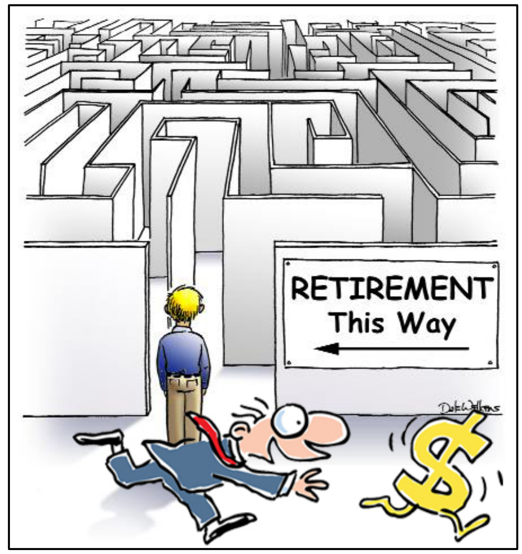
Reprinted from the
Lexington Minuteman

COROMANDEL WEALTH MANAGEMENT

December 2019

Don't let FOMO ruin your retirement

Navigating the Retirement Maze



"The four most dangerous words in investing are: "This time it's different.'" - Sir John Templeton, Investor and philanthropist (1912 – 2008)

A friend of mine has been sending me emails and text messages lately with news items about the U.S. stock market that just won't quit rising. We are ten years into the longest U.S. bull market on record, and media pundits are predicting more gains from stocks. Talking heads point to various indicators – low unemployment, consumer spending, low interest rates – as signs that there is still life left in an aging bull. One even went so far as to say that we are in the early to middle stages of the economic cycle. (Question: How does one "turn back the clock" of an economic cycle?)

Call me a killjoy, but I've seen this movie many times during my lifetime, and it always ends the same way. When clients come to me these days heavily weighted towards US equities, I give them the same advice that I would to someone who had just scored big at a casino: Take most of those chips over to the cashier and cash them in, and if you're still feeling lucky, play with what remains. This prevents a possible financial wipeout and locks in most of their gains. Or as one William Bernstein, one of my favorite financial writers, likes to say: "If you've won the game, stop playing."

As the stock market continues to grind higher, it's worth looking at some factors that might temper one's enthusiasm for a high allocation to US equities right now.

A reality check on Pollyannaism

A 10-year chart of the S&P 500 looks a lot like the mountain in the children's classic "The Little Engine That Could." "I think I can, I think I can…" gain another 20 percent? Even with a few pullbacks along the way, the market has managed to gain 375 percent since it bottomed in March 2009. The tech-heavy NASDAQ index is up 589 percent over that same time period.

Markets are mostly driven by economic factors that affect corporate profitability. Major U.S. corporations depend heavily upon global sales, and there are a number of issues that don't bode well for a continuation of this up-trend:

- Year-to-year earnings of the companies that comprise the S&P 500 are down 6 percent, the largest decline in four years.
- Auto sales, which account for 12 percent of the US economy and one-quarter of all U.S. manufacturing, have been declining for the past four years.
- China's economy, the world's second largest and the main global driver of production growth, has been slowing from its torrid pace in the past, mostly due to domestic problems; tariffs are a secondary factor.
- Three of Europe's biggest economies are likely already in a recession. With European Central Bank rates already negative, there isn't much ability to stimulate spending.

US stock valuations are quite stretched. The S&P 500's Price-to-Earnings ratio (P/E) is higher than it has been over 90 percent of the time. The tech sector P/E is at the 99th percentile compared to past valuations. High P/E multiples combined with a slowing global economy is not a good combination for continued market growth.

However, don't discount investor sentiment when considering the potential for additional market upside. It's the demand for stocks that drives prices, and when there are more buyers than sellers, prices go up. With a market that appears priced for perfection and slowing growth, what is motivating investors to increase their US equity holdings? Enter FOMO.

Are you a FOMO addict?

Numerous studies have demonstrated that humans are pre-programmed with many of our emotional responses. Behavioral finance helps explain why investors can behave irrationally and can be their own worst enemy when it comes to investing. Of the eight or so behavioral biases – yes, there really are that many – a prevalent one is Trend Chasing. It is the reason that asset managers promote their 4- and 5-star Morningstar funds, even though very few repeat that performance going forward. We like to jump onto winning trends because we're afraid to miss what seems to be a sure thing. This "Fear of Missing Out," or FOMO, is an example of where emotion overrides logic.

I am something of a market contrarian, meaning that if everyone seems to be doing the same thing, I get concerned. CNN maintains what they call their "Fear & Greed Index," which uses a variety of market indicators to try to gauge investor sentiment. As of this writing, it stands at a reading of 75 out of 100, well into the "Extreme Greed" range. A year ago, when the market was dropping 20 percent from its September high, the reading was 11, or "Extreme Fear." Investors who bailed out then would have missed the subsequent 26 percent gain.

Time to "Think different"

The risk in an elevated U.S. market is that the potential upside is probably not as great as the downside. If you manage to correctly time what is looking to be a late-stage market "blow-off," you might increase your retirement nest egg by another 10 to 20 percent. Given what we know about the market timing skills of the average investor, this doesn't seem like a good idea. Looking at the situation another way, is an additional 10 to 20 percent in your investment portfolio going to improve your retirement significantly, compared to what a potential 40 to 50 percent loss could do? Conclusion: You should de-risk your portfolio if you are near or into your retirement years.

There are a number of things that you can do to hang onto those bull market gains and reduce the risk of loss:

- Convert some of your equity allocations into bonds. Bonds aren't yielding much these days, but they are a lot less volatile than stocks. I usually recommend to retirees that they have three to five years of needed retirement cash flow from their portfolio in short- to intermediate-term U.S. Treasury bond funds.
- "Go east, old man" – Think of what Horace Greely might be saying today. Break away from your Home Country bias of holding mostly US stocks and diversify into foreign markets that have not done as well over the past decade. With P/E ratios lower than their historic averages, they may have greater upside potential.
- Consider income investments other than bonds, though selectively. Real estate investment trusts, energy master limited partnerships, and other debt funds can provide some additional portfolio diversity.

If you're experiencing FOMO in this current market, it might be a good time to step back, be thankful for a decade of exceptional market gains, and preserve what you've managed to gain thus far. Heed the advice of William Bernstein. Lock in some of your gains, scale back your market exposure, and sleep better at night.

George Gagliardi is a financial advisor with Coromandel Wealth Management in Lexington, where he helps clients develop and implement investment and retirement strategies. He can be reached at (781) 728-9001 or george@CoromandelWM.com. George is affiliated with Trust Advisory Group, Ltd., a Registered Investment Advisor. This article is intended for general information purposes only, and may not be appropriate for your specific circumstances. Investment advice is particular to each individual, and should only be given after an individual situation has been reviewed.