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Outlook for 2019 is No Mystery

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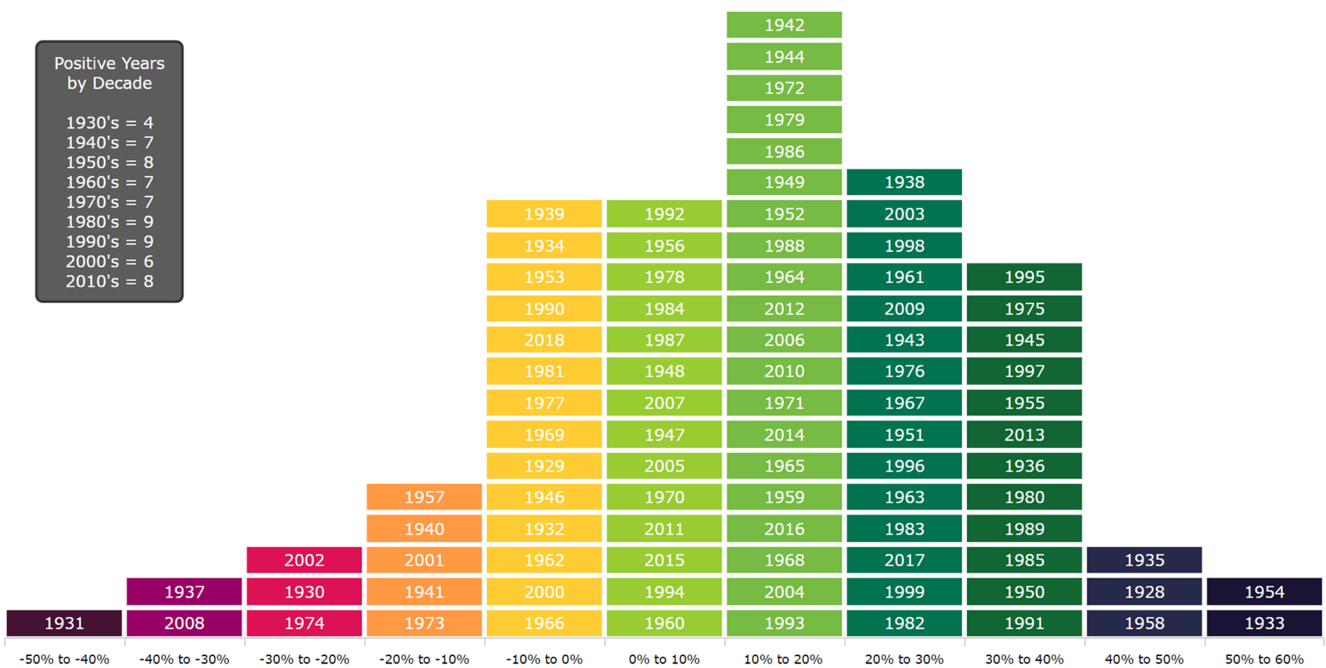
With the recent market decline, increased volatility and the deafening media noise, it can be easy to lose track of the basics. Remember, recent activity doesn't tell us much about market returns. Much like how flipping a coin is a 50% probability, regardless of how many flips have come up heads recently. The expected return for the stock market should be based on long-term probabilities, not on recent activity. The chart below shows the historical distribution of annual stock market returns, with an average of 11.4%.

S&P 500 INDEX CALENDAR YEAR RETURNS (JAN 1, 1928 – DEC 31, 2018)



Source: S&P Dow Jones Indices LLC

More importantly, the chart shows the distribution of the 91 annual S&P 500 returns from 1928 through 2018. It is clear there are far more positive years (everything to the right of the yellow bars) than negative years, with a positive return 73% of the time. The most likely annual return over this period was between 10% and 20%, occurring 20 times, or about 1 out of every 5 years. Also, noteworthy is how the large positive returns exceed the large negative turns. The latter observation may come as a surprise to many, as large negative returns are emotionally seared into our memory, while comparably sized positive returns are often forgotten or overlooked.

Examining returns as a distribution clearly demonstrates that the stock market favors long-term investors. Discussing the market in this way provides valuable long-term perspective and reframing performance in terms of probabilities helps to avoid many pitfalls. Stock market returns can vary widely from year to year, but the longer we stay invested, the more likely we are to get the desired results. The market will surely go down and up, the important thing is to stick to your plan and stay invested through the turbulence.

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From the Behavioral Viewpoint

What is going on?

1. Market declines trigger **loss aversion**. In fact, a loss feels twice as bad as an equivalent gain, according to Daniel Kahneman, author of "Thinking, Fast and Slow." As a result, investors have a powerful desire to act, trying to avoid further perceived loss.

2. The media avalanche triggers our **fight or flight** response and our **herding** instincts. We don't want to get left behind, left out or even eaten!

3. We are easily **Fooled by Randomness**. We have a hard time accepting randomness and want to believe that there is some way to forecast and navigate the markets.

4. We use patterns, stories and shortcuts to help understand what is going on around us, even if it means making up a story or adopting any plausible theory. This **Narrative Fallacy**, a natural overemphasis on narrative over data, often results in faulty analysis.

What can we do?

1. Learn to understand markets as return distributions. The more draws from the distribution the better the outcome. Develop realistic expectations and accept that both positive and negative returns will inevitably occur.

2. Use needs-based planning to separate short and long-term needs. Give resources allocated to growth necessary time to achieve their goals. Following a well-developed investment process can provide critical discipline.

3. Work with an experienced behavioral financial advisor, who has lived through many market environments. They can provide perspective and coaching to help stay on track and remain focused on long-term goals.

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