INVESTORS NEED TO BECOME MORE COMFORTABLE WITH VOLATILITY IN THEIR PORTFOLIOS

BY BEN CARLSON, CFA
A WEALTH OF COMMON SENSE
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At certain points this year, the S&P 500® Index has been up 8% and down 30% from where it finished 2019. It's currently up around 8% on the year.

The Nasdaq-100® has been up as much as 43%, down as much as 20%, and currently sits at a 35% gain in 2020.

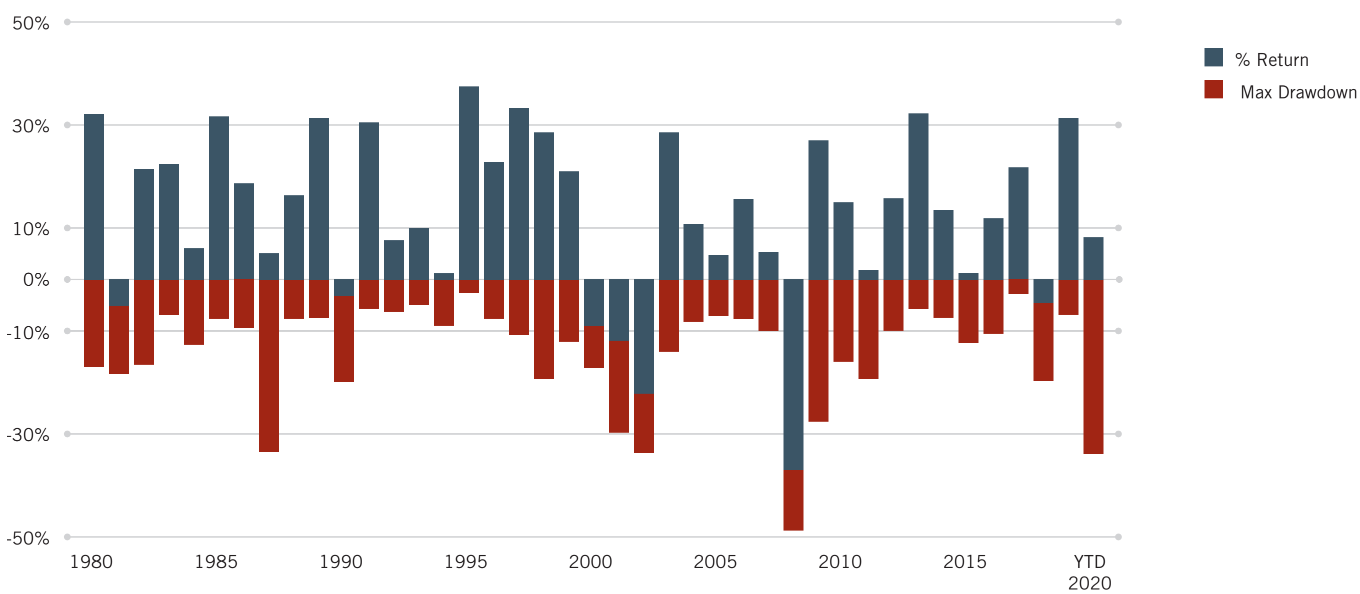
The Russell 2000® Small Cap Index has been up as much as 2% in 2020, down as much as 40%, and currently sits at basically breakeven for the year.

The stock market has been all over the map this year.

And, while 2020 is an outlier in terms of the wild ups and downs, volatility is something every investor is going to have to get used to in the coming years. You simply have to be willing to accept some form of volatility if you would like to earn anything on your capital. Volatility has always been part of the markets, but more so now than at any other time in history because interest rates are on the floor.

I've always loved this chart that compares the biggest peak-to-trough drawdowns each year on the S&P 500 to the total return for that year:

S&P 500® INDEX—ANNUAL RETURNS AND INTRA-YEAR DRAWDOWNS



Past performance is not indicative of future results. As of 10/20/20. Source: Ned Davis Research. © Copyright 2020 Ned Davis Research, Inc. Further distribution prohibited without prior permission. All Rights Reserved. See NDR Disclaimer at www.ndr.com/copyright.html. For data vendor disclaimers refer to www.ndr.com/vendorinfo/. The S&P 500® Index is defined on page 3. Maximum Drawdown is defined on page 3.

It's a little eerie how similar the 2020 profile looks like 1987. Look at that gap in 2020. Stocks were down 34% peak-to-trough back in March, yet now the market is up on the year.

In 20 out of the 40 full years listed here, there has been a double-digit correction intra-year. In 12 of those 20 years, the market actually finished the year in positive territory. And in eight of those 20 years, the stock market finished the year with double-digit *gains*.

There's a good chance these enormous differences in returns between gains and losses in a given year will continue for the foreseeable future.

Interest rates are pushing people out on the risk spectrum. The Fed is more entrenched in the markets than ever before. And, there are millions of investors out there who not only want, but need, to earn higher returns on their capital. There are retirees who don't have enough money saved for retirement and pension funds without enough capital to cover their obligations. All of these factors could lead to some interesting allocation decisions in the years ahead.

And, it's not just the stock market where investors will need to become more comfortable accepting volatility. This is true if you're investing in bonds as well.

The Bloomberg Barclays Aggregate Bond Index, which is a good proxy for many of the total bond market index funds, currently has a yield of 1.2% and a duration of nearly six years. What this tells us is you could expect to earn that 1.2% annually over the next six years.

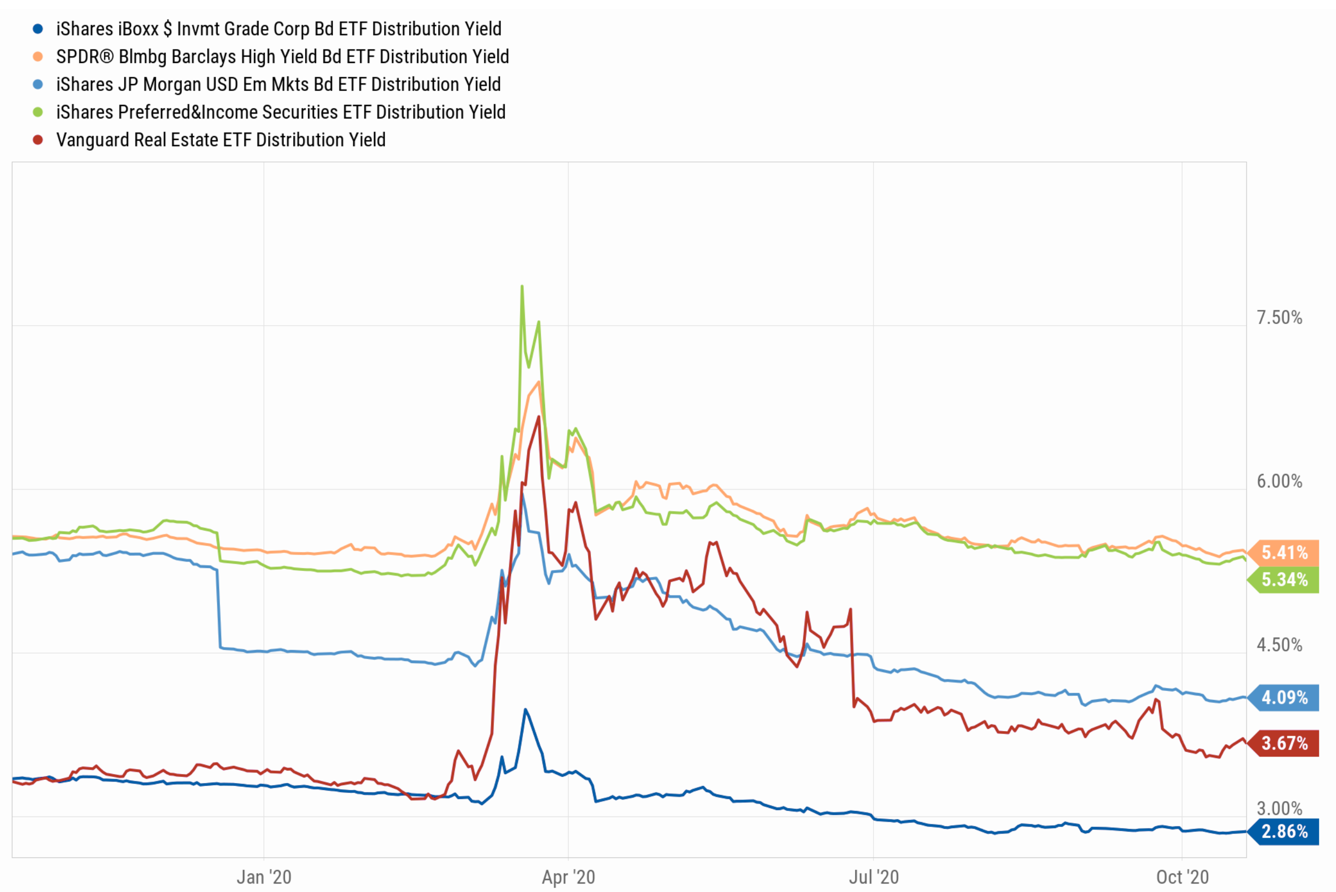
This also means for every 1% rise (fall) in rates, you could expect to see a 6% loss (gain).

These relationships aren't written in stone, but it's pretty close.

And, the volatility would be far greater in a longer maturity fund. The iShares 20+ Year Treasury Bond ETF (TLT) currently yields around 1.3% with a duration of 19 years. That means a 1% rise (fall) in rates would lead to a 19% loss (gain).

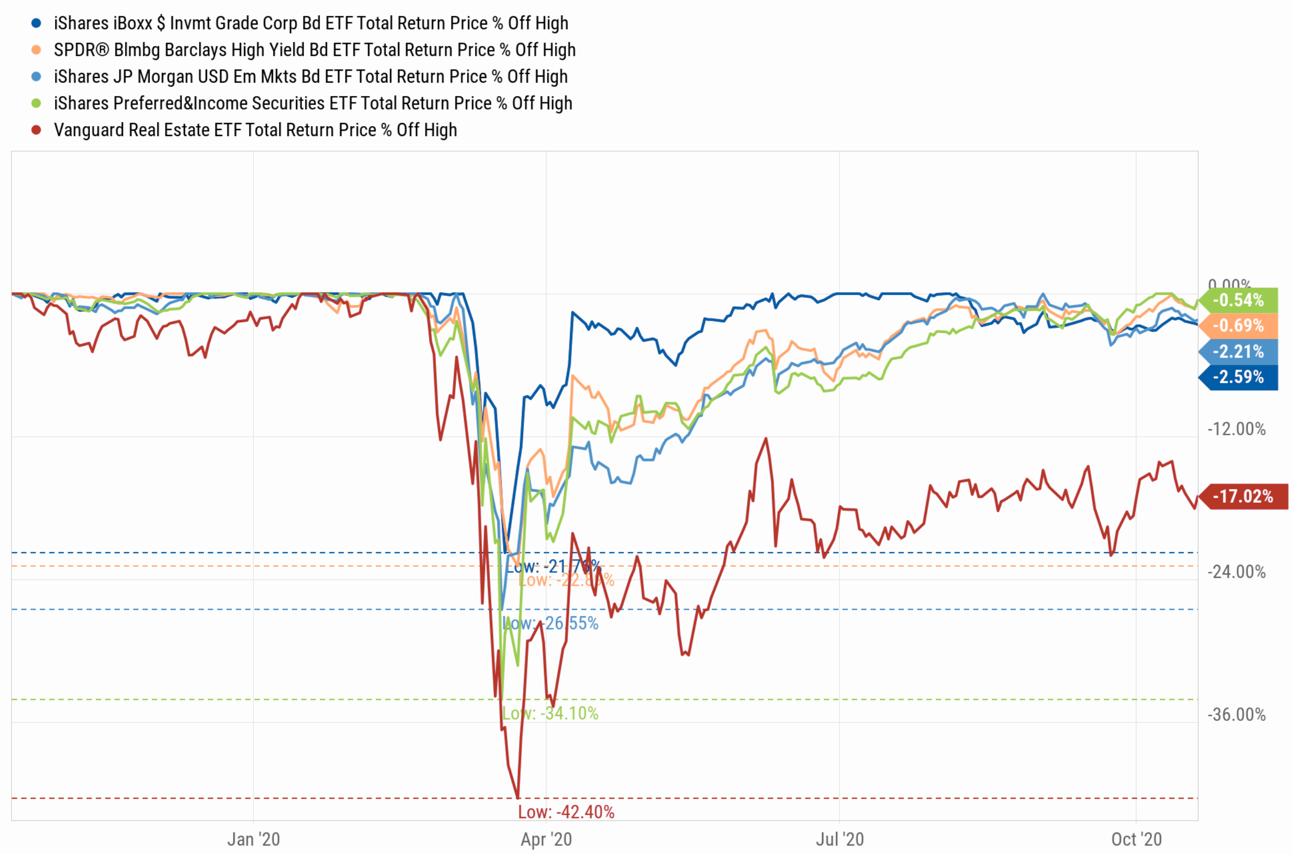
So, even if the long-term returns of bonds end up being fairly close to current rates, the path to get there could be rocky, depending on the movement of rates between now and then.

If those yields are too low for your taste, there are other options that have paid higher income:



Past performance is not indicative of future results. As of 10/20/20. Source: YCharts.

You just have to be aware that the other side of these higher yields is a higher chance of loss for these funds. These are the drawdowns on corporate bonds, junk bonds, emerging market bonds, preferred stocks, and REITs this year:



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Losses ranged from more than 20% to more than 40%. Again, 2020 has seen extreme volatility, but it's important to remember higher yields come with higher risk.

Really, the only answer to volatility is to have your money sit in cash and earn nothing.

If you want to earn anything on your money, you have to learn to live with volatility.

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Duration—Represents the interest rate sensitivity of a fixed income fund. For example, if a fund's duration is five years, a 1% increase in interest rates would result in a 5% decline in the fund's price. Similarly, a 1% decline in interest rates would result in a 5% gain in the fund's price. **Maximum Drawdown**—The peak-to-trough decline during a specific record period of an investment, fund, or commodity. A drawdown is usually quoted as the percentage between the peak and the trough.

The **Bloomberg Barclays U.S. Aggregate Bond Index** measures the U.S. investment grade fixed rate bond market. The index is calculated on a total return basis. The **Nasdaq-100®** includes 100 of the largest domestic and international non-financial companies listed on the Nasdaq Stock Market based on market capitalization. The **Russell 2000® Index** is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The **S&P 500® Index** is a free-float market-capitalization weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.

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