



RESIST ANY IMPULSE TO TWEAK THE PORTFOLIO

There are two elements to every financial plan.

The first order decision is concerned with finding the right direction. This is the strategy: it answers the “what” and “why” questions. Thinking deeply about what is important to you and what you want to achieve is crucial. Understanding the “why” is important in connecting to your vision at an emotional level. An emotional connection to what you truly value gives you the staying power in the face of challenges.

The second order decision is just as important: it answers the “how” to get you there. Having a clear understanding and commitment to what you want to achieve means very little if you do not have a clear process to achieve it. Knowing “what” is most important to you and “why” is powerful. Once you have intentionally established a clear goal you need to become process focussed.

The goal is your intention. The goal is just the destination. Understanding where you are and where you want to be guides the process you need to commit to in order to close the gap. What is the process of small actions that you need to commit to continuously on your way to your goal?

The goal is your direction the process is the path.

It is not only your desire to achieve a goal that matters, but also the commitment to a well thought out process that leads to achievement. You need to balance thinking ahead with acting now. What needs to happen in the present to make the future possible? Process is putting intent into action.

It is good to have great intentions. This defines your strategy. If you do not combine this with specific small actions, your intentions remain dreams. A good advisor would ensure that you have awareness and clarity on both the first and second order of decision-making. The result is your plan.

The iron law is: If the goals and plan haven’t changed, don’t change the portfolio.

If there are no significant life changes in the family circumstances, the plan shouldn’t change. And if the plan doesn’t change, the portfolio shouldn’t change.

If current events such as normal market cycles cause you to abandon a well thought out long-term plan, then the future price that you will pay is the result of investor misbehaviour and not the markets. We are not naturally wired to make good investment decisions when markets are falling. Evidence shows that we act predictably irrational when it would be in our best interest to stay committed to our long-term plan that is based on historic evidence.

Why do investors think that when equities are declining in price, their value is decreasing and their risk rising, when all of history and simple math demonstrates the opposite?

It is not market risk, but rather investor behaviour risk that will determine future outcomes. If you have a clear direction and a chosen path it would be best to stay committed to your plan.

What do we do know?

Market cycles are normal. Bear markets are a temporary setback in an otherwise long-term upward trend. History being our guide, the markets reward disciplined investors over the long-term. You cannot time the cycles with any consistency.

In the last 40 years the S&P 500, as a proxy for the market, has experienced a calendar year decline exceeding -20% only four times. This includes our 2022 year-to-date decline of -22,12%.

Year-ending	Return
1974	-26,31%
2002	-22,10%
2008	-37,00%

Let's look at what happened next. The graph on the right reflects the annualised return following a draw-down of more than -20% in a calendar year for the period:

Invested year after 20% decline		
3 YR Compounded Annual Return	1974	16,37%
	2002	14,39%
	2008	14,11%
5 YR Compounded Annual Return	1974	14,74%
	2002	12,83%
	2008	17,94%

If you stayed invested through the 2008 crash, you would have harvested an annualised return of 14.11% per annum over the subsequent 3-year period. Anyone who disinvested and did not get back in with timeous precision would not have experienced this. Research shows that more than 30% of investors were still sitting in cash at the end of 2009 when the index already had a 28,68% return.

It is tempting to fiddle with your plan or portfolio when markets are in steep decline. It feels as if action is required to save the day. History clearly shows that this is a bad decision.

Staying committed to your chosen investment strategy is the best policy. Financial success comes from acting on a plan. Failure comes from reacting to the market. Keep the focus on the plan not the portfolio.

It is not easy. But it is the rational decision.

The above article was written by Marius Kilian

Sources

www.nickmurray.com
<https://www.macrotrends.net>

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