THE FIDUCIARY GROUP®
INVESTMENT MANAGERS

Some Guiding Thoughts From Your 401(k) Advisory Team During the Coronavirus Crisis

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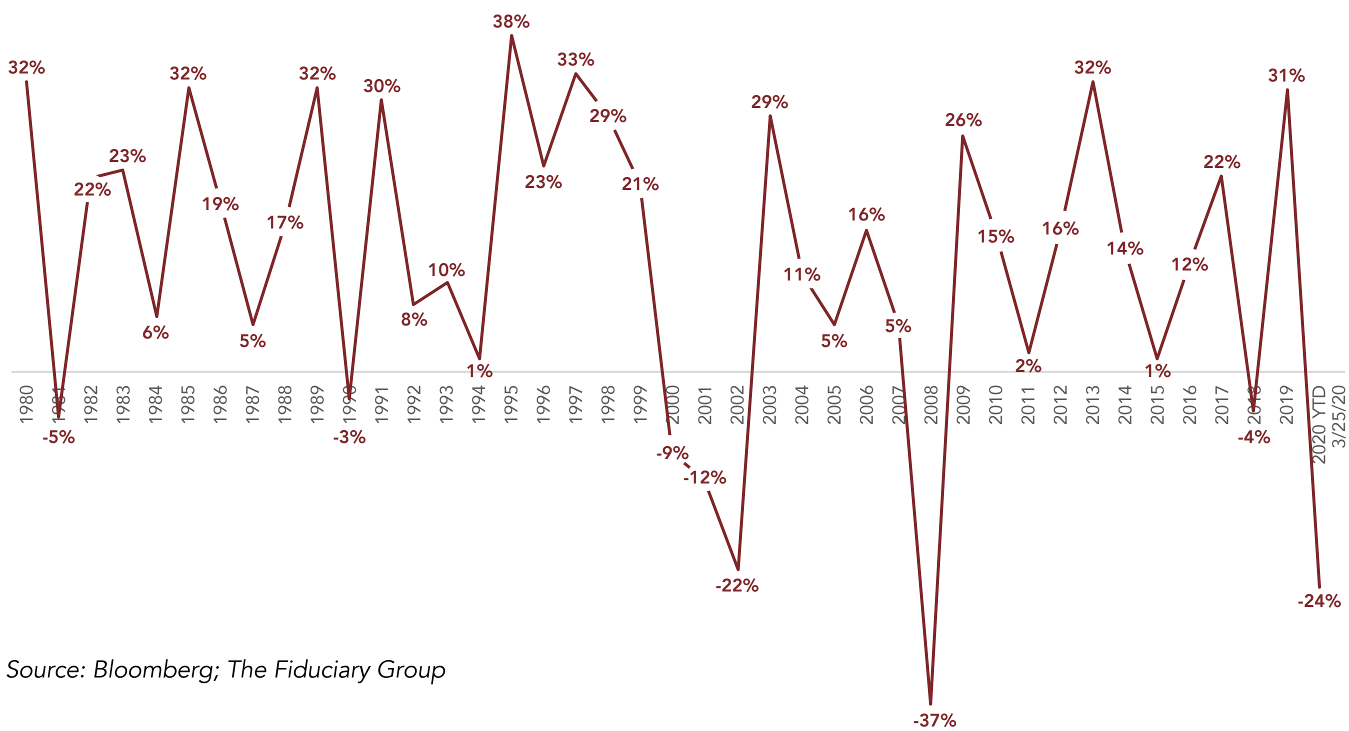
A Reminder About Keeping a Long-Term Investment Focus in Your 401(k) Account

In 401(k) participant education meetings, we routinely stress the importance of choosing an appropriately allocated long-term investment strategy with which you can live through good markets, bad markets, and everything in between. An allocation strategy is the balance you choose between investing in **stocks** versus **bonds** in your retirement portfolio. Your allocation strategy is the biggest determinant of the average compounded annualized returns you will earn over time as well as the level of market volatility—the ups and down you'll have to put up with—to achieve those returns. What makes an allocation strategy **appropriate** depends on your **time horizon** to retirement and your **personal risk tolerance**.

Why is your time horizon an important consideration in deciding how much to allocate to stocks?

The stock market, as we have been reminded in recent weeks, is highly volatile. Stocks historically have delivered higher long-term returns than bonds but have much higher short-term price volatility than bonds. Let's take a look at how the stock market has performed over the last 40 years.

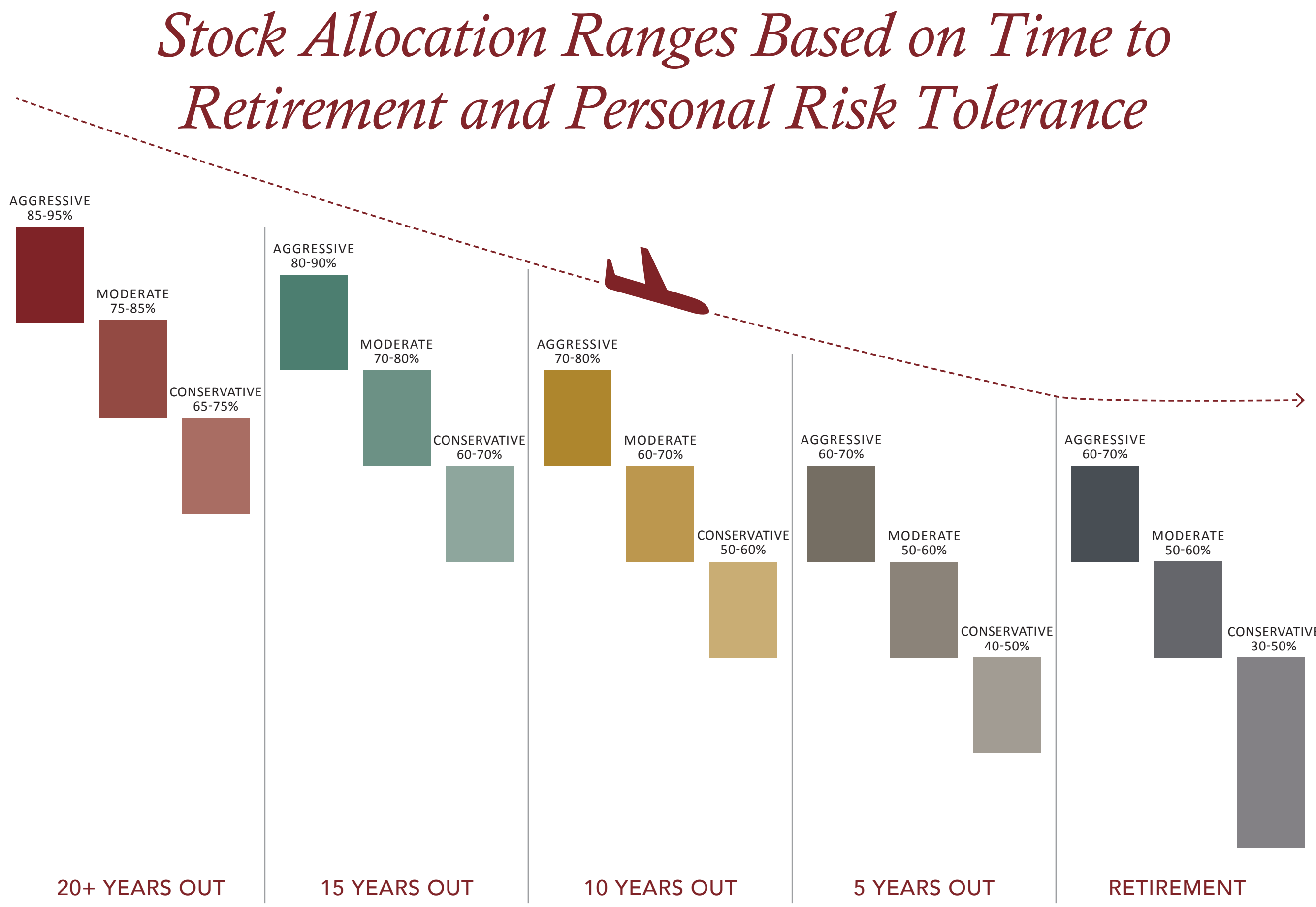
Calendar Year S&P 500 Returns Since 1980



Source: Bloomberg; The Fiduciary Group

As you can see, investments in stocks are subject to a lot of ups and downs not only annually but within each year. Historical average annualized returns in the stock market over rolling 10-year periods, provided you remain fully invested, are in the 8 to 10% range. Investments in the bond market have significantly lower volatility, but also have delivered lower average annualized returns (more in the 4-5% range).

The key to successful investing in stocks long-term is that you have a sufficiently long-time horizon (at least 5-7 years) to remain fully invested in your stock allocation so that you have the capacity to ride out market downturns. In other words, you don't want to find yourself in a position of having to sell the stocks at depressed prices. You want to be able to endure the time it takes for the market to recover.



Many of you have seen our Allocation Glidepath chart, which sets out recommended allocation strategies for different time frames and risk tolerances (conservative, moderate, or aggressive). The further away from retirement you are, the more you can comfortably allocate to stocks, knowing you've got plenty of time to ride out any temporary downturns. Once you are within about 15 years from retirement, you should start gradually reducing your allocation to stocks incrementally so that by the time you are within 5 years of retirement, you are pretty much in line with the allocation strategy you want to follow long-term in retirement.

What gets tested in markets like we've experienced recently in 2020 is one's **personal risk tolerance**. Market declines make it difficult, psychologically, for some people to stick with their long-term investment strategy. It is easy to succumb to the "flight" response of selling out of stocks when they tumble in price (which of course means you're selling out at a loss). Human beings suffer from "recency bias," susceptible to believing that what has just happened to us is going to continue happening for an indefinite time. This can lead investors to react tactically (as in, "I've got to take action now") in ways that can harm their long-term retirement goals.

Has Our Fundamental Investment Guidance Changed in the Face of the Coronavirus and Its Economic Implications?

We have received inquiries from 401(k) participants asking if our long-term investment guidance has changed in light of the dramatic health and economic fallout we're experiencing from Coronavirus. We hear many participants saying they are anxious because these are "unprecedented times" and "this time is different."

We would like to acknowledge these concerns, because this time IS, in many ways, unprecedented and different from anything we've experienced before. Never before have we experienced a wide-spread government lockdown of businesses, the economy, and the free movement of people in response to a global pandemic. The question many 401(k) participants are asking is "should I be doing something different in my 401(k) account this time, and what action should I be taking now?"

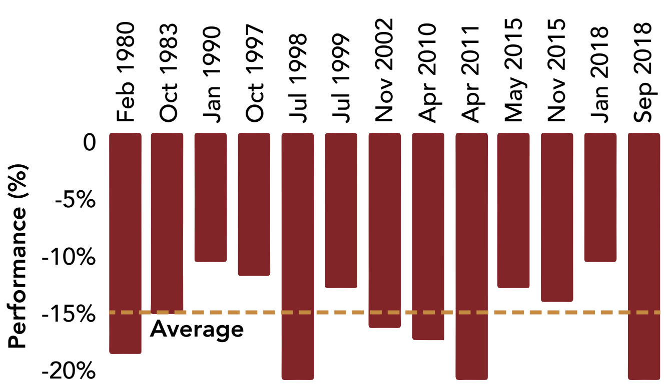
We'll try to answer this question in this communication and lay out some options for action. But first, let's look at some data that may help us put this current market volatility and decline into perspective.

There are two types of market declines: "Market corrections," and "bear markets."

A market correction is defined as a 10% decline in a major U.S. stock market index from a recent 52-week high close. Market corrections are usually short-lived, with an equally rapid recovery period.

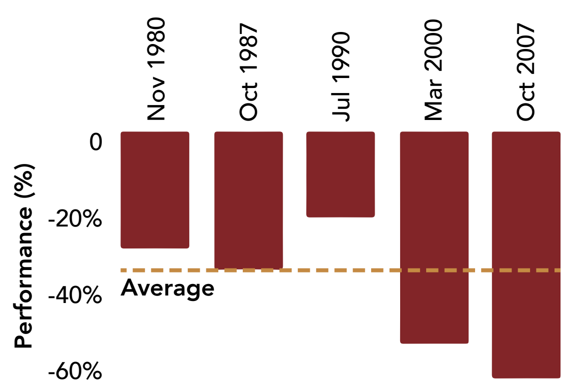
Market Corrections

1980 - 2019



Bear Markets

1980 - 2019



Source: Goldman Sachs, CNBC research

Over the last 40 years, we have experienced 13 market corrections. The average decline was over 13% and the average duration was four months. Recovery has been equally swift. On average, it took only 4 months to recover. Those of you who were invested in your 401(k) in late 2018 may remember the 20% decline in the 3 months from October through December. By mid-April 2019, less than 4 months later, your stock portfolio (assuming you remained fully invested) had recovered fully.

Bear markets, on the other hand, are periods in which the U.S. stock market falls more than 20% from recent highs, amid widespread pessimism and negative investor sentiment. Bear markets typically last longer than market corrections and take a correspondingly longer time from which to recover.

Over the last 40 years we have experienced 5 bear markets with an average decline of 32%. Bear markets have lasted on average 14-1/2 months and have taken two years on average to recover. The most recent bear market which 401(k) participants might remember were the 18 months from October 2007 to March 2009, known as the Great Recession, during which time the market dropped 57% from peak to trough. It took four years for market prices to return from the bottom to the pre-decline level.

One reason the Covid-19 related market downturn feels different and unprecedented is the remarkable **speed** at which the 2020 bear market has developed. Average bear markets historically have declined around 30% over a period of **14 months**. The bear market of 2020 has seen the market decline 37% from mid-February's high to the low on March 23, in just over **4 weeks**! Just like the run on toilet paper and hand sanitizer which emptied grocery shelves across the nation, the recent market declines have screamed of widespread panic and indiscriminate selling.

In just the last 10 days, we've experienced both the largest one-day **loss** in the Dow index since 1987 (and the second largest drop in history), as well as the largest one-day percentage **gain** in over 80 years. On March 16, the Dow plunged 12.9%. On March 24, the Dow soared 11.4%, the biggest one-day percentage jump since 1933. This extreme volatility is another reason that investors feel "this time is different." Year-to-date (through 3/24/2020), the S&P 500 is down 24%.

Are we close to a market bottom or do we have further to go? It's probably too early to call, but several economic indicators suggest we are likely in the range. There comes a point in time when risks have been priced into the market. In December 2019, Covid-19 was not a known risk in the U.S. Now, it's known and understood by everyone and has been priced into investors' expectations of companies' earnings. This is what has driven stock prices lower. We believe that many, but probably not all, of the risks associated with Coronavirus have already been priced into the market.

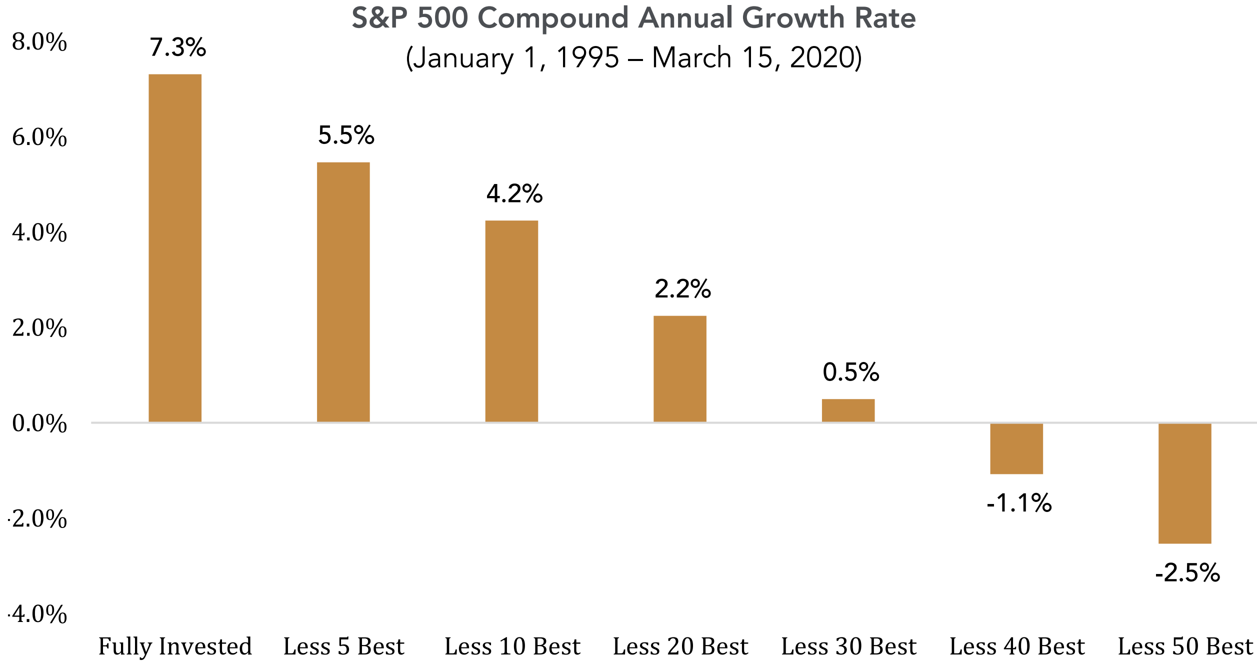
There is still uncertainty regarding (1) the duration of the government-mandated lockdown of business and social life; (2) the final toll that the shutdown will have had on businesses, households, and unemployment; and (3) the final health consequences of the virus. But every day, we learn more. If we can take any lessons from China and South Korea, which were a few months ahead of us in detection and implementation of testing and lockdown counter measures, infection rates have declined, widespread restrictions have been lifted, and their economies have started to churn again. With this as an indication, it is not unreasonable to think that we still have a few more months of containment measures before the U.S. can return to business as usual.

We are unquestionably in a bear market, and if we look to prior bear markets for guidance, the average time to recover is 2 years. The Great Recession bear market, which saw a market decline of 57%, took 4 years to recover fully. The length of this bear market and the time it will take to recover depend on how much longer the U.S. and global economies are shut down. That said, we have great confidence that U.S. businesses and our economy will come through this, just as they have come through every crisis before.

Can I Avoid Participating in the Down Markets and Only Be Invested in Up Markets?

The only way to achieve the long-term annualized returns that the stock market delivers is to **stay in the market**. Trying to time the markets--getting out when it looks bad and getting back in when we feel it's "all clear"—creates a serious risk to our long-term returns. Here is why.

Potential Costs of Market Timing



Source: Strategas

Missing the gains on the best trading days (such as March 24, 2020 when the market surged 11%) significantly reduces the long-term gains you can earn. No one can win at timing the market on a day by day basis. This chart shows that the S&P compounded growth rate over period Jan 1, 1995 to March 15, 2020 was 7.3% <u>for those who stayed fully invested</u>. If an investor just missed 5 of the best days during that time, compounded returns would have been reduced to 5.5%. Missing the best 10 trading days would have reduced compounded returns to 4.2%. And so on. Note that missing 40 or more of the best trading days would actually have delivered negative compounded returns over that time. The bottom line is, you can't really have the "good" without enduring the "bad," because you've got to be **in** the market when the good days come along, or you'll miss out.

Key Takeaways for your 401(k)

1. Your time horizon until retirement, together with your personal risk tolerance (conservative, moderate, or aggressive), are the key drivers of determining what allocation strategy is appropriate for you.

2. Once you choose an allocation strategy, you should stick with it and only gradually reduce your stock allocation in line with your glidepath to retirement. There are two exceptions to this: (1) you discover you don't have the risk appetite you thought you did (you find in challenging markets that you are more risk-averse than thought); and/or (2) your personal circumstances have changed, shortening your time horizon for accessing the funds in your retirement account. In the next section we outline some options you might want to consider if you find yourself in either of these situations.

3. The bear market we are currently experiencing is dramatic in the speed of decline, but as the factors which caused the steep decline have largely been factored into the market (ie., disruption of the economy, business earnings, and household cash flows), we are likely beginning to see a bottom of the decline, though the bottom will certainly be tested and we will continue to experience more short-term volatility.

4. The speed of recovery will depend on how long the current lockdown persists and how much economic damage will have resulted from it (ie., lost earnings, bankruptcies, unemployment, etc.). That said, we maintain a high degree of confidence that **the economy, businesses, and markets will recover**. As investors in our 401(k) accounts, we should probably prepare ourselves mentally (and financially) for a 2 to 4-year recovery time frame, and hope that we'll be pleasantly surprised with a more rapid recovery.

5. Trying to time the market (trying to get out before declines and get back in before gains) is not an effective strategy in a retirement account and poses significant risks to accomplishing your long-term retirement goals.

6. Now is a great investing opportunity for 401(k) participants! With each payroll contribution to your 401(k) account during these distressed markets, you are buying at deeply discounted prices.

Options for Action

Your 401(k) line-up has a fully diversified range of investment options, from low-risk conservative funds to higher-risk aggressive funds, and also offers a risk-free cash/ money market fund. Because this is a participant-directed 401(k) plan, you are in complete control of your account and can make any selections or changes you feel are appropriate. Our goal is to provide you a full range of mutual funds and balanced portfolios across the risk/return and asset-allocation spectrum and, hopefully, provide you with some sound guidance on what choices might work best for you given your time horizon and risk tolerance. Here are some options for action to consider:

1. Ask yourself, "has my time horizon changed?" If not, and you are in an allocation strategy that is appropriate for your time horizon and risk tolerance—giving you sufficient time to ride out the market recovery—why sell out of stock holdings while prices are temporarily depressed? Remember, you do not suffer permanent losses in your account until and unless you sell.

2. If your time horizon has not changed but you are fighting the temptation to "sell out," you may have discovered that your risk tolerance is not what you thought it was. Instead of cashing out, locking in losses, and losing all opportunity to take advantage of the market rebound, consider simply modifying your strategy incrementally. For example, if you are in the Growth strategy (80% stocks/ 20% bonds) and feeling tempted to go to cash, consider instead just decreasing your allocation to a Moderate Growth strategy (65%/35%). Or, if you are in the Moderate strategy (50% stocks/ 50% bonds) and still not feeling comfortable, consider going to the Moderate Conservative strategy (40% stocks/ 60% bonds). You get the idea. Take an incremental approach to reducing volatility risk.

3. If your time horizon has indeed changed due to financial circumstances (ie., you have been or fear being laid off from work) and your cash flow situation is such that you believe you might have to take some money out of your retirement account in the near term, consider just moving to cash only the amounts you believe are likely necessary in this impending hardship circumstance. It is worth highlighting that in times like this, we are really reminded of the importance of maintaining a sufficient emergency fund to cover at least 6 months of expenses if we lose our income so that we don't have to look to our retirement account as a last resort.

4. Whatever you do, continue investing in your 401(k) account's long-term investment strategy to take advantage of the great bargains your weekly or bi-weekly contributions can now capture!

5. If you would like further guidance, please feel free to reach out to the 401(k) team by phone or email:

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We are here for you!