Is Buy and Hold Dead?

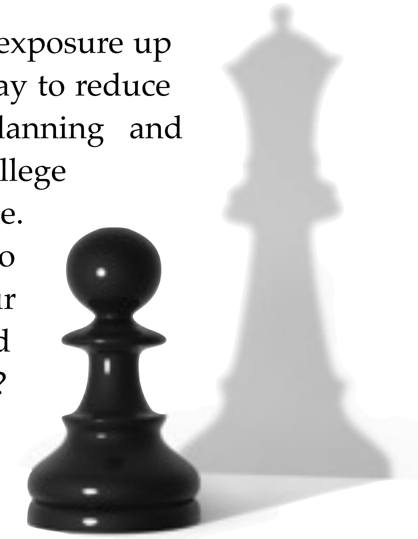
The last newsletter I wrote to our clients was in the fall of 2008, just before the second worst stock market crash in 100 years. In that newsletter, I talked about the importance of staying the course and rebalancing as the only sensible reactions to the market's jittery mood. Then the bottom dropped out.

So, in early 2009, the Abacus Investment Committee wanted to try and find a system to avoid this kind of pain in the future. Surely, there must be a point at which the market would be predictably "overvalued." And surely there must be other times when it would be "undervalued." Perhaps we could use the price-to-earnings ratio of the entire market to gauge this and, if we were in the most or least expensive ranges, we could adjust client exposures to stocks accordingly.

Without boring you with all the gory details, the bottom line was that we had to massage the data quite thoroughly to come up with a set of rules which increased return compared to a long-term buy and rebalance approach. Even then, the extra return was very small and only occurred prior to 1956. After 1956 the programs we studied yielded negative results. A few of the strategies did in fact help you avoid the pain of some downturns, but over time all of them made a lot less money, while still subjecting investors to plenty of risk. Our take-away: A better strategy for reducing risk is to increase bonds. (If you'd like more detail about the analyses we did, or copies of the studies themselves, please don't hesitate to contact your Abacus advisor.)

Notwithstanding these results, we are staying open-minded to analyzing strategies which are rules-based (as opposed to subjective or emotional) and which promise to better protect you from the next market decline.

The Best Way to Reduce Risk



Even if there isn't a proven way to profit from adjusting your stock exposure up and down in relation to market conditions, there is one definitive way to reduce risk before the next correction. Historically, most financial planning and investment allocating is "aspirational." We set retirement, college funding, house purchase, and other goals that we aspire to achieve. We then aim for the rate of return that is most likely to allow us to achieve those goals, which tends to require a larger percentage of our assets in stocks. What if we instead built our asset allocation around an "acceptable" scenario rather than the "aspirational" scenario? Would it be acceptable to work until age 65 or 70 instead of targeting early retirement; to buy a used car every 5 years instead of a new car every 3 years; to go on two trips to Europe in a decade instead of five? Why do these changes matter?

The most impactful variable in most financial plans is spending. This is because you need about $20 saved for every $1 you're going to spend annually during retirement. Therefore, if you cut spending by $1, you've actually just lowered your required savings by $20. If you cut spending by $1,000 per month (or $12,000 per year), you've decreased your required savings by $240,000.

Additionally, the aspirational part of us is never quite satisfied. In large part, this is because we think that early retirement or a second home will bring more happiness than they often do. After achieving one goal, we look for a new goal. In this way, aspirations tend to spawn more aspirations.

In contrast, a focus on "enough" tends to be self-fulfilling. By no means am I mocking aspirations – I have my fair share! Rather, I'm calling your attention to the link between prioritizing grander aspirations and needing to take more investment risk. If you want to have less exposure to the stock market, you need to increase your allocation to bonds. This will require a financial plan which can succeed with the resulting lower expected rate of return. Please contact your Abacus advisor if you'd like to explore this possibility.

Wishing you peace and prosperity,

Brent

Brent Kessel, CFP