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Cadence clips

HELPING OUR CLIENTS BUILD AND MAINTAIN WEALTH WITH AN UNWAVERING FOCUS ON CLIENT SERVICE AND COMMUNICATION.

Winning by Not Losing

There's a popular statistic in the financial services industry that highlights the theoretical penalty of having your money out of the market on even just a few key days over a relatively long period of time. For example, from January 1, 1970 through December 31, 2011, were you to miss just the 25 best stock market days (out of 10,601), you would reduce your gross earnings by a whopping 78%! It sure seems like the promoters of this statistic are right: you really cannot afford to have your money out of the market.

Or can you? When you instead consider missing the 25 worst stock market days over the same range of time, you would increase your gross earnings by 513%. Yes, *513%.*

What is particularly interesting is that over those 10,601 trading days, over half of the 25 best days are within 5 trading days of at least one of the 25 worst days. In other words, the story this "buy-and-hold" statistic isn't telling is that in order to actually enjoy all of the best 25 trading days, the majority of the time you would have to endure at least one of the worst trading days too, and frequently more than just one.

Where this starts to become useful is when you consider missing both the 25 best AND 25 worst trading days. Were you somehow able to achieve this, you would actually do better than by keeping your money in the market every single day. In fact, you would increase your gross earnings by 42% compared to just keeping it in the market every trading day over the past 42 years.

This tells us something very important: you can afford to miss some of the best days if you are also missing some of the worst days, because it appears that missing the worst days is more beneficial. As it turns out, we can use this to your advantage.

Over the course of decades, most of the best and worst days occur during volatile periods that result in net negative returns. If you could remove your money toward the beginning of these volatile periods and put it back in toward the end of these periods, you would increase your investment earnings substantially. Consider the case where you remove your money from the market a full two weeks before these best/worst periods, keep it out every day during the volatility, and put it back in a full two weeks after the last best or worst day. Were you able to do this, you would increase your gross earnings 133% over keeping it in the market for these 42 years.

That's $1,000 growing to $110,662 instead of just $48,145 since January 1970. The good news is that it appears possible to avoid many of these volatile periods provided you have a process to navigate through them. The better news is that we have two investment strategies that we feel do just that.

Our Take

Keeping with the volatility and risk theme, we certainly see an opportunity for more of it throughout the rest of this year. Between the seemingly unending flow of news out of Europe, November's elections, and potential Congressional inaction for the remainder of the year, we're not left wishing for any excitement to keep life interesting. When presented with the question, "how do you think markets will react to these events?", our instinct is to say, "not well". However, our heads remind us that markets can be funny and have a tendency to anticipate and react to potential outcomes far ahead of them, albeit sometimes incorrectly. This may be what's happening right now with the most recent market downturn that began on April 3. So pulling out of the stock market completely for the remainder of the year until all this excitement passes may very well be a losing proposition if markets rebound ahead of time.

Our investment philosophy is that active management is a critical compliment to traditional diversification in helping to navigate these types of environments. As mentioned in the research area of this communication, avoiding volatile periods can be tremendously beneficial when trying to maximize investment performance while also minimizing investment volatility. Most actively managed strategies aim to do this, and the two that we manage here at Cadence – Market Trend and Contrarian – are no exceptions. In addition to utilizing active management where possible, we also feel that the allocation of a broadly diversified portfolio should be leaning a bit more toward principal preservation given the potential for volatility through the remainder of the year. If and when we see a bigger correction in the markets, we will likely change our thinking toward a shift back in the direction of growth in a diversified portfolio (be it our Core Diversified Strategy or client 401k plans, etc).

Finally, we'd like to mention how our actively managed strategies have handled the most recent market downturn, since this is their objective over time and where they seek to add value to a diversified portfolio.

	Performance (net of fees) 4/3/2012 – 6/27/2012
S&P 500	-5.77%
Cadence Contrarian	2.04%
Cadence Market Trend	1.26%

As sure as Congress is likely to frustrate the masses in December, there's no strategy that doesn't have its drawbacks and occasional rough patches. It's our belief, however, that over time a sound strategy will prevail. Further, one that operates in a disciplined fashion in seeking to minimize risk of loss during volatile periods is something that every investor should consider making part of their portfolio strategy.

Have a great July!

Cadence Wealth Investment Department

Trivia Questions: 4th of July

1) Which of the following did not sign the Declaration of Independence?

   a) Samuel Adams
   b) Benjamin Franklin
   c) John Hancock
   d) George Washington

2) Which of the following European powers did not fight on the side of the colonists in the Revolutionary War?

   a) Spain
   b) France
   c) The Netherlands
   d) Germany

3) Which of the following was not one of the thirteen original colonies?

   a) Georgia
   b) Virginia
   c) Vermont
   d) Massachusetts

Have a wonderful 4th of July holiday!

Answers: 1:d, 2:d, 3:c

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Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve.

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