Sound Financial Bites 008 - The Market Crashed Now What

Episode Transcription

> *"People would much rather work to avoid a loss than to produce a gain."*

Hello and welcome to Sound Financial Bites, the podcast from Sound Financial Group , where we're helping you design and build a good life. My name is Paul Adams. I'm president and CEO of Sound Financial Group, and your host for today.

Today's topic is going to be on a subject of The Market Crashed Now What. You may be listening this podcast, where the market turned down tremendously yesterday, or it's been on a tear upward for 10% in the last month. This is going to be one of those podcast you're going to want to go back and listen to on a consistent ongoing basis to help you hold, learn, and understand investment discipline, when the rest of the world is getting undisciplined. Everybody gets undisciplined both in times of market - the market's climbing during bull markets, and they get undisciplined when it's bear markets. Heck, people get undisciplined when it's level. So we're going to come back to that; that's going to be the topic today.

If you've not already had a chance to engage one of our advisers, I cannot encourage you enough to just email info@sfgwa.com and spend 30 minutes on the phone with one of our advisers. We work with clients all over the country. Our purpose is to help educate you, to make solid financial decisions using that educational and coaching-based platform, so that all we need to ask you to do is intellectually engage in learning in that process.
You can also get to our website at www.sfgwa.com to download videos, white papers, articles, get the first three chapters of my book for free, or go online to Amazon and have it ordered before we're done with this podcast. We look forward to maybe even having you engage with us at one of our live client educational events that we do throughout the year. The schedule is up on the website. Now to our matter at hand today.

This idea of "Man, if we put money in the market, the market goes up and down. What do I do?", because the market is going to do well sometimes, sometimes it's not going to do well, and I need to get ahead of it. I need my money to get a good rate of return.
In our last podcast, we talked about this idea that savings is going to be key to you building wealth. It will be more important than rate of return. We need to be disciplined in our investing so that we don't lose the rate of return that we're building. So one of my favorites is a quote by Benjamin Graham, is that "Investors who have either the enterprise or the money to invest now, somewhere near the bottom, are likely to prevail over those who wait for the bottom and miss it." And what that really speaks to is this idea of market timing that we feel like we can put our money in out of the market in a way that will give us the ability to miss all the downturns. In fact, a great deal of economic and psychological research shows, people would much rather work to avoid a loss, than to produce a gain. So these market downturns can really get on people's nerves in a way that causes them to make bad decisions elsewhere in their life.

Since 1928, there's been 87 market drops of 10% or more and 23 market drops of 20% or more. But since 1946, it's taken the market just 111 days, on average, to rise back to its pre-crash levels, meaning that in less than half a year, in like five months, four months, like it doesn't take that long for the market to get back to where it was, but people try to get in and out to avoid that feeling and in fact, may actually hurt themselves. But it is the volatility that causes us to get a better rate of return. Let me give you an example.

If you wanted to put money in CDs at a bank, you're going to get in today's interest rate environment, you're going to get a pretty, miserable overall rate of return on CDs at a bank. You may be at like 2% a year. Now think about that, they're gonna give a 2% a year, but that is the rate of return that you'd get if what you'd need from the bank is a very smooth and up and to the

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right curve on your money, meaning I don't want to take any risk. I never want to dip in the money. I just want to consistently go up every year. That is, in a sense, what we would point to, in a tool that you experience when you walk into your bank, in a CD - 2% rate of return, no risk or very low risk - versus when you put money in the market, the market goes up and down, because it's opinion based. There's money that is going in and out of the market, in and out of the individual stocks that you're invested in and the volatility causes our money to go up and down. But it's also the volatility that gives us rate of return. You see, if the stock market could somehow be magically smooth, it would not pay anything more than the risk free rate of return we could get elsewhere. There would be no risk premium. It's because stockholders choose to get this - what's called risk premium - meaning I'll take a little bit of risk and you give me a better rate of return over time. That is what causes us to get a better rate of return over time in the stock market. We are willing to take the risk. So every time you see volatility, it's very easy to be upset about it, but the other thing to think about - and this is what I do when we teach our clients to do - is simply realize that it is that volatility. It's that uncertainty that gives us the better rate of return over time. That uncertainty is the thing providing the solution - it's not the problem. It's just that we have to stay disciplined and effective in our strategy over time, okay.

So what we're going to do is we're going to kind of look at what the market's done in the past. We're going to look at some crashes going back starting at 2007 - working ourselves back to the early 1900s, and seeing what happened. Looking at the S&P 500, which is a great index, for a thing about what the US markets have done, and it's the one that's most visceral to most people who may be on this call now. Our portfolios are structured, passive portfolios, and what we're doing with our portfolios is that it's much better allocated than S&P 500. We have about 12,000 different securities in them; they're managed in way that has them deployed across 42 different countries. So we're really trying to be allocated in a way that gives us the experience of the market overall, not even just the US market but the market's performance.

"Volatility gives us a rate of return."

So the crash that happened between November 2007 and February 2009 took 16 months to happen, and the total S&P return from that period of time was negative 50%. There were covers of magazines in 2008 with like the old super lines from the great depression saying, "This is it," we have quotes like "Mounting fears shake world markets as banking giants rushed to raise capital." It's the Wall Street Journal 2008. A new phase of financial crisis was on the cover of The New York Times in September 2008, and yet, if you were at the bottom of the finishing of that drop, and you just stayed in the market from February 2009 - just as the S&P 500, and then rode it back up to the end of middle of 2013. You would have had a rate of return that had 2.8 times - 280% growth in that portfolio. In fact, if you just use the simulated portfolio, there would be 70/30 allocated 30% fixed incomes, 70% all indexes, that portfolio would be up even as much at 2.5% - meaning, 250% growth. So we would have - as long as we were in, we'd be okay.

Now just that same simulated portfolio - 70/30 portfolio, since March of 2009, after the crash, one year later, that portfolio had returned 54% of the positive. Three years later, it had grown 22% a year. People don't talked about that, that we have to be in there and we have to stay in there. So let's go further back, perhaps that was an anomaly although certainly to many people they still feel that one. Let's look at the crash from 2001 to 2003.

It lasted 22 months and the S&P return was negative 36.42%. That was largely referred to as the Tech Bubble that wiped people out, and -- people left and right. It was like the world was ending that nobody knew what they were talking about and no investment was going to pan out because this new economy everybody was anticipating during the high-flying tech years had change so much. Well, let's look what happened. If you are in it the bottom again, at the beginning of 2003,

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whether you are in that simulated 70/30 portfolio or the S&P 500, if you were in then, and your portfolio went all the way through the downturn again in 2008 all the way back to today, your money in that simulated 70/30 portfolio be 300% growth. Right, your $1 will be $3 over that period of time. If it was S&P 500 it still be about 2.7, and that includes having gone all the way back down in the market downturn of 2008. Now, these are all as if you never added any more money. In fact the rate of return may actually be much better had you been consistently, and I'm not talking about necessarily adding money every single month. But, inevitably over time we're either saving money in life or were deploying money out of our investments in our life in retirement. But, we would have had a tremendous amount of growth of our money, by simply having stayed in the market. Now those annualized rates of return of our 70/30 portfolio, 1 year back would have been 44%, 3 years 20% but there with that 10 year period of time. Remember the lost decade people talked about from the end of 2003 all the way through 2013, you'd still have a 9.49% rate of return and that portfolio rate of return would have existed simply by holding strategy. If you have come to our live events or heard me speak in the past, you've heard me talked about this idea, that what we need to do is set strategy and hold strategy, that a great deal of the financial benefits we will see in life will be simply for not trying to change horses midstream, that we need to be clear about the strategy were setting, be sure that whatever advice you're working with, you fully understand what you're doing. If you ever forget what you're doing, go back and get recentered in why you did the strategy originally, so that you can hold strategy and that's particularly true for investments.

“We are either saving money over life or we are deploying money out of our investments.”

Let's go back to the next crash 1987. This is referred to as Black Monday, and we have September 1987 through October of '87 - two months long, 23% lost in S&P 500. I know several people actually got into our business - the financial advising business, the day that this happened, like their first day at work. Not a great day to start at a new industry, but here's what I want you to think about. Let's say the market fell apart, you stayed in at the bottom whereas your money -- about the end of 2005, mid 2006. If you just held for 20 years - let's just take it from November of '87 to October of '07 - all you did was hold strategy for 20 years, what would the wealth growth had been if you just held that $1. Your money will be about 10 times - worth 10 times what it was worth, if you are in the S&P 500 or that 70/30 hypothetical portfolio - meaning you would have come back and then some - $100,000 invested then would be worth a million dollars today without having added to it. Now there's going to be taxes and things that have to come out of that over time, but I want everyone here to get that each time a market downturn occurs, everybody wants to get in on the parade and talked about how bad it's going to be. Earlier in 2015, I remember taking off right as the market started to slide, and I got to watch a bunch of pro golfers I was sitting with in first class, all glued to the screen watching as the market had one of its biggest drops in 2015 in a single day, as they're trapped in an airplane. And I watched a bit bemuse as all of the financial prognosticators were on the TV, on the news media trying to get people not to make appropriate financial decisions. What did they want to do? They wanted people to not change the channel. So they have got to be able to keep our attention and tragedy does a great job of keeping our attention. I just want all of us to be able to hold that when the market goes down like that, we can know that it's actually producing returns for us, because it's our ability to hold through the volatility that makes the difference.

Now in a future podcast, I'm going to talk about the differences between building sufficiency and surplus, and what that means for you that if you have a safe strategy with promise-based assets, you can hold even better through all these problems. Let's go back to 1973, we had another market downturn that lasted 21 months, January '73 through September of '74. Twenty-one months S&P return, negative 42%, but if you just held for the following 20 years, just stayed in, your money will be worth 20 times. It was a diverse allocation of portfolio, 20 times to what

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you've started with by just holding, like don't just do something and stand there, if you would have had stood there, you would have had 20 times of return, and even in the plain old boring S&P 500, though it would have been a rougher ride than a well diversified academically allocated and globally diversified portfolio, even the S&P 500 would've be about 16 times what we started with.

The rate of return, again, one year after the downturn was 33%. The 20-year rate of return of our 70/30 portfolio was 16% after the crash. So, we can go back and look at 1970's crash, 1962's crash of negative 17% - I'm going to go back - we can look at 1946, the downturn at that time was 11 months and a 20% negative rate of return. In fact, one of the articles from the 1940's just like the equities are coming unwrapped, and there's going to be problems and people are liquidating left and right, and they're going to have to do something about this in Washington, D.C.

Truman was speaking about the market at that time of the problems. And yet, what we see is that the market came back. 1934, we had a downturn, get this, I just want you to hang here with me. This is the big one, the total S&P return from 1929 to 1932, and this is the best description of the S&P 500 - it wasn't - it didn't exist in its current form, back in 1934. But it was down 83%, and imagine if what someone would have done and said,"I'm just going to swear off the market, I'm never gonna be back in the market again." If you went through that, and then went through the remainder of World War II where three quarters of the world's capital production was destroyed. But you just held for 20 years after, that's it. You didn't do anything fancy, no market timing - holding a well-allocated portfolio that's globally diversified for the following 20 years, in the 70/30, you would have done what you would've had gone from the $1 to $24, a 2,400% return. That is simply by holding strategy. In fact, the single year after that huge dump in the market - the market was up in one year after by 226% 1 year after the crash. And yet, if you locked in losses even after the end of 2008 in the downturn in S&P 500, and then you went right into fixed income assets, which treasury bills at that time were staying at less than 1%, it would take you thousands of years to rebound your lost without staying and holding in equities.

So, the thing that I don't want people to take away from our call today in our podcast today is this idea that what you should do is blindly take risk and never look at your portfolio. In fact, I think that that causes people to not have understanding and later be a little bit resentful and not take full responsibility for their investing. I want you to look but I also want you to begin to increase your understanding because it's that volatility that gives us the rate of return. It reminds of a very funny quote that i'm going to use to close out our podcast today.

In 2001, during the big tech blowup, there was actually a stock by the name of Nortel that just got crushed. You see, if you'd purchase a $1,000 worth of Nortel stock, about a year prior, it will be worth a $67 after the crash. If you would've taken that same $1000 and purchased a bunch of Budweiser - the beer not the stock - then drank all the beer, and then redeemed each bottle for the nickel deposit, you'd have $78. The moral of the story and this is the funny thing people say out there about the market, is drink heavily and recycle, rather than invest. And the person that made that investment in Nortel is blaming the market, not their own behavior, and convinces others that it's the market and not their own behavior. And yet, we can do is we can overcome many market forces, by simply holding strategy, watching our behavior, and the future podcast, we're going to talk about the importance of making sure you have other strategies in place that produce safety and peace of mind for you, so that this market-based assets - these surplus assets, can get you the highest, most predictable and consistent performance.

Glad you can be with us on the podcast today, and we look forward to seeing you in person

perhaps in one of our upcoming events, or engaging with one of our advisers and we'll look forward to future podcast where we'll talk about sufficiency and surplus, and importance in having those safe strategies in behind your equity-based strategies. Have a great day.

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2018-55762 Exp. 3/20

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