



The Colony Group

# MARKET PERSPECTIVES

## ► QUARTER ONE 2020

While many of us were aware of the coronavirus spreading in China back in January, we had little reason to believe it would infect nearly every country in the world and become one of the worst pandemics and most tragic humanitarian crises in history. At that time, there was scarce evidence that this virus would be orders of magnitudes more disruptive than its predecessors, such as SARS, H1N1, and MERS. There will be a time to look back and analyze what could have been done to prevent this from getting so bad. For now, our hearts go out to those who have been affected by this crisis and those who are on the front lines battling it day and night.

There were reasons for optimism at the start of the year. China and the U.S. had just reached a trade deal that was expected to reinvigorate global GDP growth. Midway through February, the S&P 500 reached an all-time high, the 13th time it had done so this year. While valuations may have been rich across many asset classes, the combination of accelerating growth, low interest rates, and benign inflation was expected to produce respectable returns for the year.

As the calendar turned to March, however, and the virus spread to other countries, the investment markets rapidly took notice. Global equities experienced a spectacular selloff, pushing domestic and international stock markets lower. Indeed, the month was the worst monthly decline for the S&P 500 in history (-22.0%), with the index experiencing three of the ten worst days in history (3/16 = -12.0%, 3/12 = -12.0%, and 3/9 = -7.6%), and the second worst weekly decline in history (-15.0%).

As fear and panic began to grip the markets, no asset class went completely unscathed. Even traditional safe havens, such as gold, money market funds, and Treasury bills, experienced a bout of selling pressure during the worst week of the selloff. This was because many investors sold their least impaired holdings as they were driven by fear to stockpile cash. The Federal Reserve's quick decision to backstop select credit markets helped to ease such indiscriminate selling. These Fed measures are already greater in magnitude than what the central bank did over a period of more than a year during the Great Financial Crisis.

### Colony Investment Leadership Team



**BRIAN KATZ, CFA**

President of Colony  
Investment Management &  
Chief Investment Officer



**RICHARD D. STEINBERG,  
CFA**

Chief Market Strategist &  
Co-Chair, Colony Investment  
Management



**JASON BLACKWELL,  
CFA, CAIA®**

Chief Investment Strategist

Despite some selling pressure, investment-grade bonds served their purpose as ballast to declining equity returns. Buffeted by a fall in the 10-year Treasury to below 1% for the first time in history, the Barclays U.S. Aggregate Bond Index posted a return of +3.2% for the quarter. Not surprisingly, safer sectors, such as government bonds (+8.1%), outperformed riskier segments like high-yield corporate bonds (-12.9%).

In this environment, it is appropriate for clients to ask what steps we are taking in response. We will start our answer by telling you what

we are not doing. We are NOT allowing fear and panic to drive our investment decision making.

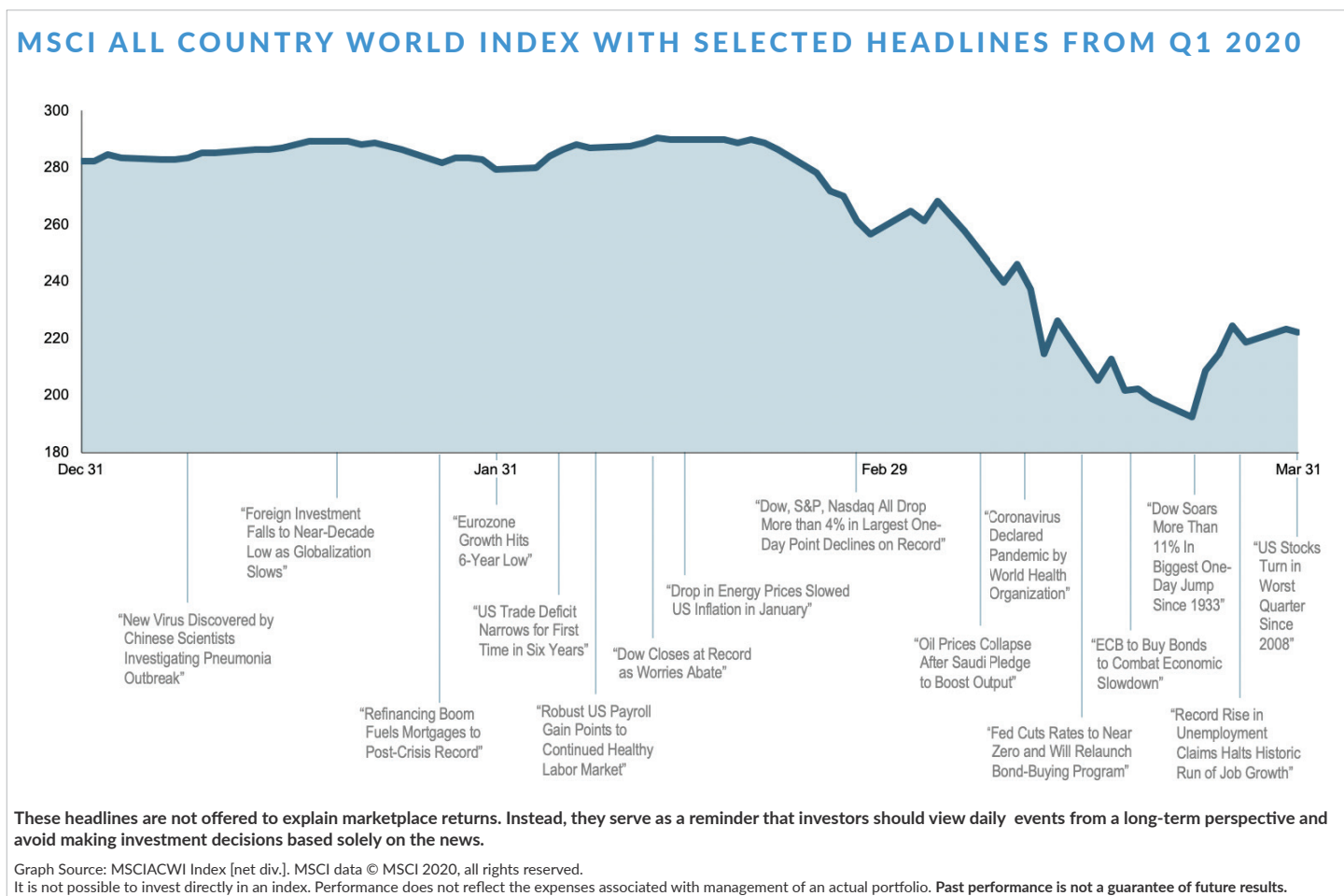
Here's what we are doing. We are maintaining our discipline and adhering to our time-tested process. We are harvesting losses where appropriate to reduce present and future taxes. We are also seeking to tilt portfolios towards opportunities and away from uncompensated risks. Actions – in this case buying or selling – have consequences, both positive and negative. In the remainder of this letter we will outline some of these considerations.

## What's Next?

As we write this, the virus's spread and when it may end remain highly uncertain. Even within the science community, there is a wide range of estimates, which speaks to a high level of ambiguity. Some of the cities and states hit earliest are starting to show signs of a peak in new cases. Nevertheless, the Coronavirus Task Force is warning of another couple of weeks of "hard days" in store for the U.S. Lastly, many experts expect a second wave of infections once social distancing measures are relaxed.

This leads to another factor that is causing uncertainty in the investment markets. What might the economic recovery look like once people's lives begin to return to normal? Economists often

use letters of the alphabet to describe the shape of a recovery: V, U, W, or L. Each letter has a left side representing the decline in economic activity and a right side representing how the recovery might progress. A V-shaped recovery experiences an immediate and sudden snapback, similar in duration and magnitude to the decline. W-shaped recoveries are often referred to as double-dip recessions, which experience a second decline before a more powerful recovery begins. U- and L-shaped recoveries describe a cycle that meanders at lower levels for some length of time. In an L-shape, the economy never meaningfully recovers, whereas a U-shaped recovery experiences a snapback after a period of sluggish activity ends. Notably, we have not experienced an L-shaped recovery in modern times.



The timing and magnitude of this recovery will likely be dependent on the length and magnitude of the economic contraction and the process by which officials relax social distancing restrictions. Recently, policymakers passed a third stimulus bill, making it the largest fiscal stimulus legislation in U.S. history. The goal of the “Coronavirus Aid, Relief, and Economic Security Act” (CARES Act) is to help individuals and businesses bridge the gap between the contraction and recovery. Experts are uncertain on whether this will be enough. Indeed, some politicians are working on a fourth stimulus package. This gives us some confidence that policymakers are committed to doing whatever it takes to support our economy.

As the pandemic has evolved, it is becoming increasingly clear that the return-to-normalcy phase will be slower and more drawn out than originally expected. Federal and state officials are likely to phase out social distancing policies slowly in order to suppress a second wave of infections. This means that the rebound in economic activity may be slow and methodical. Of course, the development of a vaccine or effective treatments would materially change this roadmap. Unfortunately, it is unlikely that a vaccine will be ready for mass distribution until late this year or early next year at best. In the meantime, access to more widespread testing will be vital to our containment efforts. Until we have more certainty around these variables, it’s probably best to temper our enthusiasm over how quick the recovery may be.

All this uncertainty makes trying to time a market bottom a challenging endeavor. This is compounded by the fact that markets typically detect a bottom in economic growth before it becomes evident to others. Successful market timing is difficult, if not impossible, even during normal times. In today’s environment, analysts and strategists are being diverted from their normal analytical rigor. They are now required to consider virus reproduction and mortality rates and how an unprecedented sudden stop and eventual restart of the global economy may impact markets.

## The Cost of Action

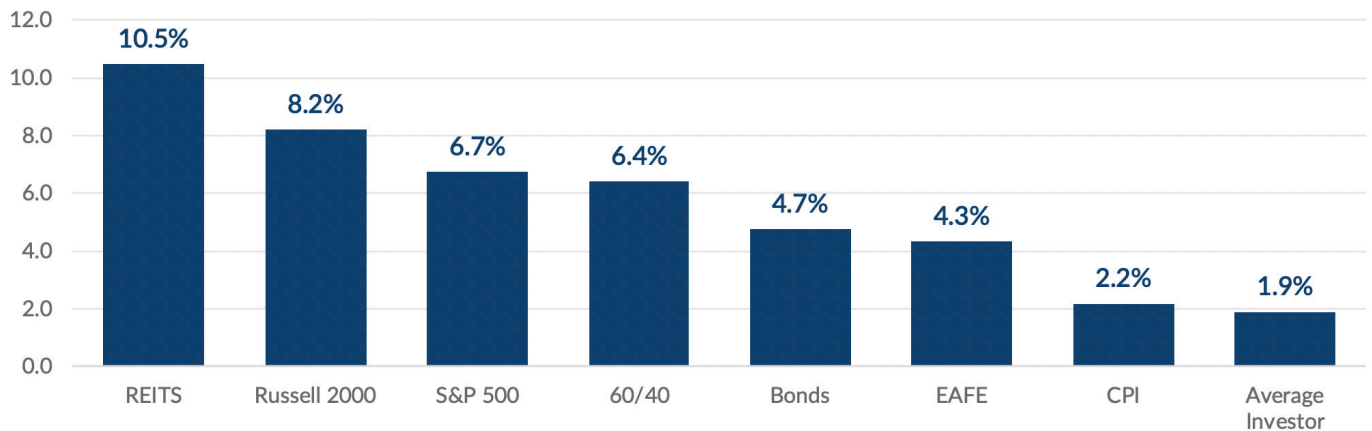
Many investors are scared right now as we are pelted by negative headlines in our 24/7 news cycle. Regardless of these headlines, we are certain of one thing: the world will get past this. Nevertheless, many investors feel compelled to act. Action brings a feeling of control. The crisis we currently are facing, however, cannot readily be controlled – not through the investment markets, anyway. While action helps us to feel better over the near-term, it comes with costs for which we may not be adequately compensated.

The most damaging cost for investors, over time, is opportunity cost. Dalbar, a financial-services market research company, publishes a widely followed report that seeks to measure the return experience of the average investor by incorporating investors’ purchases, redemptions, and exchanges of mutual funds. Using this methodology, the average investor has underperformed most asset classes over the past 20 years largely due to poorly timed trading decisions (*see chart below*).

Remember, any decision to sell must be coupled with a decision of when to get back in. Historical data shows that mistiming the reentry can be very costly. Over the past 20 years (7,811 trading days) through December 2019, the S&P 500 Index returned 10.6% annualized. Investors who were out of the market for the ten strongest up days saw their return fall to 8.2%. If you missed out on the 50 biggest up days (0.6% of the entire time period), your return shrank to just 2.6%.

Trading also has costs – implicit and explicit. Selling existing holdings from taxable accounts may cause capital gains, which could generate incremental taxes. Also, investors should consider any transaction fees and hidden trading costs. Some mutual funds carry transaction fees when buying and selling. While many custodians are no longer charging commissions for trading stocks and exchange traded funds,

## 20-Year Annualized Return



Source: Morningstar, Barclays, Standard & Poor’s, Russell, MSCI, and Dalbar Inc. Indices: FTSE NAREIT Equity REITs, Russell 2000, S&P 500, balanced portfolio of 60% S&P 500 / 40% Bloomberg Barclays U.S. Aggregate rebalanced annually, Bloomberg Barclays U.S. Aggregate Bond, MSCI EAFE, BLS CPI All Urban SA, Dalbar analysis using net aggregate mutual fund purchases, redemptions and exchanges.

investors are subject to other hidden costs. There are costs embedded in the bid/ask spread, or the price at which buyers are bidding on shares versus what sellers are asking for their shares. This spread, which is captured by a market maker in consideration for maintaining a liquid market in a position, is coming at the investor's expense; and spreads almost always widen when markets are subject to sharp selloffs.

For investors with longer time horizons, the low rates earned on cash are also a cost. While inflation expectations have come down considerably, they are still above the rates earned in most bank accounts and could increase during the recovery phase. Many investors will need to take on incremental risk just to keep up with inflation, not to mention keeping up with their saving and spending goals.

Today's crisis, like others before it, brings to investors an irresistible urge to respond. The desire to sell risky assets after a market selloff is natural. Nevertheless, it is likely the most common and repeated mistake investors make. A quick glance at a long-term price chart of the U.S. equity markets shows that they have recovered from every obstacle ever thrown their way. Currently, we see no reason to believe that this time will be different.

## Conclusion

The market correction has reinforced our conviction that our process is the right one. This starts with a well-designed financial plan that reflects an individual's investment objectives, time horizon, and tolerance for risk. These data points are then used to develop a strategic, long-term asset allocation, which is guided by reasonable assumptions regarding long-term capital market returns. Next, we select a diversified collection of carefully researched investment strategies from a wide array of investment options to represent the various asset classes. We believe that we can add value by tilting the portfolio towards opportunities and away from risks in a risk-managed range around the strategic asset allocation. Lastly, and most importantly in the current environment, is that investors must have the discipline and fortitude to stick to this plan.

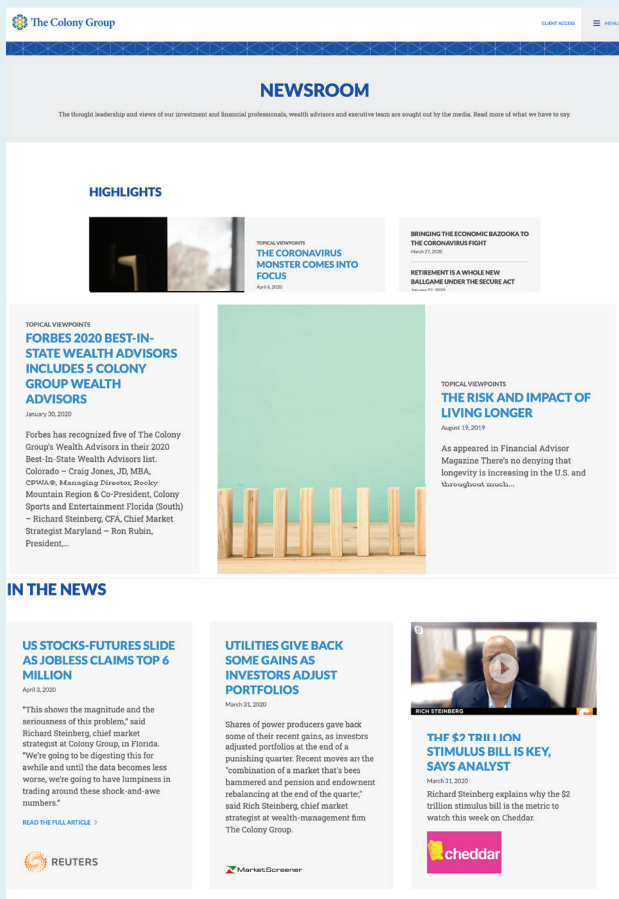
[See Colony Spotlight on page 5.](#)

## COLONY SPOTLIGHT

### ► The Colony Group's Newsroom

To help you stay informed with the latest developments on the investment landscape, we've created **Colony's Newsroom**, a page where you can quickly access our latest thought leadership, media appearances and interviews, and market insights.

We hope that you will use this page as a valuable and informative resource. Our investment and financial professionals, wealth advisors, and executive team continue to provide materials to keep you abreast of the markets, economy, tax issues, and financial planning initiatives. *To view the page, click on the image below.*



### ► Colony's Market Update Webinars

As we continue to fulfill our mission to provide peace of mind to our clients through careful, steady, and customized financial stewardship and portfolio management, our local teams hosted market update webinars featuring Jason Blackwell, Colony's Chief Investment Strategist. He offered an in-depth overview of the markets and addressed strategies to manage volatility.

We were delighted to hear that many attendees enjoyed and found value in it. If you were not able to attend or would like to view the webinar again, we've included a link to the recording presented by Ron Rubin, President, Vice Chairman & Chief Culture Officer. *To view the webinar, click on the image below.*



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