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TUNE OUT THE NOISE

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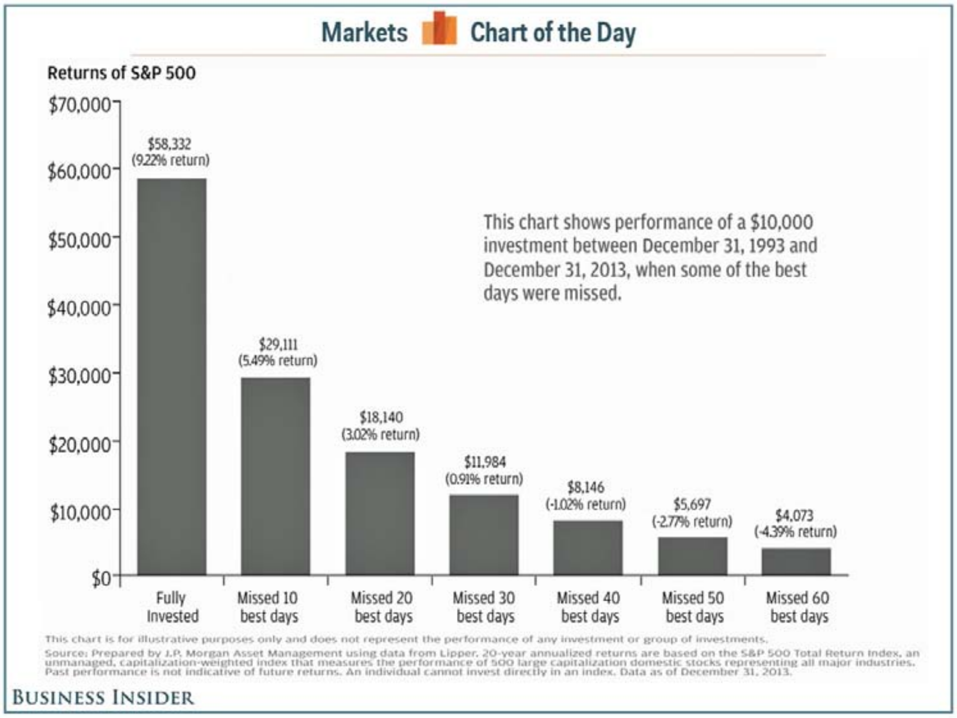
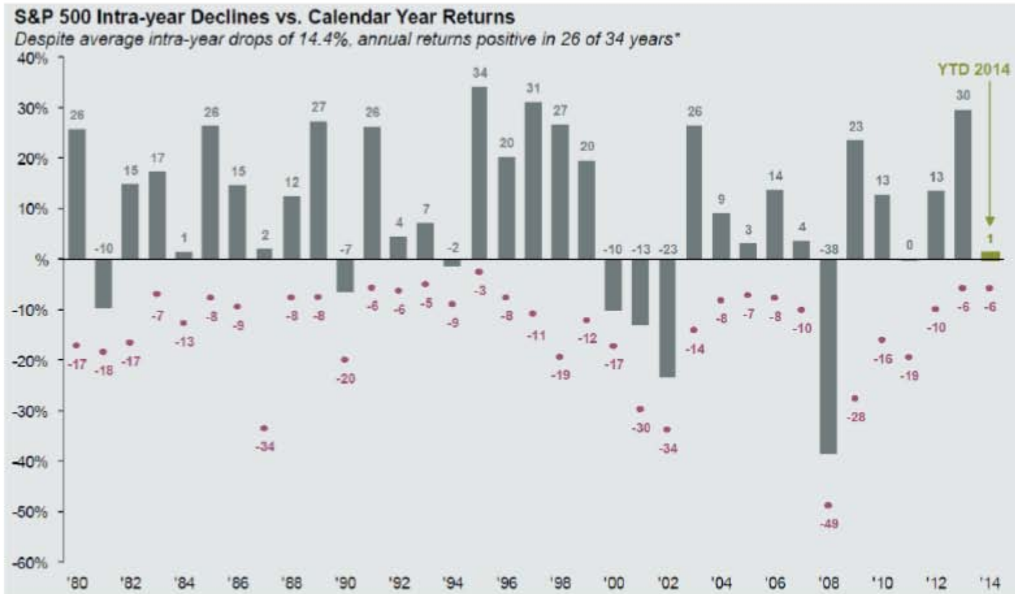
If you have cable television, satellite radio or a smartphone, it is nearly impossible to escape the constant chatter of 24x7 news and talk. The recent NFL draft has to have set records for buildup and coverage as we followed prospects in every aspect of their preparation to become instant millionaires. Like sports talk, politics dominate the airwaves for much of every evening as pundits entrenched on one side of the aisle or the other spew forth with guests that typically think just like them. Occasionally, a guest with an opposing view is invited to the set to be skewered like a sacrificial lamb. All of this talk is designed to keep us glued to the next segment in order to keep ratings up and advertisers writing checks. But what does all of this cost you? In the case of sports and political talk, all it really costs you is time. In the case of 24x7 market talk, however, the consequences can be much more costly.

Many people have seen the statistics regarding trying to time the market, but it bears repeating that being out of the market for the best days is costly. As the following chart illustrates, the cost of missing the ten best market days on a $10,000 investment in the S&P 500 for the 20-year period ended 2013 was approximately $29,000.



Furthermore, every year the market experiences some sort of pullback. Frequently it is of a magnitude that has investors thinking about moving to the sidelines. The following chart from JP Morgan’s Guide to the Markets illustrates each year’s largest peak to trough pullback going back to 1980. The average pullback over the period was 14.4%, which puts this year’s 6% peak to trough pull back during Q1 into perspective. It only feels worse because we live in a 24x7 connected world that makes you feel like a sucker if you aren’t doing something in response to the market update that just buzzed on your smartphone. But remember, it is hard to be correct on market timing once, let alone twice, because eventually you have to get back in as most would agree that cash is not a viable long-term investment strategy.

Historical Volatility



Source: Standard & Poor's, FactSet, J.P. Morgan Asset Management.

Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. *Returns shown are calendar year returns from 1980 to 2013 excluding 2014 which is year-to-date.

Guide to the Markets – U.S.

Data are as of 3/31/14.

Interestingly, over the 34 ¼ year period in the above chart, despite experiencing pullbacks ranging from 3% to 49% every year, the S&P 500 ended in positive territory in 26 of the 34 years and $1,000 grew to approximately $44,000 on a total return basis. Volatility has been a part of the equity landscape for a long time. The difference now is the connectivity and 24x7 news cycle that taunts us to do something every time the market declines 1%. There is a very important difference between having real time information and having to do something with that information. Understanding the difference can have enormous long-term financial consequences for investors.

The point of all this is that volatility is a part of equity investing. Risk, as defined by the volatility of one's overall portfolio, is better addressed, in our view, through proper asset allocation than market timing. Of course not all information is bad and there are certainly tactical adjustments one can make in response to changing fundamentals and market signals. However, as Warren Buffett so famously said, "In the short term the market is a voting machine, in the long term it is a weighing machine." In our view, the odds are in your favor playing the weighing machine and addressing risk management not through market timing, but rather through a proper asset allocation that adjusts with your needs and investment horizon over time.

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