46 PEAKS
INVESTMENT ADVISORY GROUP

Action - Reaction

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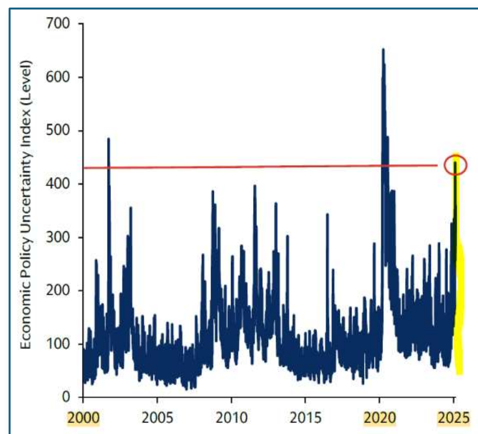
After a promising start to the year, the U.S. stock market has recently experienced a level of turbulence that could make even the most experienced investors a little queasy. In just a few short weeks, Large Cap U.S. stocks have dropped almost 9%, with aggressive growth, technology, small and mid-sized stocks down much more. We don't like to react to short-term noise, but recent events are somewhat unusual and it's important for investors to understand what's been going on and how to view it from an investment perspective.

What you **need to know about the current environment**.

- The U.S. stock market has been spooked by the speed, variability, and degree of **significant policy changes** coming out of Washington. Specifically, the potential degree of cost cutting sparked by the Elon Musk led D.O.G.E. and the new President's willingness to use bold tariffs to achieve numerous policy objectives. This chart illustrates the degree of economic policy uncertainty and tells the whole story. Current **economic policy uncertainty has spiked to levels only seen** (over the last 25 years) **previously during the 9/11 and COVID crisis**.



- However, it's important to realize that markets are **trading almost solely on news** - policy announcements and policy expectations, and their potential impact on the economy - and **not on actual economic data**.
- Due to the potential dual impact of shrinking government spending and higher tariffs, **recession risks**, near zero only 2-3 months ago, **have risen**.

During any and every period of stock market weakness, there are always several **timeless reminders** that investors should dust off:

- **Stocks going down is nothing new**. Most years see at least one or two declines of 5-10%. In the last 75 years, the S&P 500 has seen 91 declines of 5% or more. Even last year, which saw the S&P 500 gain over 20% for the year, we **endured a 9% decline last Summer**.
- Stocks sometimes decline sharply – Since 1928, on average, stocks have experienced **a decline of 15% once every two years** and a 20% or more bear market every 3.5 years.
- Stock market investors' **greatest concern is a recession**. These periods of economic weakness are when the largest stock market declines (35% - 50%) occur. Thankfully, recessions have become much less frequent the past 45 years than prior to 1980.
- **Diversification works** (most of the time). In fact, it's **working very well this year**. While U.S. stocks have suffered, **non-U.S. stocks are up nicely**. In the first week of March alone, non-U.S. stocks outperformed U.S. stocks by 6.8% - the largest weekly gap ever. Bonds are also up nicely this year.
- Your **gut is usually wrong**. Stocks historically have performed much worse following high levels of

Consumer Confidence and performed much better following bottoms in Consumer Confidence.

- **TV news is designed to scare you**, and to keep you watching. And it's usually **a great contrarian indicator**. Analyst Charlie Bilello tracks stock market performance following CNBC's scary "*Markets in Turmoil*" segments. Since 2010, stocks have been higher 12 months later 100% of the time, with an average gain of 40%.

- **Market timing is extremely difficult** and if you get it wrong, it **can ruin your long-term investment plan**.

- It's better to **buy insurance before a storm** than in the middle of or after one.

- Volatility works both ways and the stock market's largest UP days are usually clustered around its largest DOWN days. Thus, short-term trading during periods of elevated volatility is even more difficult.

- When markets decline, **all you can do is one of three things** – 1) Buy the Dip, 2) Sell to reduce risk, or 3) Hold. What should you do? See the next point:

- If your portfolio is **properly aligned with your financial plan and your risk tolerance**, most investors should "hold" and **not worry about short-term fluctuations**.

Reflecting on current market dynamics, our take on the current events should surprise no one:

- We **do not advocate extreme levels or frequency of market timing** – making large increases or decreases in an investor's stock allocation. We do think it can be prudent to make small, incremental (+/- 5%) increases or decreases in risk when presented with what might be described as a "fat-pitch" opportunity right down the middle. To us, that is **not the case today**.

- In the short-term, from a technical perspective, markets are likely "oversold", meaning short-term **selling pressure could soon be exhausted**, and markets could bounce.

- However, the meteoric rise in uncertainty and some of the policies themselves, if implemented, will make things **very difficult for businesses to operate**. To hire. To invest in new equipment. To strike new deals.

- Thus, recession risk is suddenly elevated and real - only the bravest, most risk-tolerant, and long-term oriented investors should consider increasing risk at this time.

- If the current situation devolves toward a recession, exposures to **U.S. Treasuries and Trend-Following Alternative Strategies** should prove useful in partially offsetting stock market declines.

Importantly, we should point out that in spite of all the headlines and volatility over the past few weeks, **little damage has been done to diversified portfolios**. Sure, those investors concentrated in aggressive growth stocks have taken a big hit. That's to be expected. But looking at Morningstar benchmarks for balanced portfolios across the risk spectrum, thanks to the strong returns of Core Bonds, International Stocks, and several Alternative Investments, the year-to-date performance of most well diversified portfolios is still **close to flat for the year**. In other words – nothing to get excited about. So while the current situation certainly bears monitoring, and we will, we should all try hard not to overreact prematurely to what is really just normal volatility, albeit triggered by some abnormal developments.

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