February 2020 Market Update

Corrections are normal, Bernie Sanders, and Pangolins.

By Sean Puckett, CFA, CAIA
OCIO

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We are constantly trying to remind investors that short-term events, market pullbacks, and news headlines need to be put into context with their investment time horizon. I will spend a short time offering my two cents on what I believe is causing the recent market volatility, but will spend the majority of the time showing you some data that might give you a more beneficial perspective on “risk” and how it applies to you.

It appears that the main reason we have seen such sharp, dramatic selling occur is due to growing fears of the Economic damage the Corona Virus may have during 2020. I believe this fear may have triggered the initial selloff, but it also may have woken investors up to the notion that the US Equity markets may be overvalued (see our previous commentary). Also, the shaping Political landscape may be having an impact on markets, with Bernie Sanders winning the recent Nevada Caucus, becoming the democratic party’s front-runner for the nomination. It is possible the market is pricing in a probability that Bernie may be elected and considering the impact that his policies might have on the US Economy and financial markets.

When you look at past selloffs, there usually is a fairly consistent theme during a normal, health market correction in an otherwise strong bull market. Treasury yields drop and the US dollar rises due to increased demand for safe haven assets, value stocks tend to do better than growth stocks. This time, the US Dollar index (DXY) has declined, Gold has declined, and Value stocks have declined more than growth stocks.

With a Virus, there is no clear way to measure the potential long-run economic impact, and the news from the CDC has increasingly become more concerning as efforts by China to contain the Virus have largely failed. These types of exogenous shocks to the economy are unpredictable and cannot be cured by Central Bank easing which is why I believe we are seeing such dramatic declines the past two days of trading. Sure, if the Federal Reserve decrease rates, now I can go borrow at a lower rate, but I’d prefer to not contract a potentially deadly virus and would likely stay home.

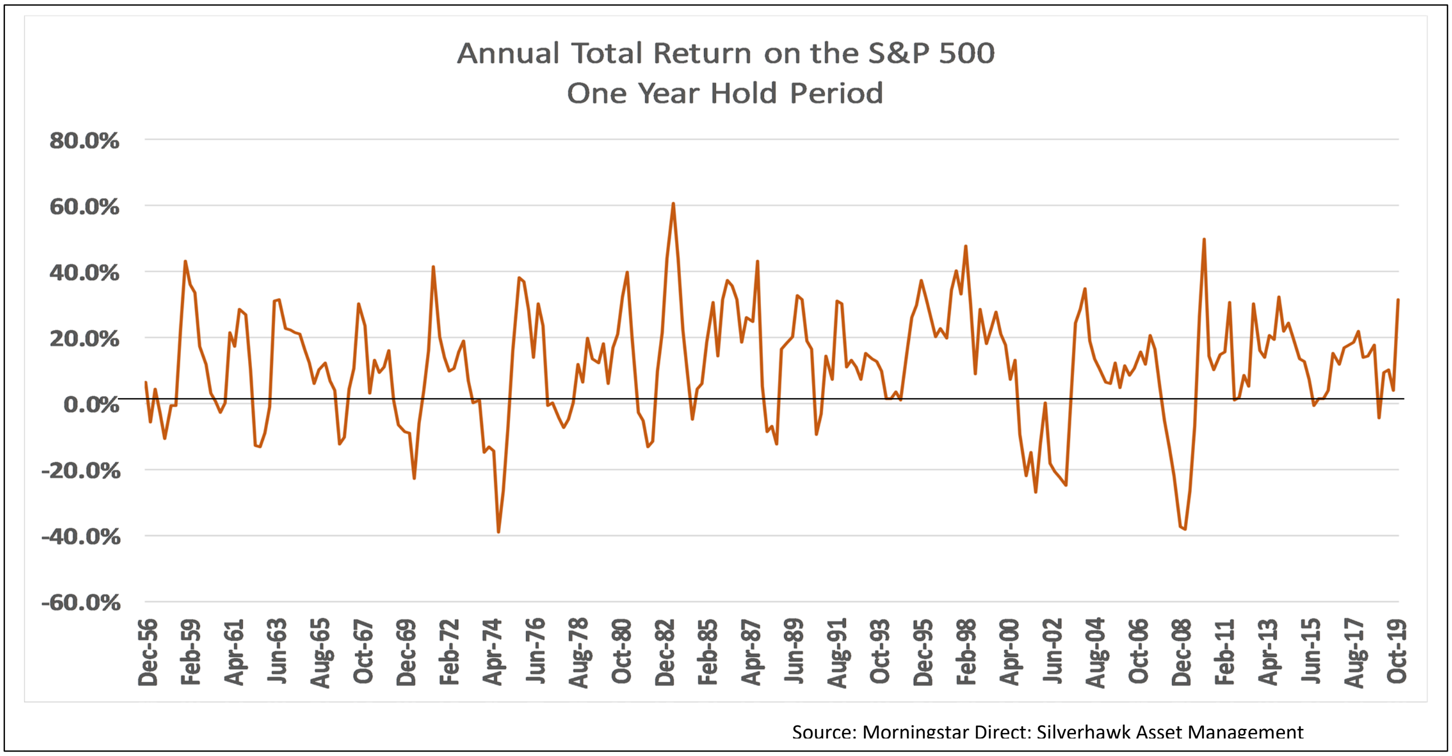
The Good Stuff

When market volatility is present in markets, we encourage our clients to ask themselves “does this impact my long-term investment objectives”. If your investment time horizon is one week, the recent pullback in the Global Equity markets without question has threatened your financial plan.

To help clients answer that question, below are some graphs that show the average returns on the S&P 500 Index (a widely used barometer of the US Stock market). I show a one-year, three-year, 10-year, and 20-year “buy and hold” investments into the index, with quarterly data. For example, for the three-year graph, the data point for December 31, 2019 represents the average annual rate of return an investor would have attained if they invested into the S&P 500 index (and reinvested dividends) on December 31, 2016 and then sold their investment on December 31, 2019. The other graphs follow the same methodology, and the story that they tell is important for clients to understand to put what “risk” means to them and their specific time horizon. There are 253 data points, each representing a unique “buy and hold portfolio” with varying entry points and exit points on their investment.

Disclosure: the following graphs are not a recommendation to buy or sell any security. Past performance is not indicative of future results. These charts are for informational purposes only and do not represent performance experienced by actual clients.

Graph Number One:



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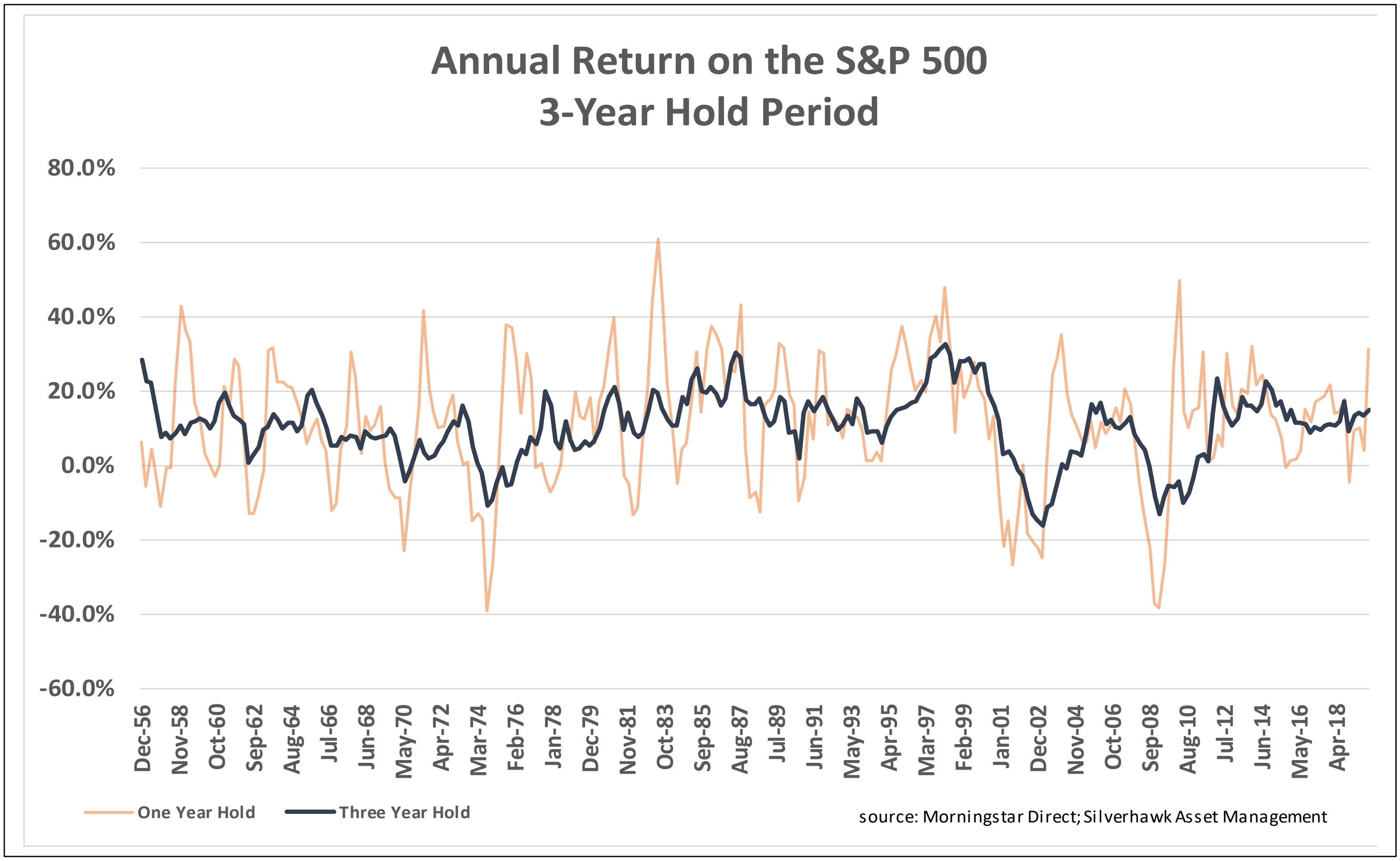
If your investment time horizon is one year, then you would care about the information in the above chart when making financial decisions, today. Most investors do not have a one-year investment time horizon, with time horizon most often meaning how long you have to invest your money (life expectancy minus current age is a proxy for this). If your time horizon is not one year, then you shouldn't care about what the stock market might return over this short-term period. The average annual return came out to 11.4%, but the average annualized standard deviation (risk) was 17%. Returns vary wildly around the average, and there were 12 periods with returns less than -20% (4.7% of observations).

Graph Number Two



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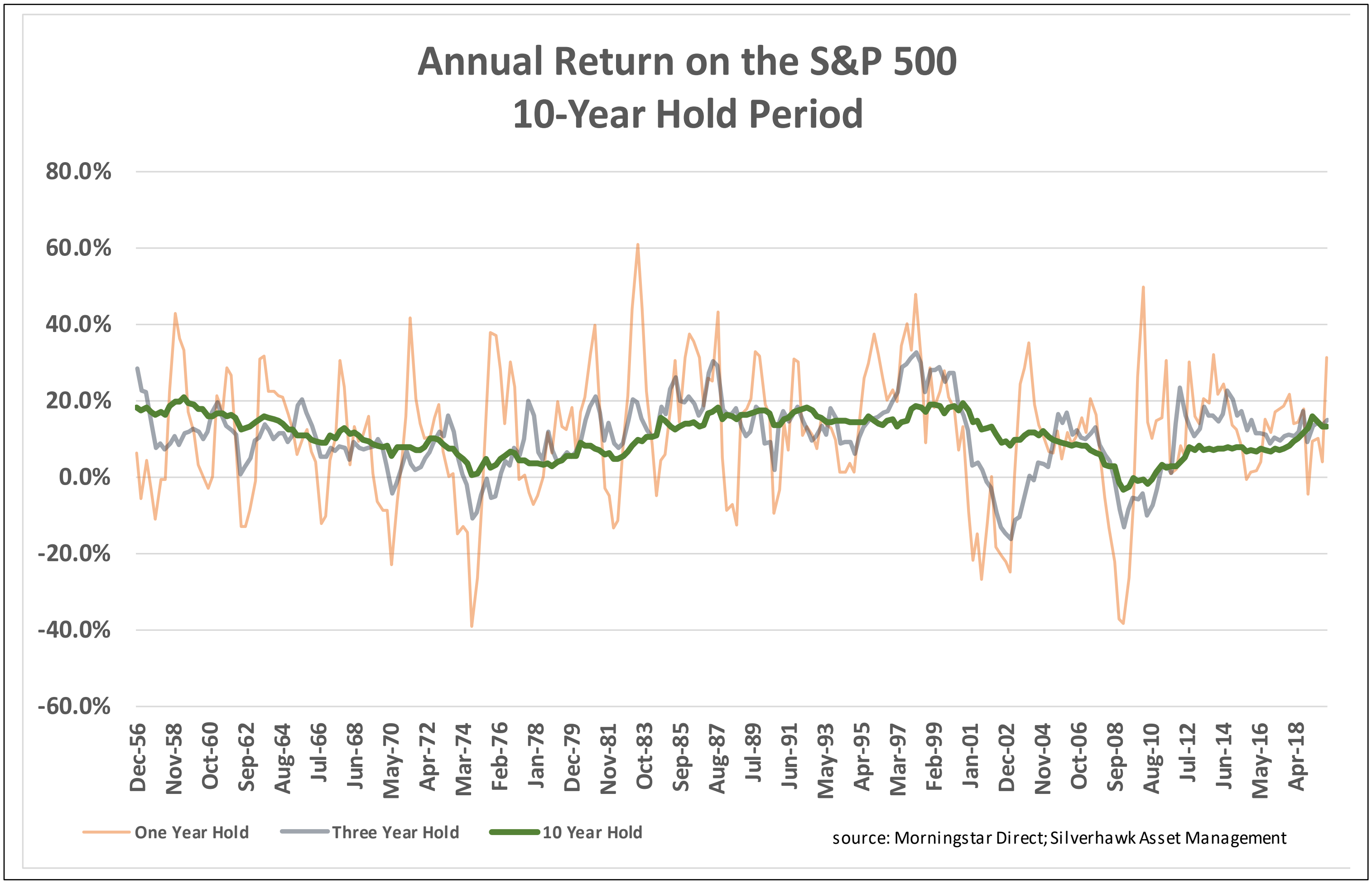
Now if we overlay the three-year buy and hold investment on top of the one-year, the average annual return was only slightly lower at 10.7%, but the three-year average standard deviation was only 9% and the portfolio did not have any period in which it recognized a loss of more than -16%. Not bad, but still a three-year time horizon is extremely short for most individual investors.

Pangolins

I think most of you by now have forgotten that you were going to read something about a Pangolin at some point, so I'll take a minute and explain the relevance to the update. A Pangolin, or "scaly anteater" is a mammal which comprises four species found in Asia. They range in size from 8 lbs. (Chinese Pangolin) to 73 lbs. (Giant pangolin). Pangolins have also been suggested by scientists at South China Agricultural University in Guangzhou to be the likely host of the COVID-19, or "Coronavirus". I have yet to see any published research confirming that they are in fact the host of the virus; however, they are thought to be one of the more widely poached and trafficked mammals in China due to a high demand for their scales and meat. If scientists do make the connection between the mammal and human virus strains, then that could potentially lead to a vaccine.

Graph Number Three



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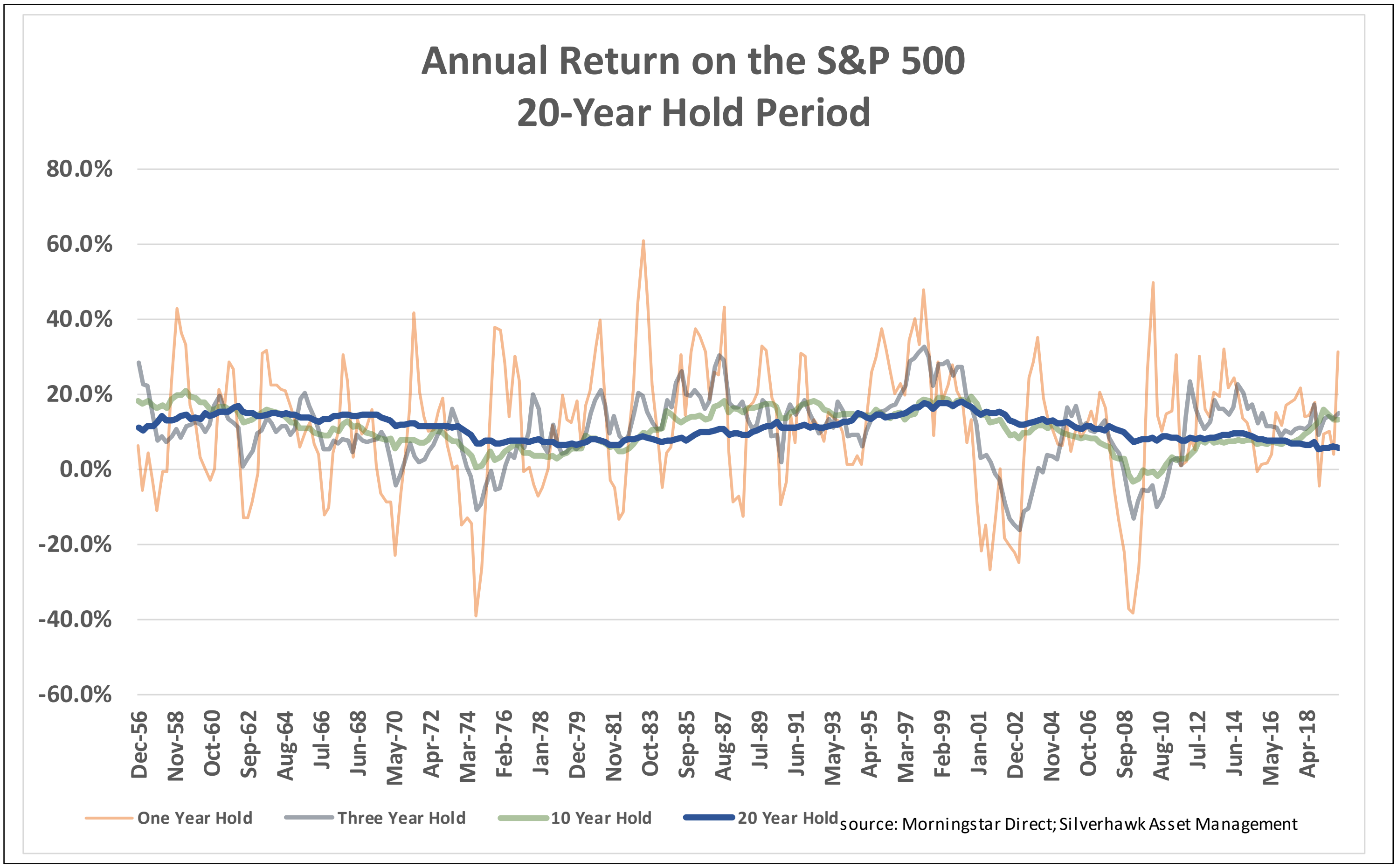
If your investment time horizon is 10 years, then you would care about the information in the above chart when making financial decisions, today. Now you can see the return data becoming even smoother, and in no 10-year period going back to 1956 did any buy and hold portfolio (out of 253 possible portfolios) lose more than -3.0% (December 2008 to September 2010 is the only period of time that a 10-year buy and hold S&P 500 investment had negative average annual returns.) The average annual return for the 10-year buy and hold portfolios came out to 10.7%, with a standard deviation of those 10-year return of 5.3%. 10-year investment time horizons do have a larger role in financial planning than the one and three-year horizon's we've looked at so far. Whether that is somebody nearing retirement that needs to start considering dialing back risk to prepare for portfolio withdrawals, or an investor that may need to pull their investment out of the market within that 10-year period. Even still, most individual investors have investment time horizons greater than 10 years.

Graph Number Four (the last one)



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If your investment time horizon is 20 years, then you would care about the information in the above chart when making financial decisions, today. The 20-year buy and hold portfolio data shows that over no period from 1956 to 2019 did any of the 253 unique portfolios have an average annual rate of return less than 5.6%. In addition, the average annual rate of return for the 20-year portfolios was 11.3%, with a standard deviation in those returns of 3.1%. Statistically, this puts the odds of not losing money over a 20-year time period (if you buy, and hold) at 99.9%.

I hope this information helps you put short term noise, headlines, and volatility into perspective based on what your investment time horizon is. Silverhawk evaluates client time horizon, risk tolerance, and multiple other factors to determine a client's suitable TRIA® allocation. Volatile markets are also a good time to remember why we allocate client portfolios into markets other than just public equity and fixed income. When equity markets begin to slide, people still pay their rent (multifamily investments), people still need to buy groceries (necessity retail real estate investments), people still travel for work or pleasure and need a place to stay (hotel investments), and businesses still need to turn the lights on (office, warehouse, industrial real estate investments).

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