Mesirow

# 1Q Market Observations

Last March, as much of the country locked down, stocks plummeted and the market began to price in a suddenly very uncertain future. And, the future was undoubtedly uncertain, as forecasts for what would come next ranged from the very mild to the absolutely dire. While we can look back and find predictions that look prescient, there are many, many more that fell far wide of the mark.

This is partially the nature of predictions; many more things can happen than will happen. Assessing possible outcomes is an important part of any decision-making process, but so is reviewing our past decision-making and using it to refine our approach. While we are unlikely to ever see another year quite like 2020, it is useful to consider what broad lessons we can learn from our experiences of the past year and how those lessons can help us be more prepared and thoughtful as we address yet unknown future challenges.

These lessons include:

- Investing requires both a short- and long-term focus.
- Knowing the future doesn't mean knowing the right investments.
- Protecting our portfolios from a crisis begins long before trouble is on the horizon.
- Asset Allocation is about both protection and opportunity.
- Safe money offers value even when its investment returns are limited.
- Many more things *can* happen than will happen.

### A year later

What can a look back at the past year teach us about investing and our process? In March 2020 we wrote to our clients:[1]

"*The health and economic impact of the virus will likely worsen before improving, and the magnitude will depend on the ability to contain it. However, a sensible asset allocation and proper diversification should help investors weather the duration of any economic slowdown that will occur in the near term. Further, we believe that the sharp sell-off is beginning to create pockets of attractive investment opportunities for long-term investors... The fear and anxiety caused by the Coronavirus and the market decline are entirely understandable; however, we remain confident that a calm, well-reasoned approach remains the proper one for a long-term investor. The best investment results are derived by taking a long-term view and positioning oneself accordingly, rather than rapid responses to the news cycle and short-term market fluctuations.*"

In retrospect, this long-term focus would have served an investor well, but we also recognize that saying so is far easier today than it was last Spring.

While we hope to never have to live through another pandemic, we can say with certainty that we will be faced with additional economic crises in the future, whether they are caused by a virus or something else. As such, we find this to be an opportune time to look at durable investing lessons learned over the past year and at how they can help us think about our investing approach, our risk tolerance, and about how to best achieve our short- and long-term goals going forward.

### Solid long-term investing is not about predicting the future

A year ago, few of us likely expected that many would still be working from home or going to school remotely a year later. To the positive, however, vaccine development has also exceeded even many optimistic timelines. Would knowing these outcomes have made us better investors? Further, if our crystal balls were truly excellent and we could have seen exactly what was about to unfold as we rang in the new year on December 31st, 2019, how would our portfolios have looked?

Had we known how pervasive the virus would become and about the lockdowns and economic damage that it would lead to, our gut likely would have told us that it was a bad time to be an owner of equities. Thus, we may have reacted by seeking to bolster the safety of our portfolios by moving money from stocks to bonds, and that would have been a perfectly sensible reaction. However sensible, our portfolio would have suffered from this decision-making process. Despite one of the worst economic environments of our lifetimes, in the 15 months since the start of 2020, stocks have returned over 25% while long-term government bonds have returned just under 2%.[2]

While a pessimistic response to that prediction would not have helped, an optimistic response may not have benefited our portfolio either. If on March 31, 2020, we were able to correctly predict four companies that would have approved vaccines within a year (Moderna Inc, Pfizer Inc, Johnson & Johnson and AstraZeneca PLC) and invest in their stocks, a year later only one of the four stocks would have outperformed the market and the three that underperformed would have trailed the market by an AVERAGE of nearly 35%![3]

The lesson is clear; even if one could predict the future, it might not help their investment outcomes.

## Don't wait for a crisis to think about risk and asset allocation

It is said that you can plan a pretty picnic, but you can't predict the weather. While this is true of dining al fresco, it also applies to investing. Economic and market trouble often comes rapidly and when least expected. An investing plan should recognize that some things are out of our control and beyond our ability to forecast.

The lesson is that it's better to proactively adjust *before* a crisis rather than reactively during the depths of one. While we showed above that an investor who owned only equities would have had solid performance since the end of 2019, they also would have had to stomach a 34% decline4 in their assets during this period. This is a decline that would have been difficult to live with for many investors, and one which could have resulted in a permanent impairment, such as in the case of a retiree drawing from their portfolio with no option but to sell near the market bottom to provide for their expenses.

An investment plan that accounts for the possibility of unforeseen storms over the horizon is a plan that is likely to help us weather those storms.

## Preparation can provide opportunity

While we cannot predict the future and cannot say for certain how the market will react to exogenous events, we can allocate portfolios in a manner that provides for both our short- and long-term needs, while also opportunistically positioning our investments in response to the current market environment. Many of the money managers that we partner with for our clients reduced their portfolio's risk exposure in late 2019; not because they predicted the spread of COVID-19, but because rich valuations offered a less favorable risk/reward tradeoff in some investments.

Having an appropriate allocation before a market downturn is not just about withstanding the panic that often accompanies bear markets. Knowing that there is appropriate liquidity to meet short-term needs and having "dry powder" on the sidelines can allow the chance to be opportunistic and take advantage of market declines. As we wrote to clients in March 2020, many of those same money managers that reduced market exposure in 2019 had "indicated to us [in recent days] that they're cautiously adding capital to existing holdings and opportunistically buying new securities."5

## Even when safe money returns are low, safe money can "buy" peace of mind

While we can create portfolios that reflect the current market environment, your Mesirow Wealth Advisor also seeks to create a portfolio that is adapted to your personal goals, needs and risk tolerance. As we wrote to clients last fall:

*"When constructing a portfolio…we can predict what our expenses might be over the coming years and ensure that we have ample liquidity to meet them even in the event of a market correction… An asset allocation that provides ample liquidity to meet those near-term needs can often buy us the peace of mind that helps us accept the higher volatility that may come with the long-term growth assets in our portfolio."6*

The lesson is that the correct portfolio is not a portfolio that seeks only to maximize overall return, but rather a portfolio that maximizes the chances for successfully achieving your goals. Returns offered on cash equivalents and fixed income investments today are near historic lows, but these assets still can serve an important role within an investment portfolio. While the return offered today on a Treasury bond may be modest, a Treasury can offer complete certainty that the bond will mature on a fixed date in the future and of how much cash it will provide on that date.

Even in a low-rate world, cash and bonds in a portfolio serve two main purposes. The first is to match cash flow and maturities with anticipated distributions. The second is to serve as a ballast for the more volatile, growth-oriented holdings in the portfolio.

Having multiple years of liquidity provided for in high-quality fixed income may help to provide peace of mind to accept market fluctuations that are likely to occur during a full investment cycle.

## The outcome we've had is not the only one that could have happened

The past year has been trying and difficult, but most feel we can see light at the end of the tunnelOver 150 million vaccines have been administered in the US with broad availability of additional vaccines expected in April and May, economic data is indicative of a pathway to recovery and growth, and markets have proved to be resilient in anticipation of economic reopening and future growth.

Even still, we are likely to spend years debating whether the pathway that got us here was the right one: Was fiscal and monetary policy too accommodative or too austere? Were the lockdowns and additional mitigative measures not strict enough or should they not have been done at all? What else could we have done differently? We cannot ever know for sure what would have happened had we reacted differently. We must acknowledge, however, that alternate histories do exist with much different outcomes, some better, some worse, many with very different winners and losers.

## Summary

The lesson is that we cannot predict the future, and even if we could, we still would not be a perfect investor. As such, we should prepare ourselves and our portfolios for a future that is unknown and uncertain—sometimes in ways that are challenging and scary and sometimes in ways that exceed our most optimistic guesses. Knowing that there are likely to be difficult and uncomfortable periods and having a plan in advance to address those challenges can help us to weather the storm and come out on the other side, still on the pathway toward achieving our goals.

1. Mesirow Wealth Management Market Observations "COVID-19 Uncertainty Continues to Impact Markets" (3.20.20) | 2. Total Return 12.31.19 - 3.31.21: S&P 500 +25.7%, Bloomberg Barclays US Long Treasury Total Return Index, +1.8% (Source: Bloomberg) | 3. Total Return 3.31.20 - 3.31.21: S&P 500 +53.7%, MRNA +337.2%, PFE +22.0%, JNJ +28.7%, AZN +14.4% (Source: Bloomberg)| 4. Total Return 2.19.20 - 3.23.20: S&P 500 -33.8% (Source: Bloomberg) | 5. Mesirow Wealth Management Market Observations "COVID-19 Uncertainty Continues to Impact Markets" (3.20.20) | 6. Mesirow Wealth Management Market Observations "October Surprise" (10.22.20).

Index definitions:

The Standard & Poor's 500 Index, often abbreviated as S&P 500, is an American stock exchange market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices.

The Bloomberg Barclays Long US Treasury Index includes all publicly issued, U.S. Treasury securities that have a remaining maturity of 10 or more years, are rated investment grade, and have $250 million or more of outstanding face value.