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THE ADVISOR

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Coronavirus Fear May Lead to More Extreme Volatility, or Something Worse

As February ended, the Dow Jones Industrial Average logged its worst week since the Financial Crisis and the S&P 500 Index dropped by more than 11% into correction territory. An estimated $7 trillion in market value was lost before the selloff slowed and the market partially rebounded the following week.[1] Meanwhile, government bond yields also fell to record lows as the sell-off prompted a classic flight to quality in the bond market. As March began, the yield on the 10-Year Treasury rate was less than 1%, well below the Federal Reserve's benchmark short-term interest rate range of 1.50 to 1.75%. This meant that the U.S. yield curve was once again inverted as it was temporarily last summer. Additionally, this forced the Fed to deliver an emergency rate cut on March 3rd, dropping the Fed funds rate 50 basis points to a range of 1.00 and 1.25%.[2]

This kind of chaos was typical of financial markets around the world as fears mounted that the coronavirus might grow into a global pandemic. First detected in China, the coronavirus has now been identified in 60 locations internationally, including the U.S. On January 30th, the World Health Organization declared the outbreak a "public health emergency of international concern."[3]

Prior to the coronavirus scare, the U.S. stock market had been experiencing a classic blow-off top rally, which saw it hit multiple new record highs since late October 2019. With the Fed and President Trump clearly committed to keeping the rally going by whatever means possible, 2020 looked like it might be another strong year for Wall Street — despite the fact that GDP growth has been consistently below the Trump administration's 3 to 4% target, and is forecast to shrink further this year.[4] So, will the coronavirus issue put an end to the blow-off top rally for good, and could it be the tipping point that triggers the long-overdue third major sustained correction of this long-term secular bear market cycle?

Completely Unpredictable

The truth is we just don't know the answer to those questions yet. However, it's also true that the tipping point for almost every major sustained correction throughout history has been something completely unpredictable, and the coronavirus certainly qualifies. Think about the last two major corrections. Everyone associates the first one from 2000 to 2003 with the bursting of the dot-com bubble, which many analysts saw coming well in advance. However, the actual sustained correction didn't take hold until a series of unpredictable events occurred, namely the Enron and Worldcom scandals, and finally the 9/11 terrorist attacks.

The situation was similar with the last major correction starting in 2007. Today, everyone associates it with the subprime mortgage crisis, which most financial strategists saw coming. That may have started the sell-off, but the real tipping point came when major banks started failing and we learned the damaging extent to which these institutions had tied themselves together with credit default swaps. No one could have predicted

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7 Psychological Traps

Sometimes, when it comes to investing, volatile markets aren't your worst enemy. You are. Unfortunately, our brains often play tricks on us, causing even the savviest of investors to make decisions that don't really make a lot of sense, such as panic selling or ignoring opportunities.

The problem of psychological investing traps is so pervasive, in fact, that there's a whole field dedicated to studying it called behavioral finance. Researchers in this discipline look at the way psychology affects how we make financial decisions. Knowing about these traps can help you avoid them and make you a better investor. Here are seven psychological traps to keep in mind.

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Coronavirus Fear

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the domino effect this would lead to, encompassing the Financial Crisis and a sustained market correction of over 50%.

The point is, if you're a regular reader, you know we've discussed many possible tipping points for the next major correction, from the Federal Reserve's continued reckless overuse of quantitative easing to the overall instability of the global financial markets. However, the coronavirus has emerged as a totally unpredictable factor and, based on history, this increases its odds of being the real tipping point. It has other characteristics that increase those odds, as well.

For one thing, it's a humanitarian crisis, and a tipping point usually has a humanitarian component. The 9/11 attacks were a humanitarian crisis that ultimately led to war. Then, when the big banks started failing in 2008 and millions began losing their jobs and homes, that was a borderline humanitarian crisis. In addition, the economic ramifications of the last two tipping points were enormous — as they are for the coronavirus.

Ripple Effects

As noted, despite the recent soaring stock market, economic growth for the U.S. has mostly fallen short of the Trump Administration's 3 to 4% target. It was 2% or slightly higher in the second, third and fourth quarters of last year, and economists predict the coronavirus could potentially shave off another 1%. A pandemic — or even just the fear of one — can disrupt the global economy in a variety of ways. People stop traveling, major events are canceled. If the fear spreads, businesses may shut down and urge workers to stay home. All of this obviously has major ripple effects that are felt throughout the economy.

Finally, another common characteristic of a market tipping point is that it's very newsworthy, and the coronavirus certainly qualifies on that score, too. It's so newsworthy, in fact, that it's been diverting attention from the presidential race and other major issues. The more it continues grabbing headlines, the more likely it is that the fear we've seen reflected in the financial markets will continue — and possibly increase. Does that mean we'll continue getting whipsawed by thousand-point swings as we did in the last week of February? Or does it mean that the long-overdue third major sustained correction of what I believe is our current long-term secular bear market cycle may finally take hold, ultimately leading to a drop of between 40 and 70%?

Again, we just don't know the answers yet. But for investors in or nearing retirement who may still be carrying too much market risk, ask yourself this: with the market already below its peak high from over two years ago, is it worth waiting much longer to find out?

[1]"Dow Jumps 1,290 Points in Biggest Point Gain Ever," Yahoo Finance, March 2, 2020

[2]"Fed Cuts Rates by 50 Basis Points Amid Coronavirus Concerns," Yahoo Finance, March 3, 2020

[3]cdc.gov

[4]"U.S. Economic Outlook for 2020 and Beyond," The Balance, March 3, 2020

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4 Reasons for Goal-Focused Investing

The fact is, investing isn't just about making your money work for you. It's about making your money work for you for a particular purpose. In other words, you need a goal. Here are four specific reasons why a goal-focused approach to investing is important.

Because It Puts You In Control

When you first start investing, it's easy to get overwhelmed. You may feel like you have little control over what happens to your money. No matter how careful you are, you could lose what you invest. When you think of it that way, it's easy to question whether investing makes sense at all. But if you take a goal-focused approach to investing, you're not just watching the value of your portfolio rise and fall based on the whims of the market. You (along with your advisor) are making specific decisions designed to help you reach specific goals. If something's not working, you change the plan.

Because It Will Be Easier to Save

Saving money just to save money is no fun for most people. After all, why invest a portion of your paycheck for the future when you could have something you really want today? Having concrete goals can turn saving from an abstract concept to a concrete step to achieve a certain aim — like being able to retire one day, take a trip around the world, or send your grandchildren to college. And studies have shown that the better you are at setting goals, the more you're likely to save. You might even do better by focusing on the intermediate steps on the way to your larger goal, like having a certain amount of money in your retirement accounts by age 45.

Because You'll Be Less Focused on How Others Are Doing

A little competition is healthy, but when it comes to investing, it can get risky. If your father-in-law is bragging about the great return he got on his investments, it can be tempting to drop your plan and copy his moves. It's especially tempting if your only goal with investing is to make more money. But if you're investing toward a goal with a clear plan, you'll be able to congratulate your relative on his success while staying focused on your needs. After all, if you were flying from New York to London, you probably wouldn't suddenly take a side trip to visit Buenos Aires. That's exactly what you're doing if you get distracted by other people's investing moves.

Because It Will Help You Weather the Ups and Downs of the Market

The market goes up and the market goes down. Sometimes, it goes way, way up or way, way down. Just like a roller coaster, these peaks and dips can make your stomach do flip flops, especially when your life savings is on the line. But having a goal-focused approach can help you cope with those ups and downs. If you know that you won't need your money for another 30 years, you can handle some volatility today. But if you're going to need your money in the next couple of years, you can select less volatile investments, so the day-to-day movements of the market won't stress you out. Knowing your specific goals will help you choose the right investments.

If you need help setting your own investing goals, please call.

7 Psychological Traps

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Sunk Costs Bias — The sunk costs bias has to do with the all-too-common tendency to stick with something, whether a bad boyfriend or a bad investment, long after it's clear that it's not worth it anymore. Still, because you've invested a certain amount of time or money, you're reluctant to give it up. In investing, you might end up hanging on to a stock long after you should sell it in the vain hope that you'll eventually come out ahead. But in these cases, it's better to cut your losses rather than to hang on to a loser.

Familiarity Bias — Most of us are biased toward what is familiar to us. We head to restaurants we've been to before and follow the same roads to work because we know what to expect. With investing, familiarity bias involves favoring investments that are familiar to you. You might prefer to invest in the company you work for or big-name businesses that are in the news. That could cause you to overlook important opportunities you don't know as much about.

Anchoring — Anchoring is the process of getting attached to a particular reference point — such as the price you paid for a stock — and using that to guide future decisions. Or you might fixate on a stock's previous high, even though that price was an anomaly. Anchoring is why buyers think they got a great deal when buying a car for $50,000 when the initial price was $60,000, even though the car's really worth $40,000.

Whether buying stocks or cars, anchoring involves using a single piece of information to determine what a stock or other investment should be worth while also discounting more relevant information, such as a company's fundamentals or broader economic trends. Unfortunately, avoiding anchoring is difficult, but considering all available information before choosing an investment can help.

Focusing Too Much on the Recent Past — Recency bias is the tendency to make decisions or judgments based on relatively new or recent information. For example, during times when the market is up, people may ignore or discount the possibility of a market decline. Or, if a certain category of stocks has done poorly recently, people may conclude that those stocks *always* have negative returns, even if the dip is an anomaly. You can avoid this mistake by doing your best to consider the entire universe of information at your fingertips, not just what happened yesterday.

Following the Herd — While following trends might be fine for fashionistas, it's not always a smart investing move. Yet herd investing is an all-too-easy trap to fall into. If everyone is telling you that now's the time to get into a certain hot investment, you may feel you need to act fast so you don't miss out. But just because something is popular doesn't make it a good investment. Blindly following the herd without first consulting your own financial goals and plan doesn't make you a smart investor.

Overconfidence — Most of us like to think we're smarter than the average person. If you hit it big with a certain investment, you may overattribute that success to your skill rather than what it really is — luck. That can cause you to repeat the same behavior.

Panic — Investing isn't for the faint of heart. When the market takes a sudden dip, it's easy to panic, which can lead you to make bad decisions, such as selling at a big loss, rather than riding out the natural hills and valleys of investing. Making these emotionally-driven choices costs you a lot of money. When making investing decisions, make sure they're based on evidence, not your initial gut reaction to the day's events.

Avoiding psychological investing traps on your own can be difficult. Please call if you'd like to discuss this in more detail.

Your Risk Tolerance and Retirement

To gain a better understanding of how we're affected by risk when building a retirement portfolio, it's important to learn about risk tolerance and what it means for you as an investor.

What Is Risk Tolerance?

Risk tolerance essentially refers to an investor's ability — both emotionally and financially — to deal with major upswings and downswings in the market. If a person is said to have high risk tolerance, he or she likely tends not to worry so much about the potential risk of certain stocks or having a large amount of stocks in a portfolio. Those with low risk tolerance are on the other end of spectrum, often too cautious to deal with volatile stocks or the market in general.

Risk Tolerance and Age

While plenty of factors must be taken into consideration when considering your own risk tolerance, age is one that can be seen as an important anchor to help risk-takers avoid getting in over their heads. This is especially true of those who are working toward building an effective retirement plan. When people are young, it makes more sense to take risks with investments than when they reach retirement age.

What's important to recognize is that risk tolerance *must* shift with age to avoid making costly mistakes at a time when it may be potentially too late to recover.

Adjusting Risk Tolerance

It may seem as if adjusting risk tolerance is challenging, but often it simply means taking a realistic approach to your investments. If you're nearing 60, for example, it's generally considered unwise for your portfolio to be comprised of 70% stocks — the number should be closer to 40%. Many successful investors find moving away from stocks to bonds is an effective later-in-life strategy.

The Importance of Working with a Financial Planner

The best way to get a better sense of what is a realistic risk tolerance for you at this point in life is to work closely with your financial planner. Please call if you'd like to discuss this in more detail.

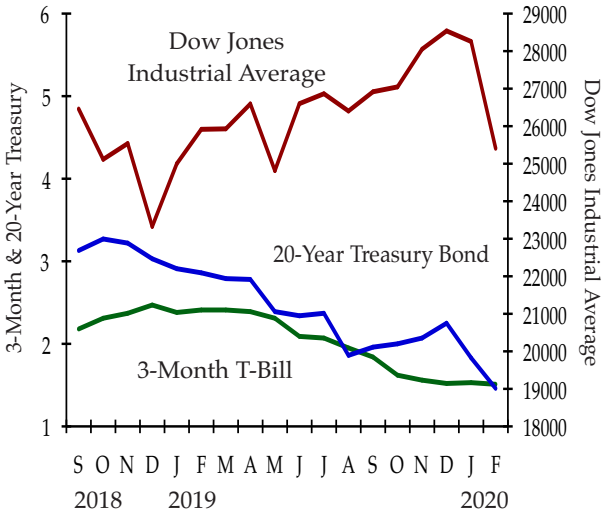
Business Data

Indicator	Month-end Dec-19	Jan-20	Feb-20	Dec-18	Feb-19
Prime rate	4.75	4.75	4.75	5.50	5.50
3-month T-bill yield	1.52	1.53	1.51	2.47	2.41
10-year T-note yield	1.92	1.51	1.13	2.89	2.66
20-year T-bond yield	2.25	1.83	1.46	3.03	2.86
Dow Jones Corp.	2.84	2.59	2.52	4.40	4.08
GDP (adj. annual rate)#	+2.00	+2.10	+2.10	+1.10	+1.10

Indicator	Month-end Dec-19	Jan-20	Feb-20	% Change YTD	12 Mon
Dow Jones Industrials	28538.44	28256.03	25409.36	-11.0%	-2.0%
Standard & Poor's 500	3230.78	3225.52	2954.22	-8.6%	6.1%
Nasdaq Composite	8972.60	9150.94	8567.37	-4.5%	13.7%
Gold	1523.00	1584.20	1609.85	5.7%	22.0%
Unemployment rate@	3.50	3.50	3.60	2.9%	-10.0%
Consumer price index@	257.21	256.97	257.97	0.3%	2.5%

— 2nd, 3rd, 4th quarter @ — Nov, Dec, Jan Sources: *Barron's, Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield
September 2018 to February 2020



Market Timing vs. Buy and Hold

Market timing involves making market buy and sell decisions based on your prediction of the future performance of the market. A buy-and-hold investment strategy, in contrast, involves buying in to the market on a regular basis and holding your investments over time.

Why Market Timing Is Difficult

The fact is that the market is an incredibly complex system. Investment returns depend on a wide range of factors. Economists suggest that stock price changes exhibit what they call random walk behavior, meaning that future performance cannot be predicted based on past performance.

Market timers retort that they have built complex models that analyze all factors affecting a stock's price. Sometimes, these models do accurately predict the movement of a stock price. But too often, unforeseen factors can quickly send a stock's price up or down.

Also, market timing is a more time intensive strategy. You need to monitor your investments closely to stay on top of all the factors that can affect them.

Buy and Hold

For the average investor, a buy-and-hold strategy is much more practical. While buy-and-hold investors will suffer in market downturns, by staying invested in the market, their investments will recover when the market recovers. While there is no guarantee this will happen, historically, the general direction of the market has been upward. The benefits of a buy-and-hold strategy over a market timing strategy include:

- It doesn't require constant monitoring of the market or the news.
- It's less complex. You'll typically make far fewer trades with a buy-and-hold strategy.
- There are fewer tax consequences. Since you have fewer trades, you'll have fewer taxable transactions.

If you'd like to discuss a buy-and-hold strategy in more detail, please call.

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