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Investment Market Dynamics August vs. October

By Frank M. Antalek, Sage Hill

Mark Twain once quipped that “October is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February.” Beyond the comedic effect, this line serves to focus the mind on the risks of stock investing.

From July 22nd to August 8th, in just twelve trading days, the stock market as measured by the S&P500 was down 17%. From October 3rd to October 27th (18 trading days) the stock market was up 17%. The last 94 trading days have seen daily price changes of more than 1%, 57% of the time. Three out of ten trading days have seen price changes of more than 2%, and price changes of more than 3% have been experienced once every eight days. And for final measure, there were 6 trading days during that time period of 4% or greater. (2 positive and 4 negative)

I’m sure most of you were aware of the stock market volatility over the last few months, but were you aware the swings were this significant? Are you aware the stock market is essentially even for the year?

Unfortunately, many investors have been rocked by the up-and-down market in recent years and have tried to manage volatility by trading in and out of stock market positions. Investors would do well to anticipate and prepare for, but above all, not react to these market swings.

In support of my warning about being a reactionary investor are the findings of a study by market research firm DALBAR: “Investment results are more dependent on investor behavior than on fund performance. Mutual fund investors who hold on to their investments are more successful than those who time the market.”

“Discipline” is important for investors because it emphasizes process regardless of the short-term volatility and emotion sweeping financial markets. Rather than be simply reactive, we believe that the consistent application of an objective, systematic process can be particularly beneficial during volatile times. Sometimes, doing nothing is a better answer than acting on emotion, but it may not always be the best answer. More on that later.....


The sharp stock market selloff this summer was accompanied by many of the usual suspects: questions about the economy, external shocks (the Treasury downgrade and European debt crisis), a spike in volatility, and massive redemptions from equity mutual funds.

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Indeed, data from the Investment Company Institute—or ICI, the investment management industry trade association— show that shareholder redemptions from stock funds surged in July and August as the stock market decline gained pace. Redemptions reached a peak in the week ended Wednesday, August 10 (which also happens to be the week the S&P 500 Index touched its most recent low). Unfortunately, the historical performance data at our disposal indicate that reacting to market downturns by selling during declines does not improve investor performance. On the contrary, data from Ibbotson Associates shows that since 1926, when stock returns for any three-month period are worse than -5%, the subsequent 12-month return is slightly greater than 10% on average. Of course, it is true that past performance cannot guarantee future results, and there is no way to be certain that buying stocks after a decline will yield positive performance down the road as it has in the past. But we can say that study after study has shown that knee-jerk selling in response to market declines does not improve returns.

The cycle of crisis, hope, relief and disappointment seems intact and we see it continuing for the time being. So what is an investor to do? As alluded to earlier... perhaps the antidote to reactionary investing of “buy and hold” is not the answer. This very topic was on the minds of many of the participants at the Investment Management Summit held at the New York Stock Exchange which I attended on November 9th. At the conference a message delivered by the Chief Investment Officer of Merrill Lynch Global Wealth management suggested that representatives need to integrate products that include hedging, shorting, options and margin strategies, along with non-correlated investments. May I suggest that the buyer beware? Full disclosure – I have witnessed many professionals acting with an aura of self-confidence that may be read as a validation of their competence. I believe there is a term that summarizes the point well: “illusion of skill”. These are complicated instruments, and in my view, the average investment professional does not understand how to properly apply to client portfolios. The Sage Hill investment management team has focused attention on risk mitigation in portfolios for many years and we believe that we have served our clients well. However, let me also add that I am not an expert in all the tools available; that is what twenty-five years of experience has taught me. No “illusions of skill” here.

So where do we go from here? The financial crisis of 2008, when the S&P 500 lost 39.2% in value, and the ensuing market volatility in the three years since, have served as a sobering wake-up call for the wealth management industry. And now it's dramatically changing the way it plans to do business in the years ahead.

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This is according to a new report from Ernst & Young, titled "Investing in the Future: A Focus on Wealth Management Product and Client Trends."

At the same time as the "industry" is playing catch-up to Sage Hill on the issue of risk avoidance strategies, another trend identified is the movement towards more open architecture. This is where asset managers partner with other wealth managers to offer best of class products and services. Existing Sage Hill clients have experienced this for years; we are glad to see a trend towards some of the old-line Wall Street firms finally joining the party of putting their client's interest first.

Meanwhile the International Monetary Fund Managing Director Christine Lagarde warned of the risk of a "lost decade" for the global economy unless nations act together to counter threats to growth. Should this scenario unfold, stock market investors may face a decade of minimal gains. We are combating this risk by deploying strategies that provide returns regardless of stock market performance. With low interest rates and performance from stock market investments erratic, we've been speaking with a lot of investors on the options available to combat a difficult environment for investors. We welcome the opportunity to speak with you as well.



Yes that's me standing on the podium of the exchange floor reflecting that the market just finished down 3.7% for the day – perhaps I released the gavel with a little extra enthusiasm - good riddance!

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