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Focusing on the Long-Term Reduces Investment Risk

(Originally Published in October 2014 Monthly Commentary)

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"Are there any secrets to achieving the benefit of investing in stocks while being able to minimize the risks? While not really secrets, there are a number of effective steps to take."

McCarthy Asset Management, Inc. is an independent, fee-only investment advisory firm that has been helping people invest wisely for over fifteen years. Our mission is to help you better understand and improve your financial situation. We specialize in Retirement Planning, Portfolio Management and Tax Planning.

The stock market can be volatile, which is not news to you. The recent sharp drop provides a vivid reminder of this. The potential reward, though, for investing in stocks is very appealing. Since 1926, U.S. stocks have returned 10% annualized. However, stocks lost money in 27% of the years since 1926. Are there any secrets to achieving the benefit of investing in stocks while being able to minimize the risks? While not really secrets, there are a number of effective steps to take:

1) **Invest for the long-term.** This is the most important step, and it is the focus of this article. *The longer the investment timeframe, the lower the risk of losing money.*

2) **Invest in a diversified portfolio**. Different segments of the market don't move in sync. Allocating your portfolio among U.S. large stocks, U.S. small & mid-cap stocks, international stocks, bonds and alternative assets will reduce a portfolio's volatility.

3) **Don't invest any more aggressively than what you can stomach in a market downturn.** If you have a hard time staying invested when stock prices are falling, then utilize a more conservative portfolio by allocating more to bonds. While this will reduce the portfolio's long-term returns, it is worth it if it enables you to stay invested during the difficult times.

4) **If you are living off your portfolio (i.e. taking regular distributions), set aside up to three years of withdrawals in a conservative investment** (such as an intermediate bond fund). This way, you should not need to sell any of the stock portions of your portfolio to cover regular distributions. This is because, other than during the Great Depression, stocks have fully recovered from each bear market within three years.

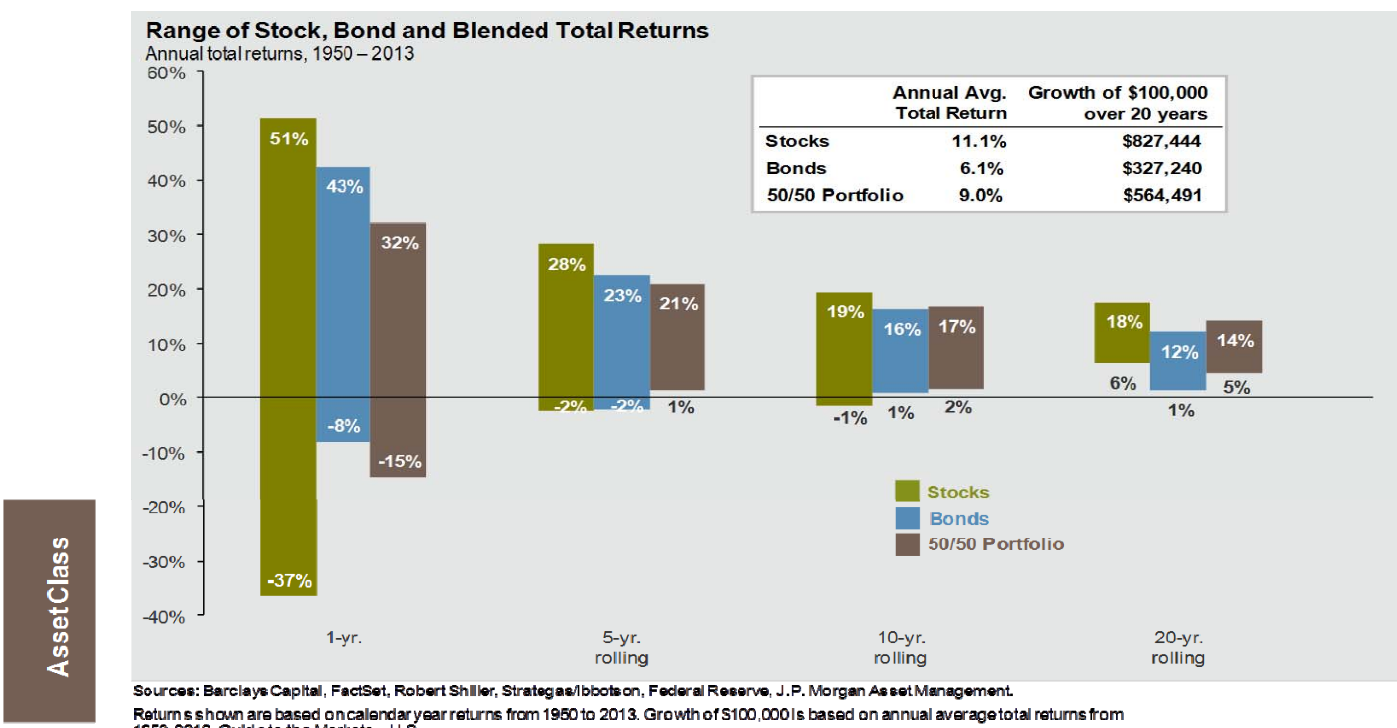
While we are able to implement steps “2” through “4”, we need clients to assist with the first step. During difficult markets, it is important for them to focus on the long-term and not be overly influenced by the short-term gyrations and the negative stories being reported by the press. During those times, we can help by talking with clients. In addition, we can help clients focus on the long-term by providing educational pieces like this article.

<u>Historical Worst Returns by Holding Period- 1950 to 2013</u>: The chart below from J.P. Morgan is very insightful. It shows for different timeframes the range of annual returns from 1950 through 2013 for an all-stock portfolio, an all-bond portfolio and a portfolio made up of 50% stocks and 50% bonds:

1) *Maximum loss for all-stock portfolio:* While the maximum loss was 37% for 1 year (i.e. 2008), for 5 years the annualized maximum loss was 2% and for 10 years it was 1%.

2) *Maximum loss for Blended portfolio:* For a 50% stock, 50% bond portfolio, the maximum 1-year loss was 15%. For 5 years, the worst performance was an annualized gain of 1% and for 10 years it was a gain of 2%.

3) *Maximum loss for 20-year timeframe:* Since 1950, the worst performance for 20 years for an all stock portfolio was an annualized gain of 6%. Not too bad considering this was the worst performance for any 20-year timeframe since 1950!



Sources: Barclays Capital, FactSet, Robert Shiller, Strategas/Ibbotson, Federal Reserve, J.P. Morgan Asset Management.

Returns shown are based on calendar year returns from 1950 to 2013. Growth of $100,000 is based on annual average total returns from 1950-2013. Guide to the Markets – U.S.

Data are as of 9/30/14.

Our Services

Investment Management Services:

- MAM creates and manages customized investment portfolios based on each client's investment objectives, timeframe and risk tolerance.

Financial Planning Services:

- The Net Worth Analysis (NWA) tracks the accumulation of Invested Assets for pre-retirees and the retention of Invested Assets for retirees. Updated annually.
- "Retirement Analysis" a comprehensive analysis of your retirement goals, which produces easy-to-read, interactive working plan, stored in the cloud. Updated as needed for life events.

Tax Services: Clients have the option of utilizing the income tax services provided through the firm Stephen P. McCarthy, CPA. These services are offered at an hourly rate and may include:

- Tax Return Preparation
- Income Tax Projections
- Tax Minimization Ideas
- Tax Authority Representation

Other Services: MAM has retained several outside experts, whose services are available at no cost to our clients:

- Long Term Care Planning– Allen Hamm of Superior LTC Planning Services, Inc.

Historical Worst Stock Returns- 1926 to 2013: The figures above cover the last 64 years (1950 to 2013). Let's go back further in time to include the Great Depression. What were the worst periods like if we go back to 1926 (so now we are covering 88 years: 1926 to 2013)? Here are the figures, courtesy of Ibbotson SBBI, a Morningstar company:

Holding Period	No. of Rolling Periods	No. of Periods With Negative Returns	Best Period	Worst Period
1 year	88	24	54.0% (1933)	-43.3% (1931)
5 years	84	12	28.6% (1995-99)	-12.5% (1928-32)
10 years	79	4	20.0% (1949-58)	-1.4% (1999-08)
20 years	69	0	17.9% (1980-99)	3.1% (1929-48)

Futility of "Market Timing": Many times I have written about the futility of trying to "time the market". For the last twenty years, Dalbar has released its annual study that has consistently shown that individual investors dramatically underperform the market averages. In its most recent report, Dalbar reported that for the last 30 years the average equity fund investor earned an annual return of 3.7% compared with the S&P 500's 11.1% return. This is dramatic underperformance for a long period of time!:

⇒ Earning 3.7% per year for thirty years will turn grow $100,000 into $297,414.

⇒ Increasing the annual return to 11.1% for thirty years will grow $100,000 into $2,351,916.

⇒ Investors can resist the urge to market time by focusing on the long term.

In Summary: This article provides four steps to reducing the risk of investing. While we are able to handle most of the actionable items, the one thing we ask of clients is for them to focus on the long-term and try not to worry about short-term market volatility.