OSBORNE PARTNERS
Capital Management, LLC

Smart Things for Investors to Do During Periods of Volatility

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You can't control a volatile market, yet you can control your strategies and rein in emotions to lower the probability of making a costly mistake.

You can't control a volatile market. However, you can control your strategies and rein in your emotions to lower the probability of making a costly mistake. Below are some recommendations to consider during these volatile times:

When It Feels Really Bad, That's When Investors Are Paid the Most to Stay the Course

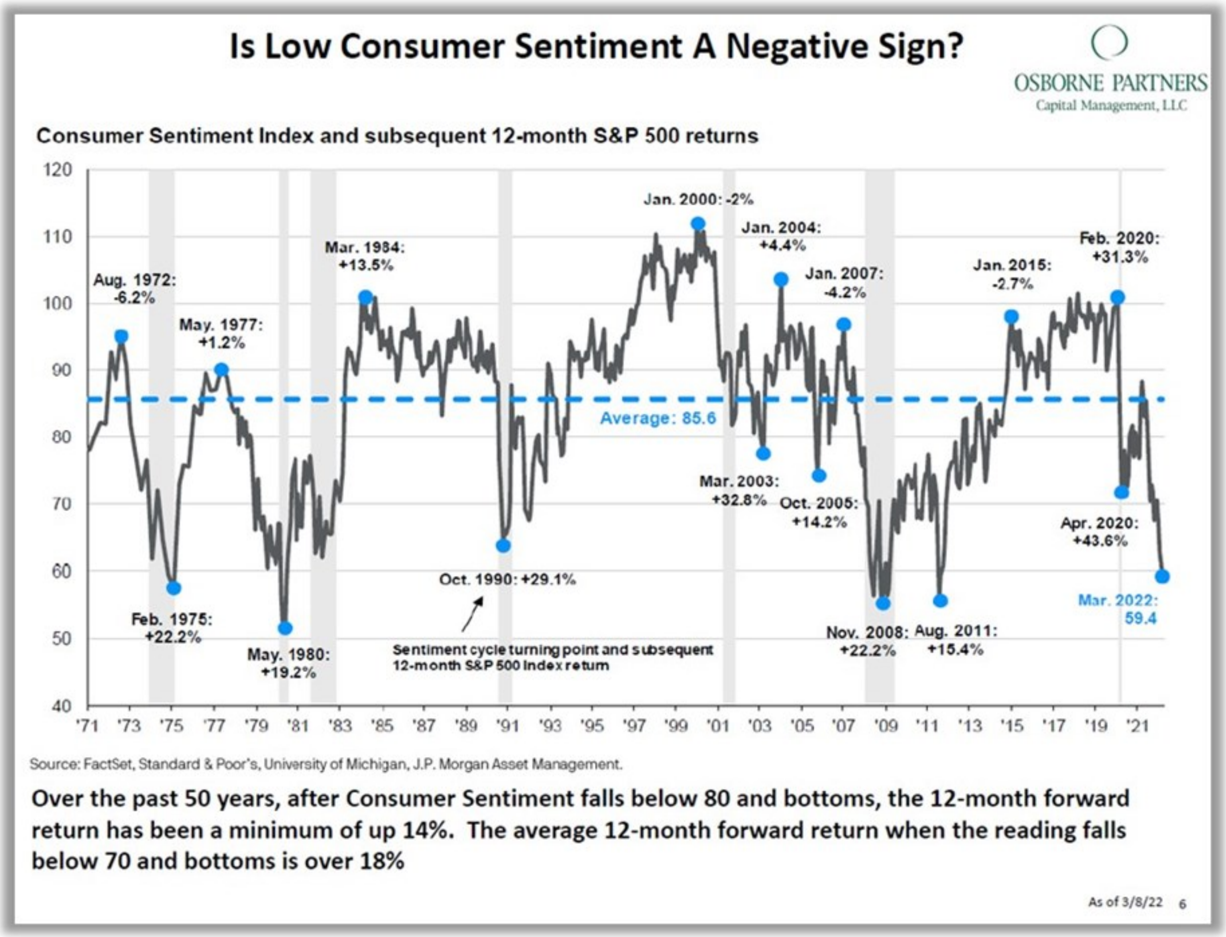
2022 has been a volatile year. For U.S. stocks, the S&P 500 fell 20%, the worst first-half to a calendar year in over 50 years. Technology stocks fell even more, with the tech-heavy Nasdaq falling over 30%. It seems that every time we turn on the news or scroll through our phones (or if you're old fashioned like me, read through a newspaper), there is bad news: inflation, rising interest rates, risk of recession, etc. It's seemingly endless bad news.

Given all of this, it is understandable that investors can become unsettled. And if investors become unsettled enough, there is a strong desire to bring relief and sell stocks. While selling stocks can bring relief, that relief is often temporary and comes along with a hefty, hefty price.

History shows that volatile periods like this are when investors are rewarded handsomely for staying the course. Usually, when consumer and investor sentiment are negative, historically markets have delivered some of their best returns.

There are a number of indexes/metrics that demonstrate this phenomenon, known as a contrarian indicator. I often refer to the Consumer Sentiment Index. See the following chart, which illustrates Michigan University's Consumer Sentiment Index, along with the S&P 500's subsequent 12-month returns, following index highs and lows.

What I always encourage clients to think about is comparing the twelve month returns when consumer sentiment hits a high and when it feels good to invest (generally, the observations in the top half of the chart), relative to the returns when sentiment hits a low and it is painful to invest (the observations in the bottom half of the chart). You'll certainly observe that the returns on the lower half of the chart (low consumer sentiment) are much higher. For instance, in March of 2003, as we were emerging from the dot-com crisis and Sept 11th attacks (and sentiment was low), the S&P returned more than 32% over the next 12 months. Or in April of 2020, the depths of the COVID-19 pandemic, consumer sentiment had plummeted. However, the S&P returned 43.6% over the next 12 months. The take-away here: historically, when it feels the worst, you'll be rewarded the most for staying the course.



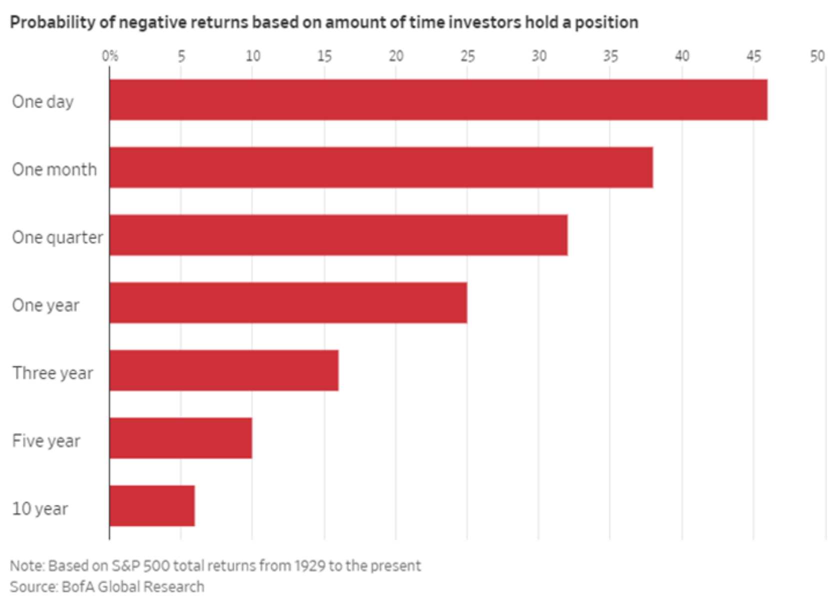
Looking Too Often Can Cost You. Talk to Your Portfolio Counselor

Of course, staying calm and collected during periods such as this is easier said than done. But there are a number of ways to help make things easier on yourself.

First, avoid the temptation to log in and view your stocks or account balances daily. Taking a glance at your portfolio, especially during times of volatility, can cause investors to take action that undermine their long-term financial success. More specifically, you can become more tempted to sell your stocks at very low prices to bring about temporary relief (see section above about how this temporary relief is very, very costly).

There is no "one size fits all" rule for the optimal frequency to review your portfolio. However, history and numbers will show, you make things much easier on yourself emotionally by checking less frequently (and certainly not daily). The reason being is that the probability of seeing negative returns decreases over time.

Going back to the start of the Great Depression, the S&P 500 has declined 46% of the days when markets were open as shown in the following chart. For investors who check their accounts daily, you would be subjecting yourself to quite a bit of pain. However, for investors who look only quarterly, losses occur 32% of the time. And over three- and ten-year periods, losses only occurred 16% and 6% of the time, respectively. By checking less frequently, you are certainly less likely to subject yourself to bad news. More importantly, you are less likely to make an emotional decision, and sell stocks at an inopportune time.



Additionally, it is helpful to engage with your Portfolio Counselor during periods of volatility. One of Osborne Partners' primary jobs is to help you remain unemotional (despite market volatility), and make data and evidence-based decisions. It is often reassuring to understand the investment team's current investment thesis, and actions we're taking to either protect your portfolio, or position it to take advantage of market recoveries.

Use This Volatility to Your Advantage

While talking to your Portfolio Counselor about Osborne Partners' market outlook, there is also an opportunity to discuss tactical strategies that can help you take advantage of market volatility.

And though every client situation is unique, a partial Roth IRA conversion is a common and powerful tax planning strategy during volatility. Your Portfolio Counselor can guide you through the process, provide color and context, and help you determine the optimal amount to convert from a traditional IRA to a Roth IRA. (Or read my article "Three Powerful Tax Strategies to Evaluate Now" from the October 2021 Wealth Report).

As a quick refresher, a partial Roth IRA conversion has the primary objective of reducing your retirement account tax liability over time. To do so, an owner of a traditional IRA, will "convert" part of their traditional IRA (which is pre-tax / you owe taxes when taking money out) to a Roth IRA, which is post tax – meaning investments in Roth IRAs grow tax free, and are withdrawn tax free. The key to a successful Roth IRA conversion, is converting your traditional IRA at a time when either your personal income tax bracket is relatively low, or the investments you're converting are relatively low in value (or have a high-risk reward).

A Roth IRA conversion is particularly advantageous during periods of volatility because converting after markets or individual stocks have declined, you can convert the same number of shares, just at a much lower tax liability. For instance, let's assume you wanted to convert 100 shares of Apple stock ($182.01 on 1/2/22) to a Roth IRA at the beginning of 2022, you would owe taxes on $18,201 (100 shares at $182.01 / share). Alternatively, if you were to convert 100 shares of AAPL to a Roth IRA on 6/30/22, the tax liability would only be $13,893 (100 shares at $138.93 / share). The benefits here are twofold:

1. The tax liability generated is 23.7% lower ($18,201 compared to $13,893)
2. As the market and/or Apple recovers, all of the growth will be tax-free in the Roth IRA.

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If a Roth IRA conversion makes sense for you, the Osborne Partners team will be happy to identify the optimal holdings for you to convert and help you take advantage of the volatility. This is just one of the many ways Osborne Partners can help you capitalize on market volatility to reach your long-term wealth goals.