



James H. Fydroski CFP®,
President, Haas Financial Services Inc.

What's Your Number?

What's your number? No, I don't mean your telephone number, your cell phone number, your Social Security number or even your driver's license number. What I am looking for is your volatility number. And that concept will be discussed in this article.

In a year when a client's account is not keeping pace with the stock market as typically measured by the S&P500, it is not unusual to think, "Why am I not up as much as the overall market?" Another version of that same question is, "My next door neighbor (or co-worker, brother, aunt etc.) is getting "X" return. How come I am not?"

While it may be true that the manager you are invested with is having a bad year, it is more likely that your financial profile is the primary culprit inhibiting those returns. As financial representatives, we are required by the regulatory authorities to create a profile on all active clients. The profile includes, as would be expected - name, address, telephone number, Social Security number, employment information and identification information such as a driver's license number. In addition, we are required to obtain information on annual income, net worth, investible assets, risk tolerance, time horizon, investment knowledge and investment objectives. The idea is to integrate this information and recommend investments that are in line with a client's profile.

Recognizing and addressing risk tolerance is a key element in this process. When most people think of risk, it is usually equated with volatility or the upward and downward movements of the stock market. When the market is experiencing extended down periods, it is not unusual to hear exhortations like, "I don't want to lose all my money." However, even in the worst of times, the stock market has *never* gone down to zero. So it is usually a matter of waiting it out until the market bounces back. Since the stock market goes up about 75% of the time, waiting is all well and good if you have the years and financial means to do so. If you do not have those years to recover or do not have an adequate nest egg to wait it out, then managing the risk/volatility equation becomes much more important. That is especially true if you are retired or are nearing retirement.

The more risk you are willing to take, the more investment returns that you are likely to receive. The opposite is also true. Less risk typically equals less return. Enduring market volatility is a part of the process. Unlike the last two years, ebb and flow, up and down is normal and what we can expect. Thus, it becomes a question of how much volatility an individual can endure and that varies from individual to individual. It is for this reason that we need to know our volatility number.

Earning market returns requires accepting market volatility and that is where the problems arise. In the financial profiles that clients fill out, most indicate that they want capital appreciation (good returns) and capital preservation (little risk) as their two primary objectives. These goals are actually on opposite ends of the spectrum since accounts must be primarily managed for either risk or opportunity. Consequently, when your neighbor tells you they are receiving market returns and you are not, the neighbor is also inherently telling you that they are accepting market risk and greater volatility. In actuality, your neighbor may not realize that he or she is opening himself/herself to market risk and volatility to obtain those returns. Please let them read this article. So what is your risk and volatility number? Let's review the chart on the opposite side of this newsletter so that you can decide for yourself.

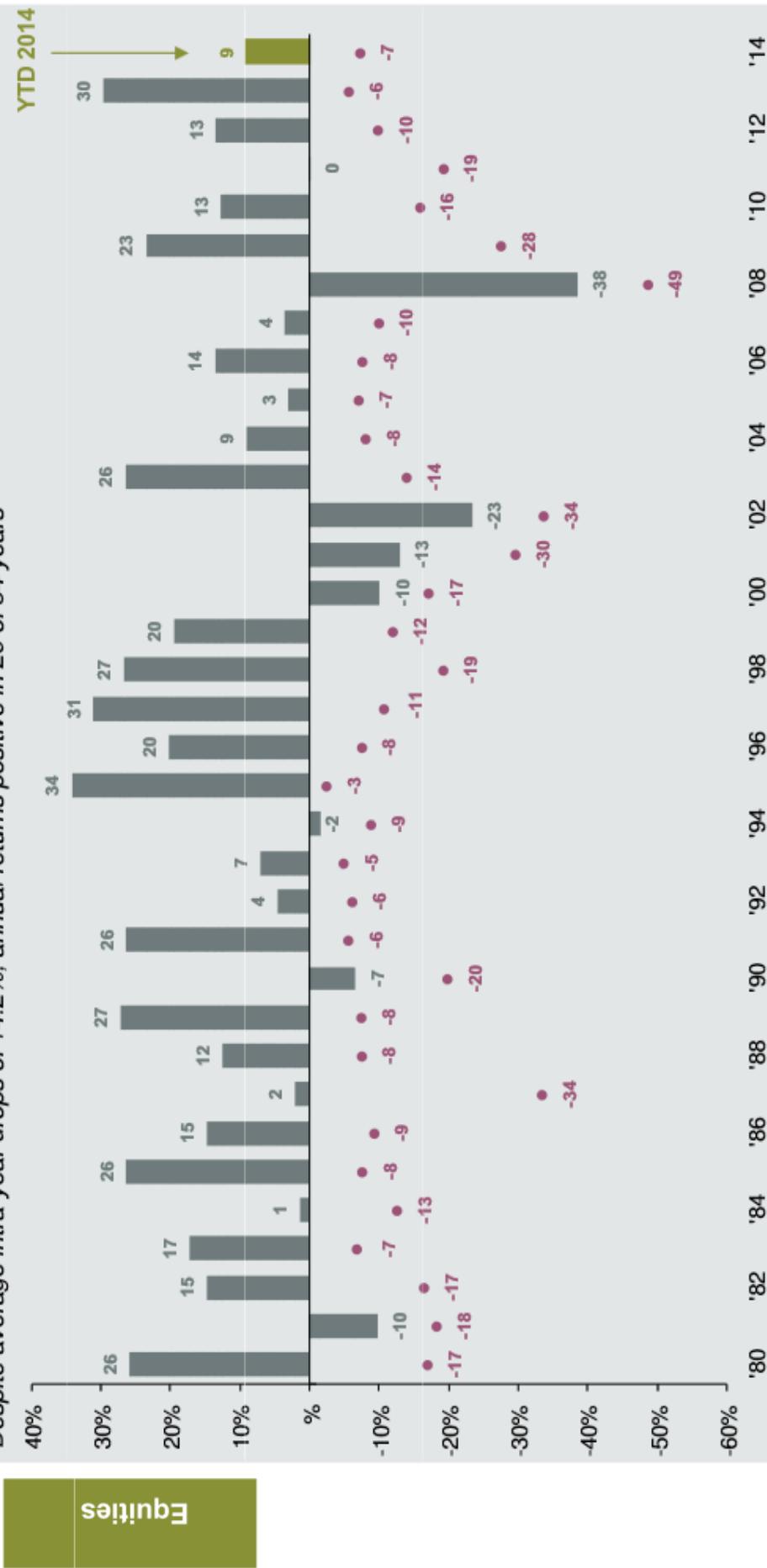
As a member of the Financial Planning Association, I attended the annual Michigan meeting in late October. This chart was part of a presentation given by J.P. Morgan in one of the sessions. The red dots and numbers represent the largest intra-year market drops in the S&P500 from a peak to a trough during the year indicated. The grey bar chart and numbers represent the calendar year returns where the S&P500 ended the year. What does the chart tell us? The chart tells us that the **average** intra-year drop of the S&P500 since 1980 is **14.2%**. The largest intra-year drop was **49%** in 2008 and the smallest intra-year drop was **3%** back in 1995. Primarily due to the stimulus money of the Federal Reserve, the intra-year drop of 2013 was a modest 6% and only a 7% drop so far in 2014. It should also be noted that as of October 2014, the Federal Reserve stimulus program has ended. After the huge 49% intra-year drop of 2008, the intra-year drops from 2009 to 2012 were 28, 16, 19 and 10 percent respectively. As an example, if your account was worth \$100,000 at the start of 2008 there would have been a point in the year when it was worth only \$51,000 before finally ending the year at \$62,000. It would have taken you until 2013 to regain your losses from 2008. Remember, intra-year drops are not the final year end return, they are the lowest point of the year.

So I started out this article by asking, "What's your (volatility) number?" I now ask you to think about what you can reasonably accept as your volatility number when the average intra-year decline for the last 33 years was 14.2%. Also knowing that intra-year drops of greater than 19% occur almost every four years and have ranged from -3 to -49%. Can you accept these potential declines to get "market returns" because that is what your neighbor is likely doing to get those returns whether they realize it or not. Only you can answer that question and it is important for both you and me to know your answer.

As we enter this magical holiday season, I wish you and yours a Merry Christmas, Happy Hanukkah and joyous Kwanzaa. Take good care!!!

S&P 500 Intra-year Declines vs. Calendar Year Returns

*Despite average intra-year drops of 14.2%, annual returns positive in 26 of 34 years**



Source: Standard & Poor's, FactSet, J.P. Morgan Asset Management.

Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. *Returns shown are calendar year returns from 1980 to 2013 excluding 2014 which is year-to-date.

Guide to the Markets – U.S.

Data are as of 10/31/14.