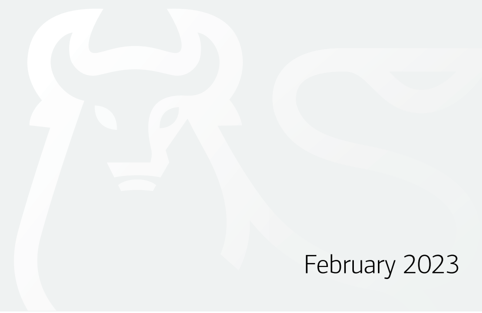

CHIEF INVESTMENT OFFICE

Investment Insights

The Journey of Long-term Investing

February 2023

All data, projections and opinions are as of the date of this report and subject to change.

AUTHORED BY:

Chief Investment Office

Data as of 2/1/2023 and subject to change.

Investors have faced an incredible shift in markets over the last several years. The S&P 500 returned a cumulative 100% on a total return basis from 2019 to 2021, an annual rate that was significantly higher than the historical norm.[1] While an impressive recovery in economic activity and corporate profits from the pandemic lows contributed to stock market gains, another significant tailwind was the accompanying accommodative monetary policy of zero interest rates, quantitative easing and historically high growth in money supply.

However, as higher-than-anticipated levels of inflation became the primary economic concern in 2022, the Federal Reserve (Fed) and other central banks shifted to a tightening mode to rein in the possibility of a further acceleration in inflation levels. As the Fed reduced liquidity from markets, a major repricing of risk across asset classes unfolded as U.S. Equities entered a bear market, or a decline of greater than 20%, and the aggregate U.S. bond market posted its largest annual loss in the history of the data series.[2] Looking ahead, uncertainty over the depth of a possible economic and earnings recession could keep volatility elevated, but the major derating in valuations over 2022 has shifted forward looking return expectations higher, setting the stage for investors to possibly switch from defense to offense on Equities soon once again.

Volatility Is Considered Normal

Volatility is integral to investing in the financial markets and pullbacks are an opportunity for long-term investors to add to high-quality investments. Shallow 5% pullbacks happen quite regularly—on average three times a year for the S&P 500—and the market tends to bounce back quickly from these.[3] Declines of 10% to 20% are also not that uncommon and occur about once every 2.5 years, with the markets recovering the selloff in roughly four months. Severe declines of 20% to 40% are usually associated with recessions and occur about once every 8.6 years, but even those recover fairly quickly from the perspective of a long-term investor—14 months on average.

Exhibit 1: S&P 500 Drawdowns And Recovery Times (since 1946).

Decline	Number of Declines	Average Decline	Average Length of Decline from Peak to Trough (Months)*	Average Time to Recover From Trough to Previous Peak Level (Months)*	Average Length Between Declines (Years)**
10%–20%	30	-14%	4	4	2.5
20%–40%	9	-28%	8	14	8.6
40%+	3	-51%	22	57	23.6

* Based off of number of complete months in the period. **Trough Date to Trough Date. Table excludes the 2022 market drawdown. Sources: Chief Investment Office; Yardeni Research; Bloomberg as of January 27, 2023. **Past performance is no guarantee for future results.** Performance would differ if a different time period was displayed. Short-term performance shown to illustrate more recent trend.

[1] Bloomberg. Data reflects total return from December 31, 2018 to December 31, 2021.
[2] Equities represented by the S&P 500 Index. Bond represented by the Bloomberg U.S. Aggregate Bond Index.
[3] BofA Global Research. January 2022.

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Portfolio Considerations in an Era of Tight Financial Conditions

During the next phase of the market cycle characterized by economic volatility, earnings uncertainty and a potential shift in monetary policy, we suggest that investors consider the following portfolio actions:

- Prepare for portfolio decisions to become more frequent heading toward a new market cycle. Investors should continue to remain anchored in their long-term asset allocation; ensure appropriate diversification across asset classes, regions, styles etc.; consider risk-appropriate tactical tilts and rebalance opportunistically to ensure optimal exposures. These are all tenets of our disciplined investment process that we apply to managing Chief Investment Office (CIO) portfolios.
- Persistent inflation means that long-term investors should access and stay invested in assets that have a history of providing real returns i.e., returns above inflation. Growth assets like public Equities and certain similar private assets make sense.
- Seek total return opportunities. Dividends and other forms of yield become more important as equity market price returns appear more muted compared to the strong gains from the last several years. Dividend growth strategies can provide income and benefit from rising prices in the economy which add to company cash flows.
- Positioning may need to be more micro than macro as the effect of weaker economic activity and tighter liquidity conditions will be specific to sectors, industries and companies, leading to a higher dispersion in earnings. High quality, free cash flow, pricing power, operating leverage, sustainable yields, and relative earnings strength are features that are likely to be rewarded in the marketplace. The opportunity set for fundamental research-driven Active Management[4] strategies has improved.
- Having some allocation to Alternative Investments, for qualified investors, aimed at the purposes of capital appreciation, yield, inflation protection, and non-correlated exposure to traditional asset classes should be beneficial to portfolios from a risk/return perspective. The amount allocated to alternative assets depends on an investor's financial goals, liquidity needs, risk tolerance and time horizon, and diversification.
- Maintain a longer-term outlook and stay invested in the market. History shows that the longer one's time horizon, the less likely one is to lose money in the equity markets. For an Equity investor, the probability of losing money over a 1-year holding period is 26%. Whereas the probability of losing money is only 6% for a 10-year holding period.[5]

The Importance of Knowing Yourself As An Investor

Before developing a disciplined investment plan, process and overall framework, it is important to understand who you are as an investor. This is the foundational element of the overall investment framework and can significantly determine your response to major turning points in the economy and markets and, in particular, during periods of heightened volatility.

These areas highlighted on the right affect the type of investor you are and may help inform your original plan and the responses during bull markets as well as sharp, short term stressful periods. Creating your ultimate blue print involves understanding your financial goals, risk level, time horizon, liquidity needs, tax status, and, importantly, the type of investor you are. All of this may seem like an overly complex undertaking. At times, it can be. However, if you have a disciplined investment process, utilize a consistent research and due diligence framework, understand the type of investor you are, and work with an advisor that can help you manage all of this, stressful market periods may be viewed as an opportunity and not a daunting experience.

ARE YOU AN INVESTOR THAT...

- has a well-developed plan and rebalances back to your asset allocation targets during times of excess market gains or stresses?
- attempts to "time market gyrations" by moving in and out of specific investment exposures and then back in again?
- typically takes advantage of corrections or sell during more fearful periods?
- has a highly diversified portfolio which allows for more subtle adjustments across and/or within asset classes during market stress periods?
- aims to beat a specific benchmark, outpace the popular industry gauges such as the S&P 500 or MSCI World Index, or do you prefer to set your own asset-weighted personal benchmark based on your goals and objectives?
- is a home country bias U.S. investor not interested in non-U.S. exposure and is comfortable potentially missing out on international opportunities or their diversification benefits?
- invests in Alternative Investments,[6] if qualified, to help mitigate against large market drawdowns, to capture excess returns, or to help diversify the return streams of public, more liquid investments?
- leverages areas such as due diligence of managers, solutions, and individual investments, plus taxes, portfolio turnover, and the overall costs of developing, managing and maintaining your portfolio?

[4] Active management seeks to outperform benchmarks through active investment decisions such as asset allocation and investment selection.

[5] BofA Global Research, Chief Investment Office. Data as of December 30, 2022.

[6] Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to qualified investors.

Index Definitions

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in dollars.

S&P 500 Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

MSCI World Index is a market cap weighted stock market index of 1,546 companies throughout the world.

Important Disclosures

Investing involves risk, including the possible loss of principal. Past performance is no guarantee of future results.

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All recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors.

Asset allocation, diversification and rebalancing do not ensure a profit or protect against loss in declining markets.

Dividend payments are not guaranteed, and are paid only when declared by an issuer's board of directors. The amount of a dividend payment, if any, can vary over time.

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Alternative investments are speculative and involve a high degree of risk.

Alternative investments are intended for qualified investors only. Alternative Investments such as derivatives, hedge funds, private equity funds, and funds of funds can result in higher return potential but also higher loss potential. Changes in economic conditions or other circumstances may adversely affect your investments. Before you invest in alternative investments, you should consider your overall financial situation, how much money you have to invest, your need for liquidity, and your tolerance for risk.

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