Boring Is Underrated

Historically Disconcerting

With all that happened last year, itâ€™s easy to miss the fact that the major stock market indexesâ€”the S&P 500 Index of large U.S. companies among themâ€”reached record levels last February. Up to that point, things seemed to be going well, with the markets set for another solid year of gains. Just a few weeks later, as news of the novel coronavirus crept into the headlines, the tone began to change.

On Monday, March 9, the markets experienced a tsunami of selling, resulting in a 7.6 percent drop in the S&P 500 Index. At the time, that was the largest single-day point drop in the indexâ€™s history. Not to be outdone, March 12 and March 16 both set new records, with the index falling 9.51 and 11.98 percent, respectively. In fact, eight of the 20 largest point declines in the S&P 500â€™s nearly 100-year history happened last March.

Of course, the market didnâ€™t go straight down. March also witnessed eight of the top 20 largest single-day point increases in S&P 500 history, including big bounces on the days after those historic drops.

While investors fret less about big gains than big losses, they count as volatility too and can be equally confusing. In the fog of war, itâ€™s tough to see clearly.

Different This Time?

Last year proved to be a very bumpy ride that challenged the patience of even the most seasoned investors. The fact that all of this market turmoil happened amidâ€”and perhaps because ofâ€”stay-at-home orders, rising virus case counts, skyrocketing unemployment, and social and political tensions made it seem like it really would be different this time. But it wasnâ€™t.

While the details change, the story is always the same. Markets donâ€™t like uncertainty. This is true of all marketsâ€”stock and bond markets around the world and currency and commodity markets. When a new uncertainty rears its ugly head, markets react. The uncertainty could be political (e.g., an election outcome or federal budget impasse), geopolitical (e.g., trade negotiations or terrorist attacks), economic (e.g., pandemic lockdown or Federal Reserve policy change), or natural (e.g., hurricanes or earthquakes).

Itâ€™s the surprise that matters. Markets need time to recalibrate, finding new levels as they seek to understand the practical impacts of a new reality. In the beginning, when little is known, different investors or analysts may have wildly different viewsâ€”or they may just be reacting to take risk off the tableâ€”resulting in significant levels of volatility. The bigger and more complex the uncertainty, the more volatility.

Over time, views converge as more information becomes known, or, as the range of possible outcomes starts to narrow, volatility subsides. If you need an example, just recall how little we knew about the virus and its effects on society and the economy last spring versus what we knew at year-end.

Of course, realizing this doesnâ€™t make it easier. Even normal levels of volatilityâ€”a 10 percent pullback every year or twoâ€”can be disturbing and cause investors to question their strategies, especially as they get older. The thought of a major market pullback in the last few years before retirement is enough to cause many to move to the sidelines. And yet thatâ€™s a very bad idea.

Boring for the Win

Even as you approach retirement age, you still need to think like a long-term investor. A 65-year-old woman has a life expectancy of 86.6 years; a man the same age has a life expectancy of 84.1 years. Thatâ€™s a minimum of 20 years to plan for. And remember: Life expectancy is an average. There is a very good chance that you will live longer than that. Perhaps a lot longer.

With interest rates at or near 0 percent, riding out a couple decades in cash is not viable. So how exactly can you get comfortable investing in stocks, knowing that volatility is inevitable? The answers to this question will sound like clichÃ©s. They are boring, but that does not mean that they lack merit or are untrue.

Spread It Around

Diversification, investing in a variety of asset classes, is both the single biggest investing clichÃ© and single best way to preserve and grow wealth. True, diversification means that you will never hit it out of the park, but it will help dampen risk and reduce the impact of a stock market pullback on your portfolio. Bonds, in particular, have historically been a powerful portfolio stabilizer and continue to add value, even at todayâ€™s low interest rates.

There is also a behavioral trick here. Any individual investment or asset class may be volatile at a given moment. However, viewing your portfolio in aggregateâ€”rather than focusing on a single componentâ€—will help moderate your fight-or-flight instinct when volatility rises.

Make a Plan

Investing for your major life goals without a financial plan is like going on a road trip without a mapâ€”or, these days, your smartphone. You might get there, but it will probably take a lot longer than you expected.

A solid plan will help you understand the income, expenses, and portfolio mix that will get you where you want to go and help you understand best-case, worst-case, and expected outcomes given a range of portfolio returns and market conditions. Done properly, a financial plan will provide you with a sense of purposeâ€”you know where youâ€™re going and what you need to do to get there. When the markets get rocky, revisiting your plan can provide a sense of confidence that the goals you have set remain achievable.

Find Your Sweet Spot

Putting it bluntly, if your money is keeping you up at night, you should consider how aggressively youâ€™re invested. An investment strategy that is too exciting may be difficult to stick to for the long haul. And thatâ€™s important because staying invested in the stock market is how you generate returns.

Missing even a few days can drastically reduce your return. For example, in 2020, stocks (as measured by the S&P 500 Index) returned 16.3 percent. If you missed the best day of the year, that return falls to 6.3 percent. It falls to -19.3 percent if you missed the best five days.

Put It on Autopilot

Our aversion to losses means that, for most people, investing is fraught with angst and emotion. A couple of rules-based strategies that keep your emotions from getting in the way might help.

Knowing when to put money to work is always a difficult question. Is this the bottom? Should I wait for the inevitable pullback? *Dollar-cost averaging* is a popular strategy for investing cash by splitting it up into a series of installments over a predetermined period, typically months or quarters. While studies report that investing via a single lump sum can be just as effective, systematically investing via dollar-cost averaging can both be efficient and assuage fears of getting in at the wrong time.

Over time, a portfolio can stray from its original risk level. For example, if stocks outperform bonds over time, they become a larger relative portion of your portfolio, and it becomes riskier; if bonds outperform stocks, it becomes less risky. This is completely normal because different investments will perform better or worse in different markets or economic conditions. Thatâ€™s when *rebalancing* â€”a process of systematically selling some of your outperformers to invest in the underperformersâ€”comes in. There are many ways to implement rebalancing that have merit, but they are all designed to keep your portfolio risk on target over time via small, incremental moves.

Scratch the Itch

When the markets get volatileâ€”as they are certain to do from time to timeâ€”itâ€™s OK to spring into action. Focus on facts, and donâ€™t act rashly or out of emotion. Ask your financial advisor to rerun your financial plan to make sure youâ€™re still on track for your goals. Take a look at your portfolioâ€™s risk level, and dial it in, as appropriate. Use a pullback as a time to rebalance. Put some of your sideline cash to work in the most beaten-up asset class. Taking action to exert some control over your situation will make you feel better and can turn a crisis into an opportunity.

As the saying goes, â€œMay you live in interesting times.â€• At first blush, that sounds excitingâ€”a blessing even. But, ideally, your life is more interesting than your money. In fact, when it comes to long-term investing, boring is vastly underrated.