Q1 REVIEW 2018

WHEN IS VOLATILITY RELEVANT?

The resurgence in volatility we saw during the first quarter of 2018 was a good reminder that financial markets can experience major swings from day to day—even hour to hour.

Chances are, you needed that reminder. After all, big market fluctuations were practically non-existent in 2017. The S&P moved by one percent or more on only eight trading days last year—far below the annual average of 50 days that the index has experienced since 1945. That long, smooth ride may have caused you to forget that volatility is a normal, regular occurrence in the financial markets most years.

With rising volatility back on investors' radar screens, it's important for you to have the right perspective about volatility: what it really means—and doesn't mean—to you as you save and invest to achieve specific financial goals.

The good news: As a goals-based investor, volatility probably doesn't need to take up nearly as much of your attention as you might think it does. In fact, volatility can be largely irrelevant to you—almost a non-factor, *if you are able to put it in its proper place.*

Once you understand how to think about volatility the right way, you'll be empowered to make even better decisions about your investments—and avoid some major pitfalls that could trip you up on your goals-based journey.

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THE TRUTH ABOUT VOLATILITY

In many ways, it can seem like market volatility is a major problem that should occupy a great deal of your time and energy as an investor. Certainly, the media spends plenty of time talking about volatility—which is one reason why many investors focus so closely on it from day to day. Whenever stock prices gyrate significantly, you should expect to see headlines like these from the first quarter:

- "Volatility Swings Reach New Milestone."
- "Wall Street's 'fear index' jumps 22.6% as stocks extend losses"
- "VIX Up 81% Shows Extent of Stock Market Pain in Jarring Quarter"

Notice a trend here? The financial media nearly always presents volatility in terms of large losses or negative price movements. As you can see, they've even nicknamed one measure of expected future volatility—the CBOE Volatility Index, or VIX—the "fear index."

So you might get the impression that volatility is a massive threat to your financial future that you should avoid at all costs.

But that would be taking the wrong perspective about volatility.

It's important to recognize two key principles:

1. Volatility is a fundamental component of financial markets. Experiencing volatility is unavoidable—it's part of being an investor.

2. You don't want to avoid volatility entirely. The fact is, volatility to the upside can be a vital ally in your journey toward achieving your most important financial goals as an investor. (For a closer look at that idea, see the sidebar below.)

WHY VOLATILITY CAN BE IRRELEVANT TO A GOALS-BASED INVESTOR

Of course, none of that changes the fact that you will continually be confronted with headlines about market losses in the wake of rising volatility.

The good news: To a large extent, you can safely ignore and tune out those headlines—if you have the right perspective about volatility as it relates to your goals-based investment plan.

When Volatility is Your Friend

Volatility merely reflects the price movements of a stock, a sector of the stock market or the entire stock market—both to the downside (when stock prices fall) and to the upside (when stock prices rise). Therefore, volatility represents both the ups and the downs ~~that~~ investors experience. If stocks fall 2% in a day, that's volatility—but if stocks soar 2% in a day, *that's also volatility.*

It's that upside volatility—the big increases in stock prices that can (and often do) occur over short periods—that is a key driver of the relative outperformance that stocks have delivered over time. Other asset classes (such as bonds and cash) have generated significantly lower returns over the long run than stocks. Part of the reason is because those other asset classes tend to experience far less upside volatility.

This is great news for you as a stock investor. It means that the volatility inherent in the equity market is actually helping fuel stocks' relative outperformance over time—the type of returns that you likely need to grow your assets sufficiently to reach your key life goals.

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To see why, consider this example: Say you're investing specifically for a goal (such as retirement) that is 20 or more years away—meaning you don't need to tap your investment assets to start paying for that goal for at least another two decades. In that case, intense downside volatility during a particular week or month or even over the course of a year doesn't really impact your future. That volatility is essentially irrelevant in terms of what is most important to you as an investor: reaching your financial goal.

WHY IT'S NOT IRRELEVANT: MANAGING YOUR EMOTIONAL RESPONSE TO VOLATILITY

That doesn't mean the volatility you encounter as an investor is always unimportant. Far from it.

Volatility can become *extremely* relevant to you and your future financial prospects—if you don't know how to properly manage your reaction to it as an investor.

For example, say you're that same investor from above who is roughly 20 years away from needing your investment assets to fund a goal. If you allow the headlines about volatility and market losses to cause you to make decisions about your portfolio based on fear, you can jeopardize your ability to achieve your key goals.

The reason: Fear-based investment decisions cause us to make exactly the wrong moves at exactly the wrong moments—such as selling out of a particular asset class after a period of intense downside market volatility, when prices may be deeply depressed. That move, in essence, turns a portfolio loss that's only "on paper" into a realized loss that reduces your bottom line. Rather than ignore volatility and hold steady as you wait for prices to rise again, you allow an emotional reaction to volatility to cause you to make a costly decision.

As you can see, letting your emotions dictate your behavior can lead to investment returns that are lower than the returns your actual, underlying investments generate. That's exactly what you don't want to see happen with your hard-earned invested wealth!

Volatility is a fundamental component of financial markets.

Volatility to the upside can be a vital ally in your journey toward achieving your most important financial goals as an investor.

PUTTING IT ALL TOGETHER

As a goals-based investor—one saving and investing to reach key life objectives for yourself, your family or both—the reason to take volatility seriously is not because of the market declines that can accompany volatility. Nor is it because of the scary headlines during those moments.

Quite simply, those things are irrelevant to you and your ability to achieve your goals.

The reason to pay attention to volatility is because it can potentially cause you to become so nervous that you end up making emotion-based decisions about your portfolio. It's those rash moves, made enough times, can damage and even ruin your ability to reach your goals.

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This is true during all stages of a goals-based investment journey: (See below)

1. **The Gain stage.** If you're an accumulator trying to aggressively save and significantly grow your portfolio for a distant goal years down the road, volatility won't actually impact your ability to reach that goal. However, volatility is a risk in that it could cause you to make bad financial moves. So volatility does need to be acknowledged and guarded against for that reason.

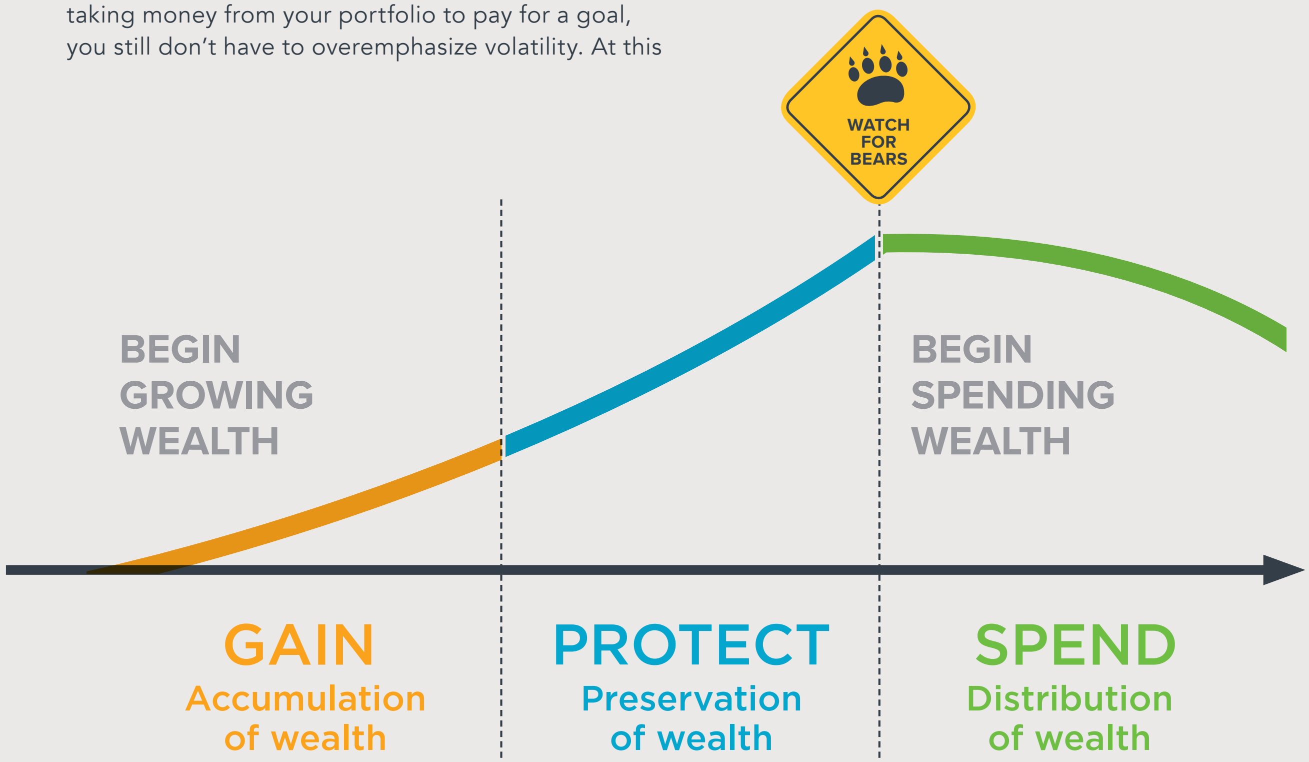
2. **The Protect stage.** Even if you're approaching the time when you'll need to use portfolio assets to fund a goal, volatility still isn't your biggest risk. Instead, your key concerns are drawdowns—the actual amount of money you lose—and missing out on additional asset growth to get you to the finish line. Here again, it's your emotional reactions to volatile market conditions that you need to manage.

3. **The Spend stage.** If you're at the point where you're taking money from your portfolio to pay for a goal, you still don't have to overemphasize volatility. At this stage, your major risk is longevity risk—running out of money while you still need to fund your goal. Usually this risk occurs when investors don't generate enough portfolio growth over a long enough time period—forcing them to rein in their goals and "live on less."

THE TAKEAWAY

So is volatility irrelevant to you as a goals-based investor? Hardly. But it's not the massive threat that the media and others make it out to be, as long as you know how to put volatility in the right perspective.

Armed with the knowledge of what volatility means and does not mean to you as an investor striving to achieve a financial goal, you can make better decisions on your investment journey, avoid some of the worst behavioral pitfalls along the way and stay on course the entire way.



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