human investing

September 12, 2017

Seasons of Change; Investing, Volatility, and the Risk-Reward Trade-Off

With a week or so left of summer we come to the close of an enjoyable schedule of vacationing, traveling, summer reading, and relaxing. One book I've been reading talks about the timing of making investment changes based on your financial plan and if there is a "best" time. The author uses the analogy of conducting life-boat emergency drills. When done while the ship in in port during calm seas, these drills can make the difference between surviving the storm or sinking. Careful, thoughtful planning and strategizing during times of peace can provide the greatest probability of surviving an emergency.

Similarly, in the context of investing, the best time to discuss asset allocation and how much is in growth assets like stocks (more volatile) versus income assets like bonds (less volatile), is when the markets are in a calm, low volatility state. Currently the Volatility Index (VIX) is near a 27-year low. This is 80% below the October 2008 peak in volatility during the housing and financial crisis. Applying the analogy of the sea, we are currently in port with lake level waves. October 2008 was like being in stormy high seas in the Alaskan Bering Sea. It would be extremely difficult to make sound investing decisions during the peak of a market storm with heightened volatility.

With that said, today is the day to discuss the risk reward trade-off, where to take the risk, and how much is appropriate based on your financial plan. Your financial plan, not the markets, should dictate how much you have in stocks versus bonds. The best time to make changes (if the plan dictates) is during seasons like the one we are currently in when market volatility is low. Using specially designed software to show what "risk-reward" looks like, the visual below are a comparison of a 100% stock allocation versus a balanced 50/50 stock to bond allocation. This shows the volatility of a particular allocation and the normal range based on historical events. You can see the financial benefits and drawbacks to certain allocations at differing times. Does your plan suggest more growth or more income? Due to historically low volatility, this is a great time to reassess your plan and investments.

T 503 905 3100 — F 503 715 4940
5335 MEADOWS ROAD, SUITE 450, LAKE OSWEGO, OREGON 97035
humaninvesting.com

Considering the market, we can also draw upon the analogy (and one we in Oregon are currently living through) of forest fires. While devastating, these fires clear out the excesses and overgrowth to reset the clock of growth and life. The markets act in much the same way. After many years of growth and abundance there comes seasons of cleansing where the inefficiencies and excesses in the market are reset. These resets come in the form of recessions and market corrections. On average, there is a 20-30% correction every 5-6 years. Fires are a normal part of the environment where we live and the markets where we invest. While we can't predict exactly when these events will occur, we can plan, prepare and make appropriate adjustments to weather them with as minimal damage as possible. Take the time today. If you would like to talk with one of our advisors please call Jill at 503-905-3100.