Core Investment Principles for Times of Market Turbulence

Investment Strategy Group

Michael Halloran, CFA  Investment Strategist
Core Investment Principles for Times of Market Turbulence

History shows that corrections typically occur every couple months. With the market now experiencing volatility, we thought it would be prudent to review our core investment principles for market turbulence.

1. Stock market corrections are a normal occurrence. Despite average intra-year drops of 14%, the S&P 500 has produced positive annual returns in 29 of 39 years with average total returns over that period of 9.6% (slide 2).

2. Owning stocks is critical for maintaining purchasing power. Stocks have significantly outperformed every major asset class over long periods of time (slide 3).

3. Market timing is very difficult and a major threat to portfolio returns is short-term emotional decisions related to market volatility. The average investor significantly underperforms most asset classes because of poor market timing and a lack of portfolio diversification. Investors are usually best served by focusing on long-term returns and maintaining a diversified portfolio that includes significant exposure to risky assets (slide 4).

4. Diversification matters. Asset class returns vary from year-to-year and diversification can greatly reduce portfolio volatility. A balanced portfolio reduces volatility while maintaining long-run returns (slide 5).

5. Investment time horizon is critical for investment success. While yearly returns can be volatile, holding a diversified portfolio for longer time periods usually results in significant, positive returns (slide 6).

While the Sino-American trade negotiations bear monitoring, we believe the economy will be able to fend off the effects of tariffs and produce positive growth for the foreseeable future. Obviously, a resolution to the trade negotiations will improve the clarity around that view but the underlying conditions that typically support share prices are still in place. U.S. consumer and business confidence remain at elevated levels and consumers are benefitting from record net worth and significant job creation. Meanwhile, China is providing significant stimulus to its economy that should improve the global economic backdrop. Despite the inevitable occurrence of market corrections, we think further economic growth, supported by strong profit growth, will ultimately lead to further market gains.
Stock Market Corrections are a Normal Occurrence

- Despite average intra-year drops of 14%, the S&P 500 has produced positive annual returns in 29 of 39 years with average total returns over that period of 9.6%.
  - Market corrections are not a financial loss...unless you sell.

S&P 500 Intra-year Declines vs. Calendar Year Returns

Despite average intra-year drops of 14%, annual returns were positive 74% of the time.

Source: Janney ISG, Bloomberg
Too Little Equity Exposure is a Major Mistake

- Significant stock exposure is critical for portfolio growth and maintaining long-term purchasing power.
  - Compounding returns are powerful over time, despite bouts of volatility.
  - Stocks have significantly outperformed every major asset class during long periods of time.
  - While we face significant economic challenges today, stocks significantly outperformed during the last 90 years which included the Great Depression, World War II, The Cold War, and numerous other economic and market challenges.

<table>
<thead>
<tr>
<th>Value of $1,000 in 2018 invested in 1926</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Cap Stocks</td>
</tr>
<tr>
<td>Large Cap Stocks</td>
</tr>
<tr>
<td>Corporate Bonds</td>
</tr>
<tr>
<td>U.S. T-Bills</td>
</tr>
<tr>
<td>U.S. Inflation</td>
</tr>
</tbody>
</table>

(Source: Janney ISG, Bloomberg, Barclays, Standard and Poor’s, Russell and BEA)
Market Timing and Lack of Diversification

- The average investor significantly underperforms most asset classes because of poor market timing and a lack of portfolio diversification.
  - Investors are usually best served by focusing on long-term returns and maintaining a diversified portfolio that includes significant exposure to risky assets. A major threat to portfolio returns is short-term emotional decisions related to market volatility.

Source: Janney ISG, J.P. Morgan, Dalbar Inc.

Indexes used are as follows: REITs: NAREIT Equity REIT Index, EAFE: MSCI EAFE, Oil: WTI Index, Bonds: Barclays Capital U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Gold: USD/troy oz, Inflation: CPI, 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high quality U.S. fixed income, represented by the Barclays U.S. Aggregate Index.
Diversification Reduces Yearly Volatility

- Asset class returns vary from year-to-year and diversification can greatly reduce portfolio volatility.
  - A balanced portfolio reduces volatility while maintaining long-run returns.

### Periodic Table

<table>
<thead>
<tr>
<th>Period</th>
<th>Asset Class</th>
<th>ISG Balanced Portfolio</th>
<th>ISG Balanced Portfolio</th>
<th>ISG Balanced Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Best</td>
<td>MSCI Emerging Markets</td>
<td>19.8</td>
<td>FTSE NAREIT (REIT) 27.5</td>
<td>FTSE NAREIT (REIT) 19.7</td>
</tr>
<tr>
<td></td>
<td>Barclays High Yield 15.1</td>
<td>MSCI Emerging Markets 10.9</td>
<td>MSCI EAFE (International) 12.1</td>
<td>MSCI EAFE (International) 17.3</td>
</tr>
<tr>
<td></td>
<td>S&amp;P 500 26.5</td>
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<td>MSCI EAFE (International) 15.8</td>
</tr>
<tr>
<td></td>
<td>Bloomberg Commodity 18.9</td>
<td>MSCI EAFE (International) 7.6</td>
<td>Bloomberg Commodity 11.3</td>
<td>Bloomberg Commodity 9.0</td>
</tr>
<tr>
<td></td>
<td>Barclays Agg (Bonds) 6.5</td>
<td>MSCI Emerging Markets 18.4</td>
<td>Bloomberg Commodity -11.1</td>
<td>Bloomberg Commodity -9.5</td>
</tr>
</tbody>
</table>


ISG Balanced Portfolio assumes the following weights: 51% MSCI ACWI, 3% Bloomberg Commodity Index, 3% NAREIT Equity REIT Index, 3% Alternative Investments, 40% Barclays Capital Aggregate.

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Time and Diversification are Critical

- While yearly returns can be volatile, holding a diversified portfolio for longer time periods usually results in significant, positive returns.
  - Annual total returns, 1950 - 2018

<table>
<thead>
<tr>
<th>Annual Avg. Total Return</th>
<th>Growth of $100,000 over 20 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks (S&amp;P 500)</td>
<td>11.0 %</td>
</tr>
<tr>
<td>Bonds (Barclays Aggregate)</td>
<td>5.8 %</td>
</tr>
<tr>
<td>50/50 Portfolio</td>
<td>8.8 %</td>
</tr>
</tbody>
</table>

Source: Janney Investment Strategy Group, Bloomberg, Barclays, Standard & Poor’s
Index Definitions:

**The S&P 500 Index** is widely regarded as the best single gauge of the U.S. equities market. The index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The S&P 500 Index focuses on the large-cap segment of the market; however, since it includes a significant portion of the total value of the market, it also represents the market.

**The Russell 2000 Index** measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

**The MSCI ACWI (All Country World Index)** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

**The MSCI EAFE Index** (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.

**The MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

**The Barclays Global High Yield Index** is a multi-currency flagship measure of the global high yield debt market. The index represents the union of the US High Yield, the Pan-European High Yield, and Emerging Markets (EM) Hard Currency High Yield Indices. The high yield and emerging markets sub-components are mutually exclusive. Until January 1, 2011, the index also included CMBS high yield securities.

**The Barclays US Capital Aggregate Bond Index** is an unmanaged, broad-based index consisting of Treasury securities, Government agency bonds, Mortgage-backed bonds, publicly issued US Corporate and specified foreign debentures and secured notes that are rated investment grade (Baa3/BBB or higher) by at least two ratings agencies, have at least one year to final maturity and have at least $250 million par amount outstanding.

**The NAREIT EQUITY REIT Index** is designed to provide the most comprehensive assessment of overall industry performance, and includes all tax-qualified real estate investment trusts (REITs) that are listed on the NYSE, the American Stock Exchange or the NASDAQ National Market List.

**The Bloomberg Commodity Index** and related sub-indices are composed of futures contracts on physical commodities and represents twenty two separate commodities traded on U.S. exchanges, with the exception of aluminum, nickel, and zinc.

**The Bloomberg Barclays Long Term Corporate Bond Index** is designed to measure the performance of U.S. corporate bonds that have a maturity of greater than or equal to 10 years.

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