

Driving Through the Valley with Investing Evolved



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We are going through some unprecedented times and we're not sure what tomorrow will bring, but we do know that the impact of COVID-19 will be felt for some time. However, we also know that its impact will diminish over time. Looking back at the 12 historical bear markets that fell more than where we are today, they fell on average by 44% over 300 days only to rebound by 55% on average over the subsequent one year. And over the three years from the bottom, the average cumulative rebound was 88.6%, or an annualized average return of 23.6%.¹ This is a key reason why with investing we need to take a longer-term view.

Rob Lovelace, vice-chairman of Capital Group and a 30+ year investing veteran, recently shared his thoughts about the investing environment today being similar to looking out over the valley. He commented that while there is a lot of near-term uncertainty, one thing we can be pretty sure of is that if we look out over the valley the world is going to look a lot like it did before COVID-19. Some things may be a little different, and some industries may not be the same (think cruise lines), but generally the world will eventually return to normal. The other thing we know about the other side of the valley is that the journey to get there isn't going to be simple. There will be several ups and downs and we are going to be in for quite a journey to get there. Knowing this journey will be filled with ups and downs, a comprehensive financial plan is an important roadmap to help you get to your destination.

To help us in our journey we have **Investing Evolved** and diversity of strategies. Investing Evolved is a portfolio construction framework, which we can use to create a portfolio of investment strategies. Each strategy has a unique place and purpose within a portfolio, the same way that the different parts of a car have a unique place and purpose to take you on a journey.



The car's engine is the key part that keeps the car going and driving us through our journey. It helps us go up and down the hills and round the bends, and with each different move, we feel it in the car. That's like our core market strategies. They are the foundational piece of a portfolio – they give us the exposure to global economic growth, and we feel every up and down of the market with the severity of the ups and downs being tempered by the risk profile.

The journey down into the valley tends not to be a straight down this hill, there tends to be sharp bends, some steep drops and some shallow drops. This is where we need the car's brakes and steering wheel to help us on our way. The steering wheel will move us around the sharp corners and the brakes will slow our speed on the way down. Tactical Limit Loss

strategies steer their exposures to different asset classes based on the environment and slow down the speed of participation in the downfall of the market by reducing equity exposure. But, remember that if there is a sharp upturn, these strategies won't participate so much initially. Think about a car trying to go uphill with the brakes on – it doesn't keep up until you press on the gas pedal! Tactical Limit Loss strategies need time to respond to markets before adding equity exposure back to the portfolio.

As we near the bottom of the valley, maybe we suddenly see a pile-up of cars, as someone was going too fast and missed the curve in the road, or deer tried to cross the road creating a hazard that a car swerved to miss only to cause a bigger crisis. We hit the brakes hard, but not in enough time to avoid a slight collision. We are thankful we are buckled in with the seat-belt and the airbags engage to limit the impact of the crash. The diversifying strategies in the portfolio are like the seatbelt and the airbags. These solutions really help in times of a crash to limit the impact on a portfolio and provide a source of return. Using strategies that do not tend to move in the same direction as the equity market potentially provides a positive return in a time of market crisis. The key difference between bond and equity alternatives is around the impact their return will have on the portfolio. Bond alternatives will have a lower impact on portfolio return while equity alternatives will have a higher impact on portfolio returns.

Eventually we start to climb out of the valley and begin the journey uphill. This is where we need the steering wheel once again to move around those hairpin bends, and we also need the gas pedal instead of the brake. We need some additional power behind the car to get us up the hill. This is where the Tactical Enhanced Return strategies earn their place in the portfolio. These strategies navigate the changing markets by tactically allocating their portfolios to specific sectors or regions in a search of higher returns. As part of that search for return, these tactical strategies will look very different from a benchmark.

And all along, our engine has been purring, keeping us going throughout the journey, just like the Core Markets strategy keeps the portfolio ticking through all market terrains.

Investing is like a journey — there will be many ups and downs along the way with sharp turns and obstacles to work around. Like any journey we take in a car, we're not using all parts of the car at the same time, each part has a use and purpose in the journey. It's the same way to think about Investing Evolved where we look to combine complementary investment strategies, each one having a unique role within the portfolio. Each one will work well at different times along our investing journey and together they will get us to the other side of the valley.

ⁱ A Wealth of Common Sense, "Returns from the Bottom of Bear Markets", Ben Carlson 3/19/2020

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