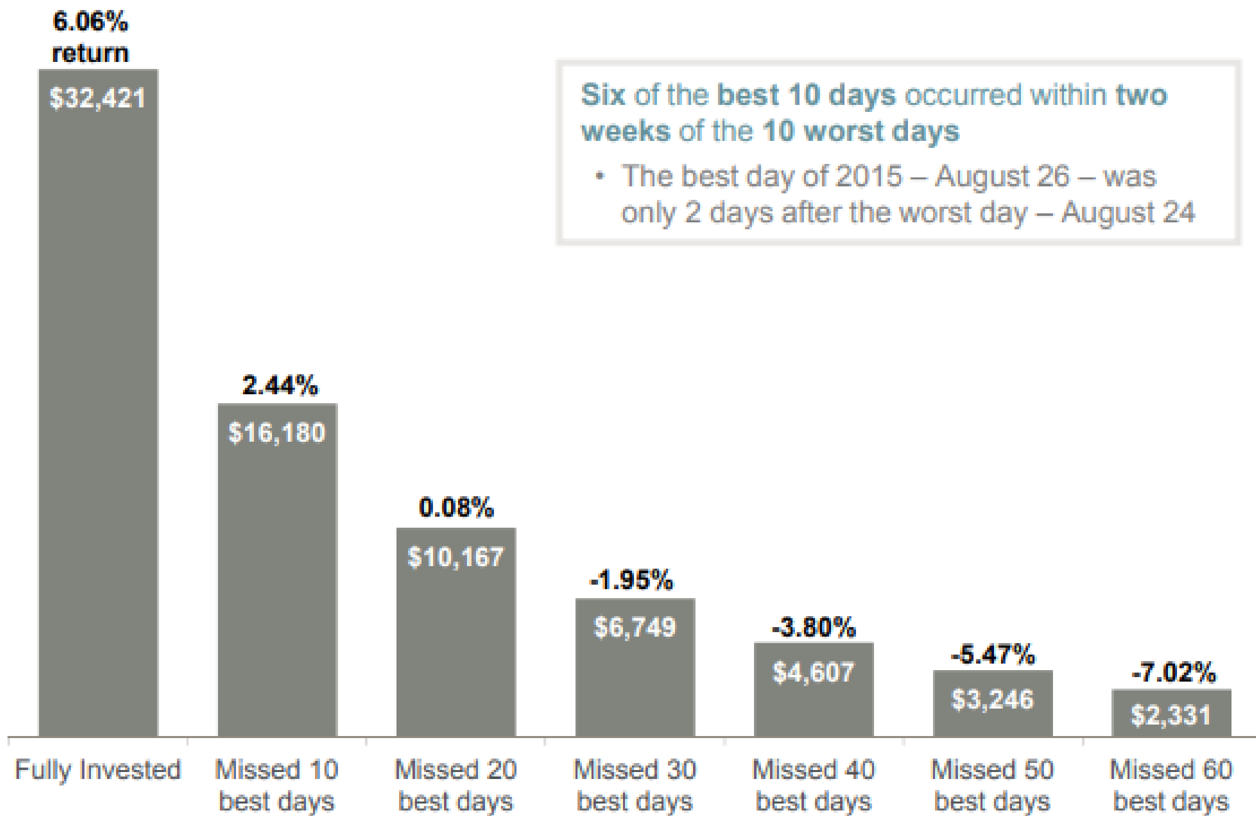
The chart below shows 20 years of data for the S&P 500 through the end of 2019. It shows an investor's return on a $10,000 investment if they were fully invested (left bar), or missed the 10, 20, 30, 40, 50, or 60 best days in the market over that time.



See Disclosure #3

You might be thinking that you would have to be unlucky to miss even the 10 best days over 20 years, and we would agree. However, from January 3rd, 2000 to April 19th, 2020, six of the seven best days occurred after the worst day and seven of the ten worst days were followed the NEXT DAY by either top 10 returns over the 20 years OR top 10 returns for their respective years. The point being, when the markets turn, they often turn very quickly and that is exactly what happened in 2020.

Does this mean we recommend putting all your money in the stock market then never touching it again? Absolutely not, as plans need to be adjusted to your goals and risk tolerance over time. However, we believe a well-thought-out diversification strategy and periodic rebalancing is still the fundamental basis of a good investment plan. In times of uncertainty, sticking to a disciplined investment approach utilizing strategic, diversified asset allocation will hopefully allow you to benefit from those best days in the market that can be critical to a portfolio's long-term performance.

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Disclosure #1: Source: Barclays, Bloomberg, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management. Returns shown are based on calendar year returns from 1950 to 2019. Stocks represent the S&P 500 Shiller Composite and Bonds represent Strategas/Ibbotson for periods from 1950 to 2010 and Bloomberg Barclays Aggregate thereafter. Growth of $100,000 is based on annual average total returns from 1950 to 2020.
Guide to the Markets – U.S. Data are as of December 31, 2020.

Disclosure #2: Source: Barclays, Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management. Large cap: S&P 500, Small cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Comdty: Bloomberg Commodity Index, High Yield: Bloomberg Barclays Global HY Index, Fixed Income: Bloomberg Barclays US Aggregate, REITs: NAREIT Equity REIT Index, Cash: Bloomberg Barclays 1-3m Treasury. The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Bloomberg Barclays US Aggregate, 5% in the Bloomberg Barclays 1-3m Treasury, 5% in the Bloomberg Barclays Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period from 12/31/05 to 12/31/20. All data represents total return for stated period. The "Asset Allocation" portfolio is for illustrative purposes only. Past performance is not indicative of future returns. Guide to the Markets – U.S. Data are as of December 31, 2020.

Disclosure #3: Source: J.P. Morgan Asset Management analysis using data from Bloomberg. Returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Indices do not include fees or operating expenses and are not available for actual investment. The hypothetical performance calculations are shown for illustrative purposes only and are not meant to be representative of actual results while investing over the time periods shown. The hypothetical performance calculations for the respective strategies are shown gross of fees. If fees were included, returns would be lower. Hypothetical performance returns reflect the reinvestment of all dividends. The hypothetical performance results have certain inherent limitations.
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