



# Is Your Portfolio Suffering from S&P Envy?

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## Even When Diversification Wins, It Can Feel Like It's Losing

Year	S&P 500	Diversified Portfolio
2000	-9.10%	-0.81%
2001	-11.89%	-3.75%
2002	-22.10%	-9.16%
2003	+28.68%	+18.85%
2004	+10.88%	+8.26%
2005	+4.91%	+3.92%
2006	+15.79%	+11.21%
2007	+5.49%	+6.08%
2008	-37.00%	-20.10%
2009	+26.46%	+18.25%
2010	+15.06%	+11.65%
2011	+2.11%	+4.40%
2012	+16.00%	+11.29%
2013	+32.39%	+18.62%
2014	+13.69%	+10.69%
2015	+1.38%	+1.05%
2016	+11.96%	+8.23%
<b>Total Return</b>	<b>+4.51%</b>	<b>+5.30%</b>



"I lost money"



"I didn't make as much"



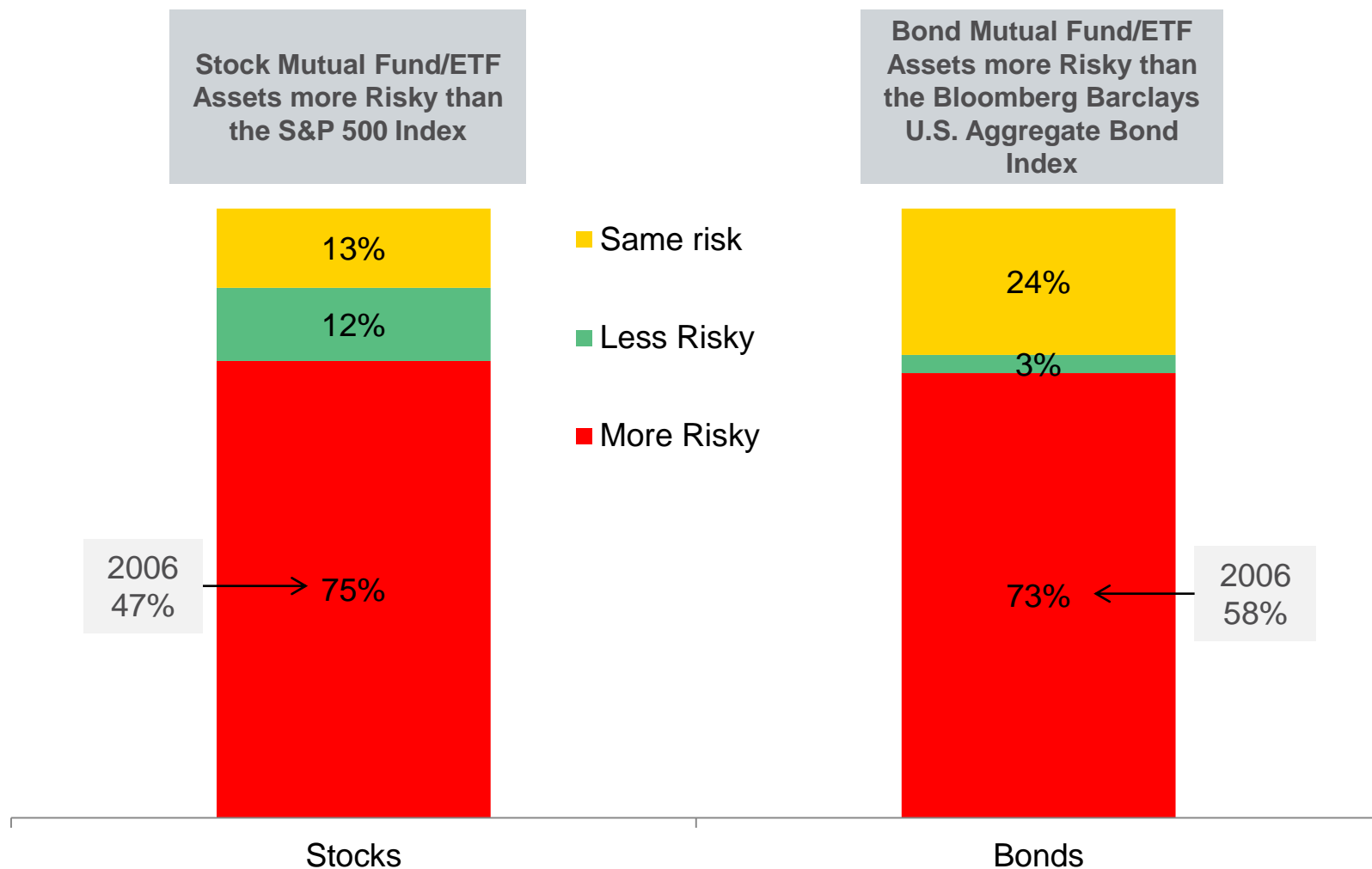
"I lost money"



"I didn't make as much"

Source: Morningstar as of 12/31/16. Past performance does not guarantee or indicate future results. Diversified Portfolio is represented by 60% S&P 500 and 40% in the Barclays US Aggregate Bond Index. Index performance is for illustrative purposes only. You can not invest directly in the index.

# S&P 500 Envy can Lead to More Risk



Source: Morningstar Global Broad Equity Category, which includes all categories of equity mutual funds and ETFs, as of 12/31/16. Risk is represented by the 10-year (2007 – 2016) standard deviation vs. the S&P 500 Index and Bloomberg Barclays U.S. Aggregate Bond Index. Past performance does not guarantee or indicate future results.

# Importance of Benchmarking

Are you able to answer the following questions?

Did my investment decisions add value?

What level of risk is reasonable for my asset allocation?

How much return should I expect from my portfolios?



Without guidance on benchmark selection, investors are subject to the availability bias – namely, they'll use the most easily available information as a benchmark, whether or not it's appropriate

# Is Your Portfolio Suffering from S&P Envy?

## Agenda

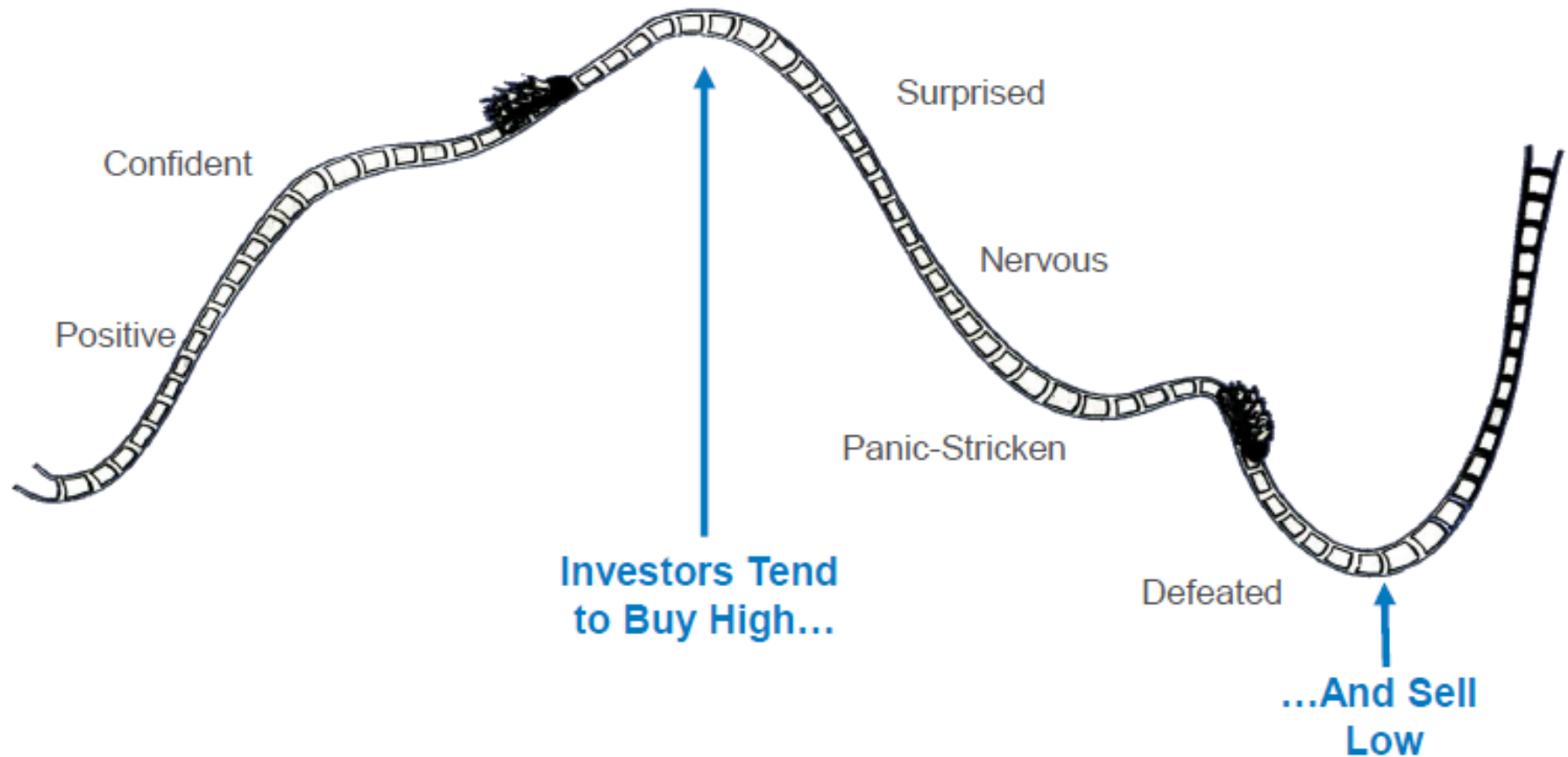
- ▶ Win More by Losing Less: Why Downside Risk Mitigation is Critical
- ▶ Downside Risk is Extremely High in Today's Market
- ▶ Building Downside Risk Mitigation Back Into Your Portfolio

## Win More by Losing Less

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# Reducing Downside Risk can Reduce Volatility...

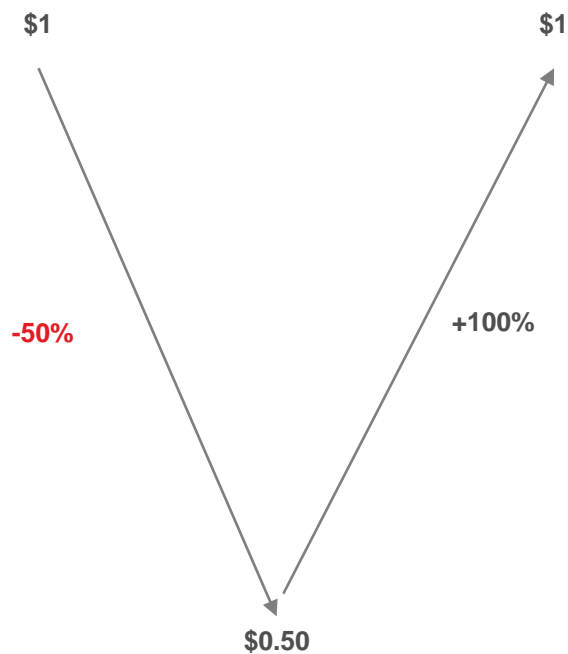
## Riding the Ups and Downs of the Market



Hypothetical example.

## But, more Importantly, can also Help Lead to a Better Outcome

### Breaking Even



Investment loss	Return needed to breakeven
-1%	+1.01%
-5%	+5.3%
-10%	+11%
-20%	+25%
-30%	+43%
-40%	+67%
-50%	+100%
-60%	+150%
-70%	+233%

Source: BlackRock. Past performance does not guarantee or indicate future results.

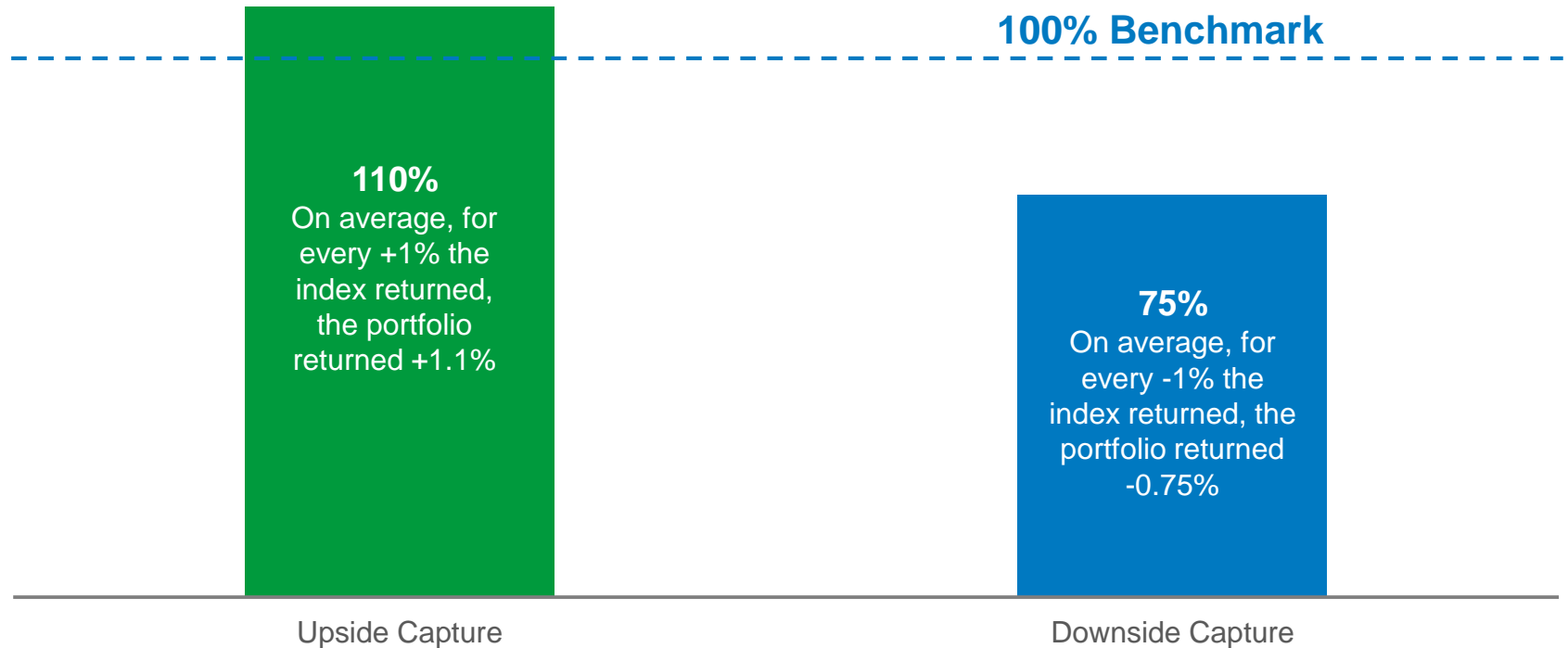


# How do we talk about upside and downside risk? Upside and Downside Capture

## Upside Capture

$$\frac{\text{Avg return of portfolio when market is positive}}{\text{Avg return of benchmark when market is positive}}$$

## Downside Capture

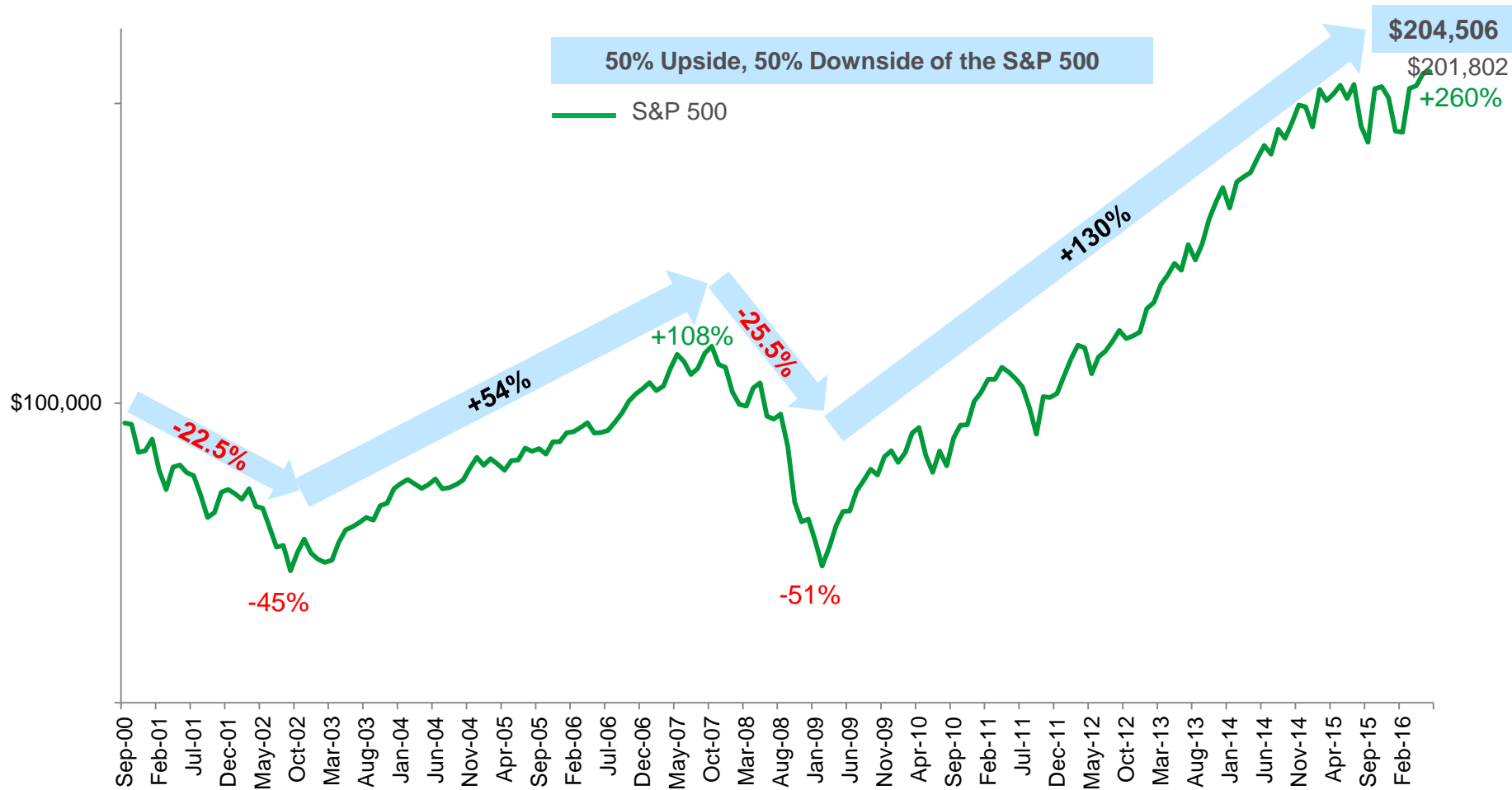
$$\frac{\text{Avg return of portfolio when market is negative}}{\text{Avg return of benchmark when market is negative}}$$


Sources: BlackRock; IMCA; Investopedia. This is a hypothetical example.

# Why Limiting Volatility (Downside Risk) is so Important

## 50% Upside/Downside Capture

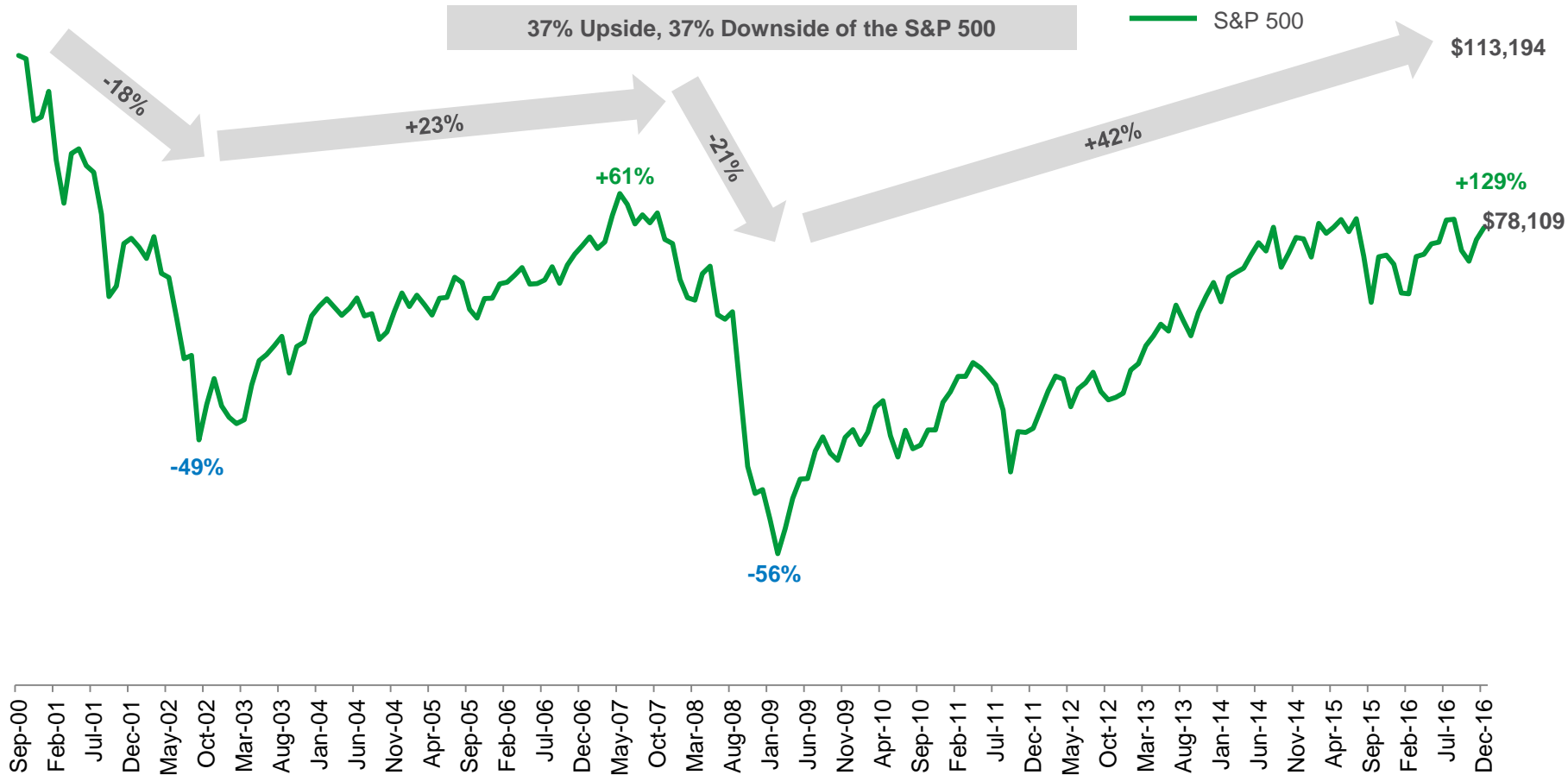
S&P 500 versus 50% Upside/50% Downside Capture (8/31/00- 12/31/16)



Source: Crestmont and Morningstar as of 12/31/16. Past performance does not guarantee or indicate future results. Index performance is shown for illustrative purposes only. You cannot invest directly in an index.

# Dollar Cost Ravaging: Retirees taking Withdrawals would have Fared Better with an Even Lower Capture Ratio of 37%

An Initial 4% Withdrawal (\$4,000 annual) Dropped the Optimal Capture Ratio to 37%!

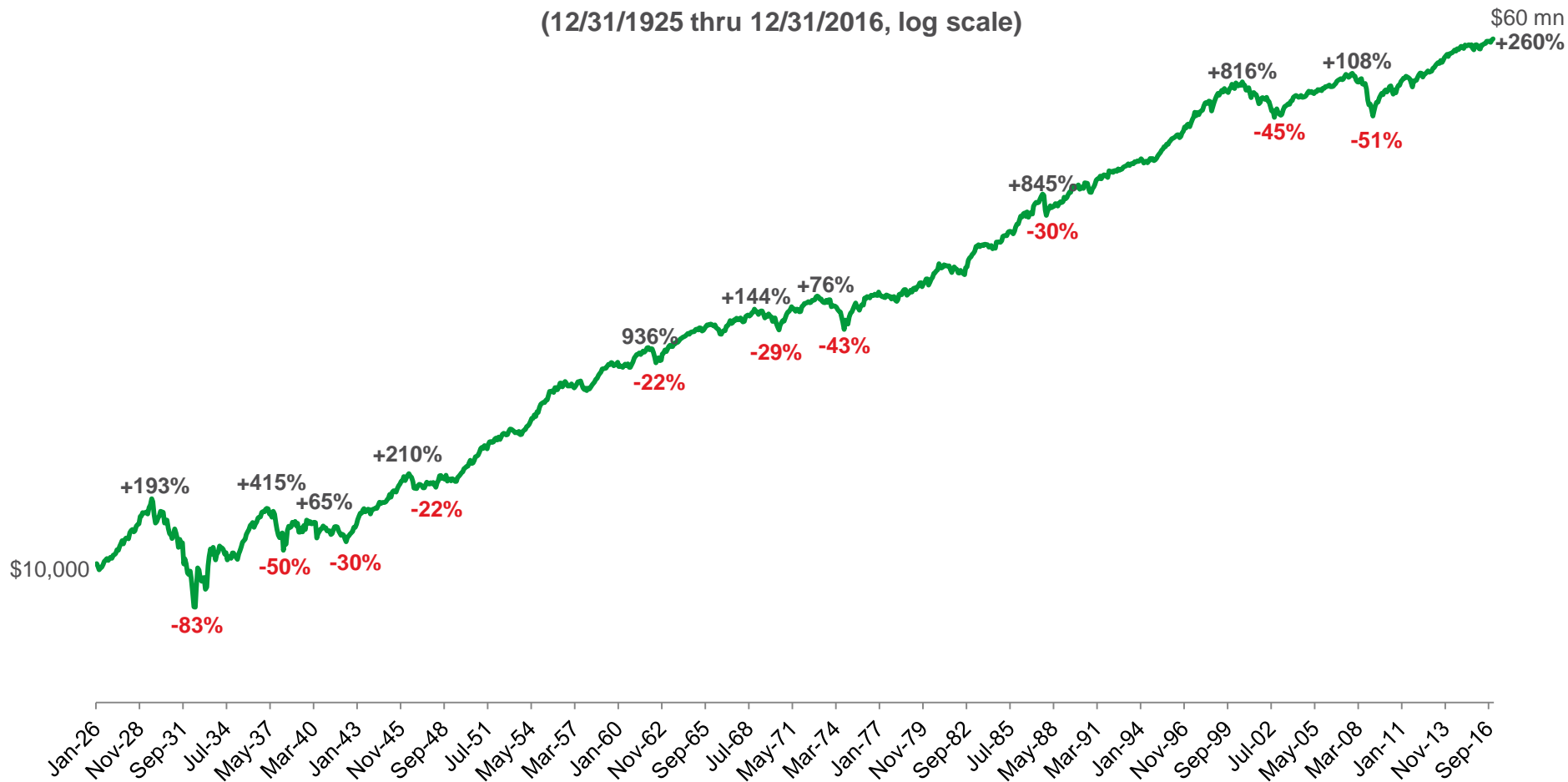


Hypothetical example. For illustrative purposes only

# Stocks Since 1926, Bull and Bear Markets

**\$10,000 in Stocks in 1926 Grew to over \$60 million**

(12/31/1925 thru 12/31/2016, log scale)

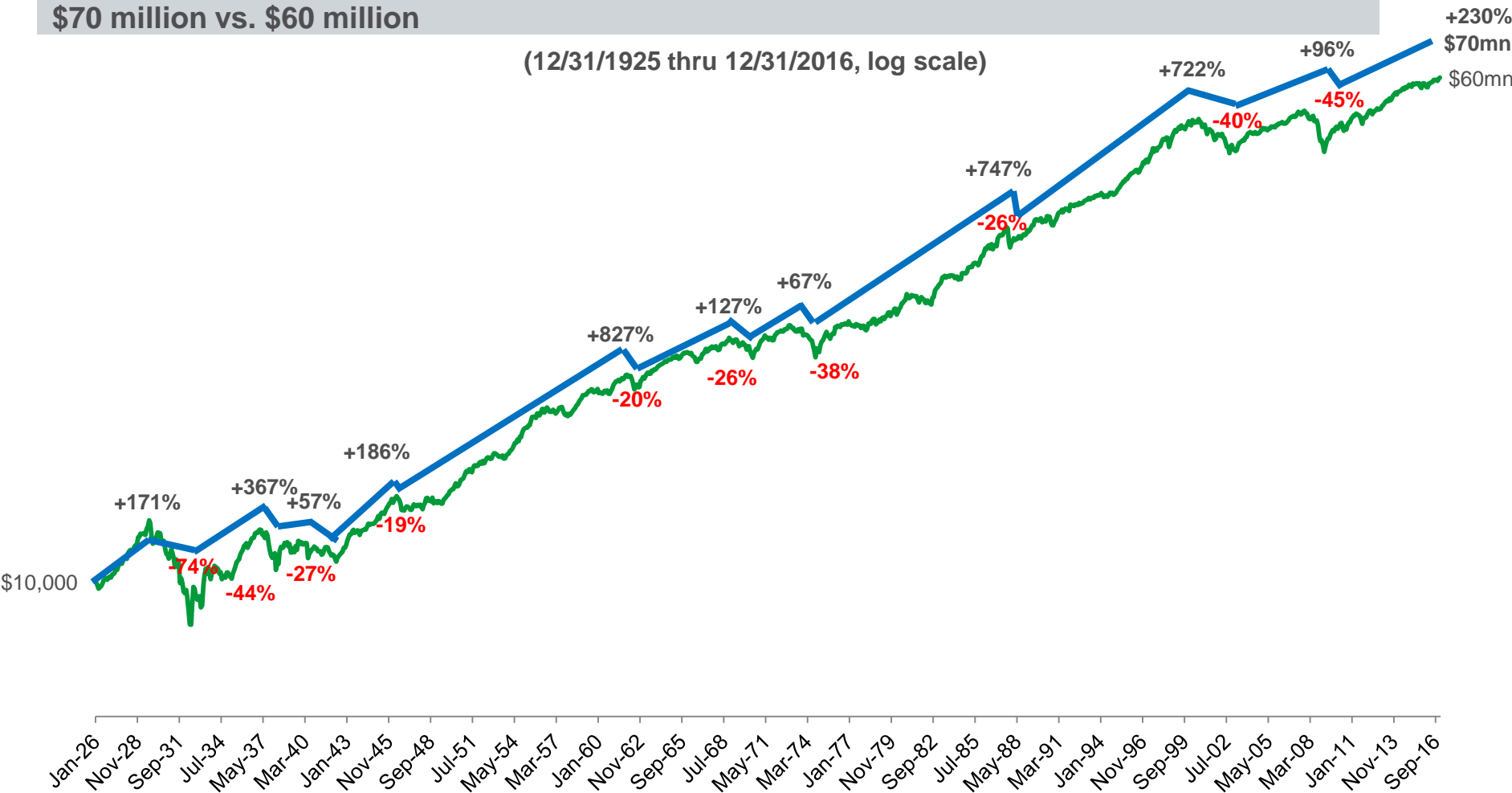


Source: Morningstar and BlackRock. Past performance does not guarantee or indicate future results. It is not possible to invest in an index. U.S. stocks represented by the Ibbotson SBBI US Large Cap TR Index. Index performance is for illustrative purposes only.

# Stocks Since 1926, Less than 100% Capture Outperformed

Capturing 88% of the Bull / Bear Markets Outperformed 100% Stocks \$10,000 Grew to over \$70 million vs. \$60 million

(12/31/1925 thru 12/31/2016, log scale)



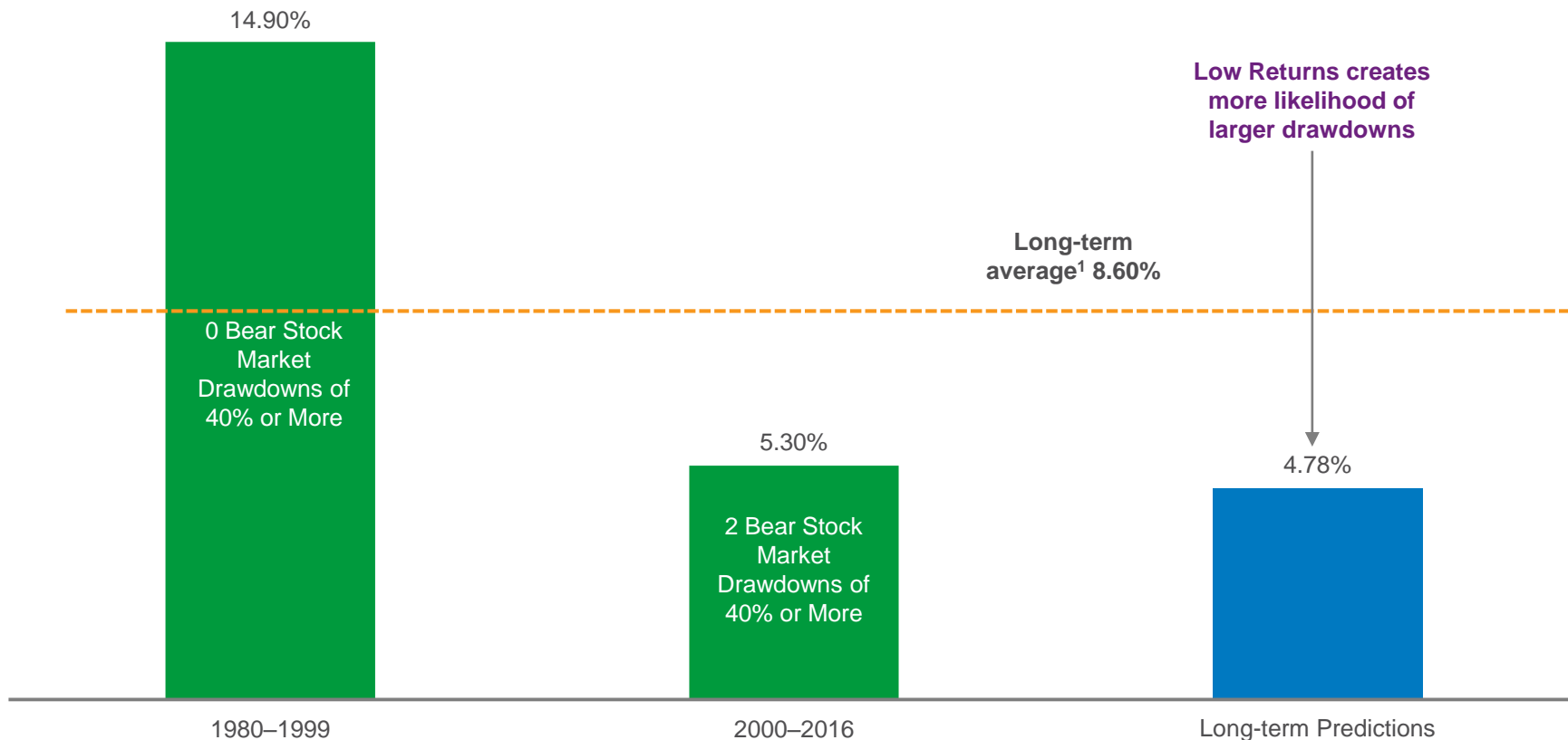
Source: Morningstar and BlackRock. Past performance does not guarantee or indicate future results. It is not possible to invest in an index. US stocks represented by the Ibbotson SBBI US Large Cap TR Index. Index performance is for illustrative purposes only.

## Downside Protection is Difficult to Find Today

# The Return Environment has Changed

## 60% US Stocks/ 40% US Bond Portfolio

Average annual returns by decade



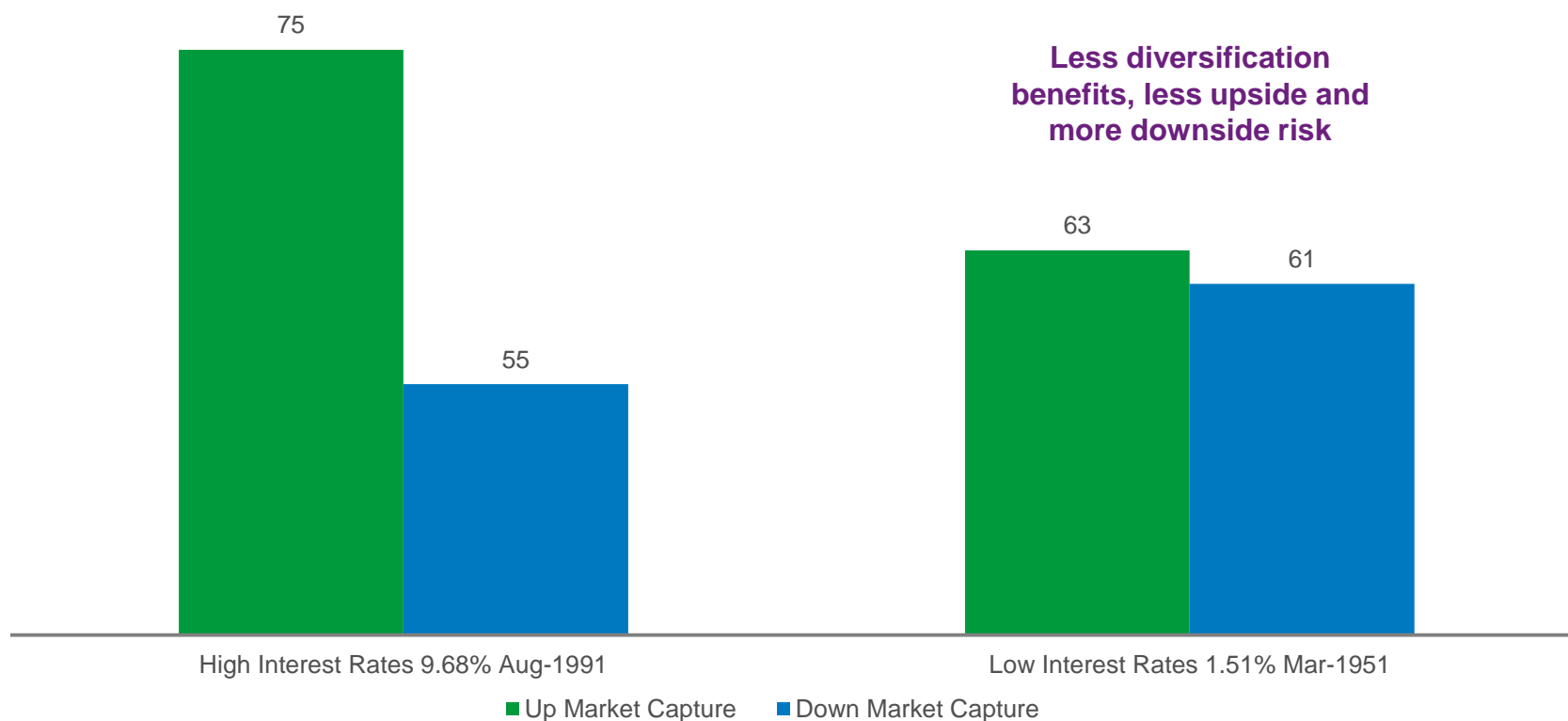
1. 90-year average.

Source: Morningstar, Inc. as of 12/31/16. Stocks are represented by the S&P 500 Index. Bonds are represented by the Morningstar/Ibbotson Intermediate-Term Government Bond Index. The value of equity investments are more volatile than other securities. Fixed Income investment options are subject to interest rate risk, and their value will decline as interest rates rise. Equity index returns assume reinvestment of all distributions and unlike mutual funds, do not reflect fees or expenses. It is not possible to invest directly in an index.

# Today, Low Interest Rates Equal Less Diversification Benefits (more Downside)

**60/40 Diversified Portfolio:** 60% U.S. Stocks, 40% U.S. Bonds

All-Time High and Low in the Natural Diversification of a 60/40 Portfolio (Up-Down Capture)



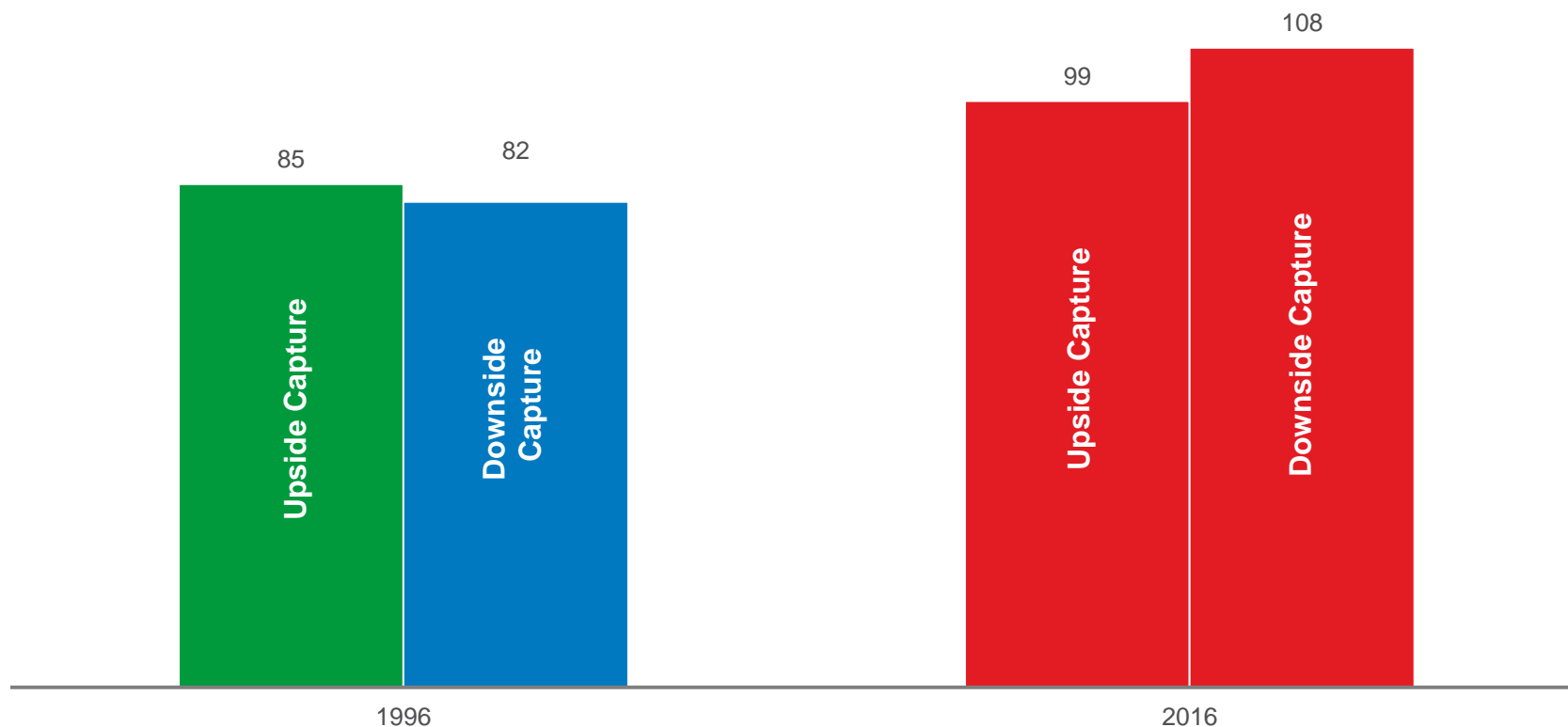
Source: Morningstar as of 12/31/2016. US Stocks represented by IA SBBI U.S. Large Cap Stocks, US Bonds by IA U.S. IT Gov Bond Index. **Past performance does not guarantee or indicate future results.**



# Stock Diversification has not Reduced Downside Like it has in the Past

**Diversified Stock Portfolio:** 60% US Large Cap Stocks, 30% International Stocks and 10% Small Cap Stocks

## 10-Year Upside / Downside Capture Ratio

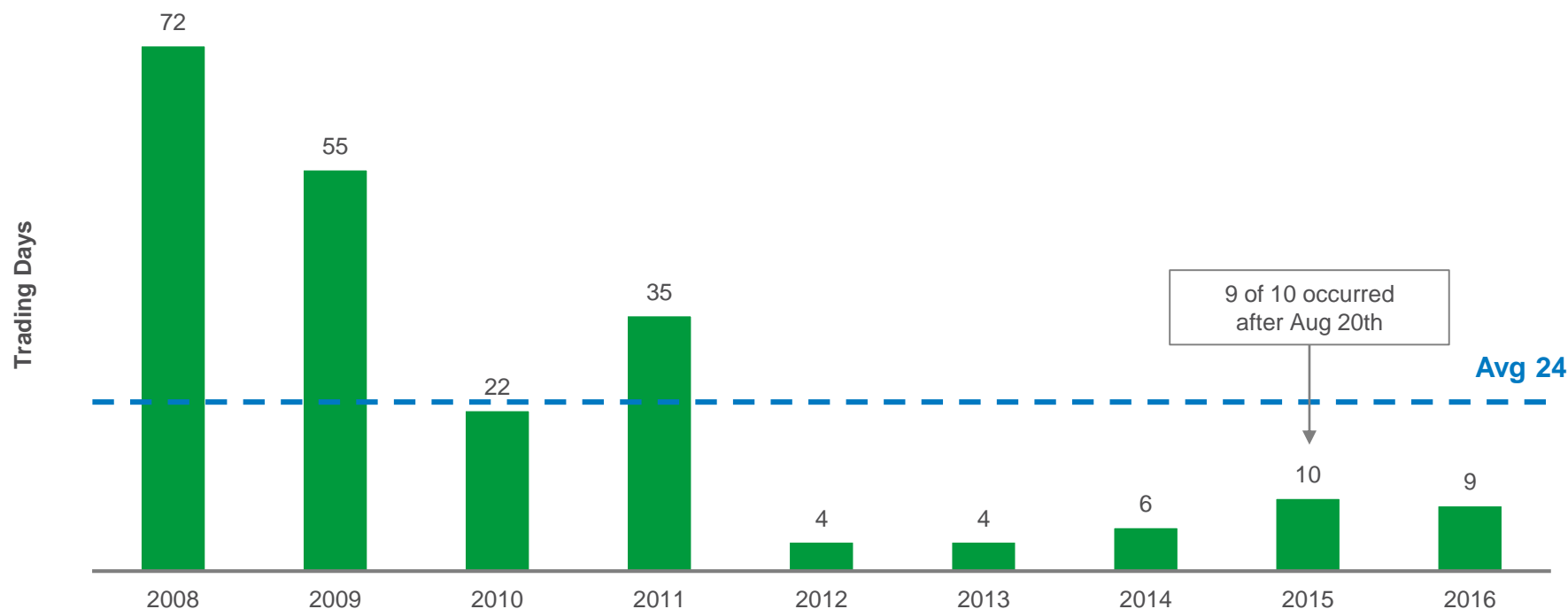


Diversified Stock portfolio (ref at the top) made up of 60% Large Cap Stocks (30% Russell 1000 Val and 30% Russell 1000 Growth) 30% Intl (MSCI EAFE), 10% Small Cap (Russell 2000).

# Risk could be a challenge as Market Volatility Returns

Risk matters again. The return of volatility exposes too much risk in portfolios.

## Number of Single Day Stock Market Returns of +/-2% or More



**Look to strategies that dampen volatility, and find true diversification**

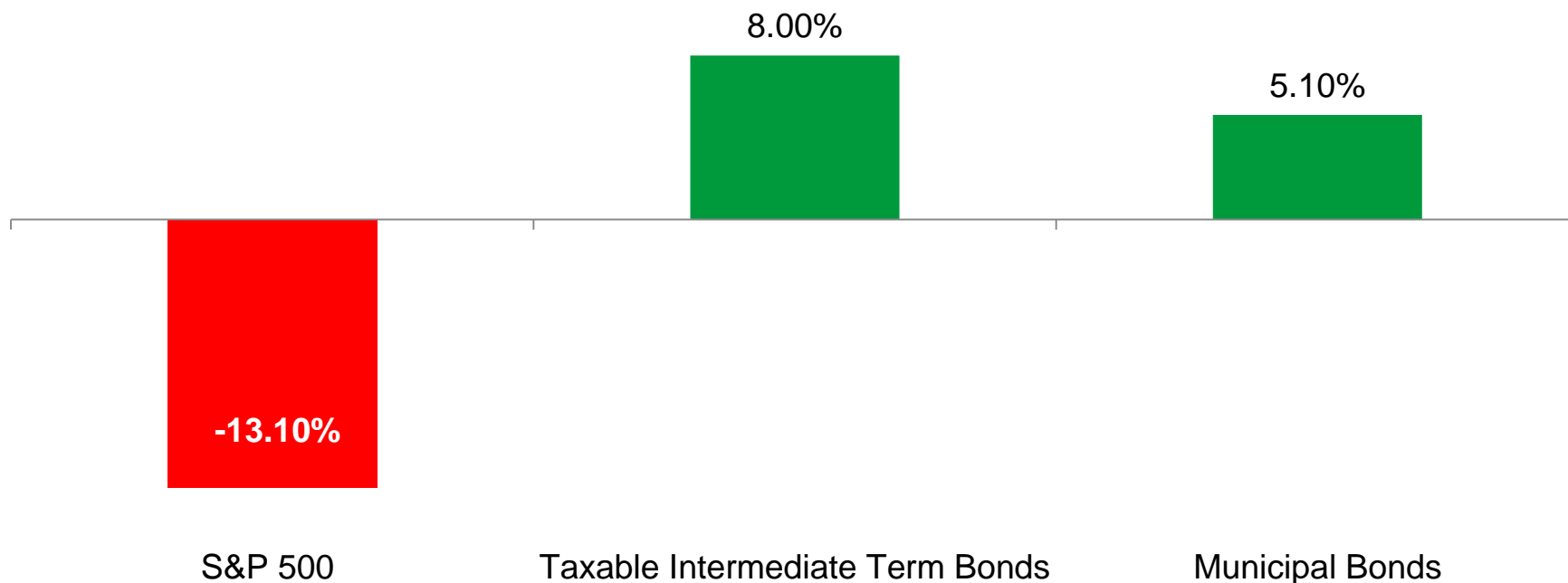
Morningstar as of 12/31/16. Stock market represented by S&P 500. Past performance does not guarantee or indicate future results.

## Building Downside Protection Back Into Portfolios

# Traditional Fixed Income - the First Line of Downside Defense

## Muni and Taxable Bonds Have Delivered Downside Risk Mitigation During S&P 500 Declines

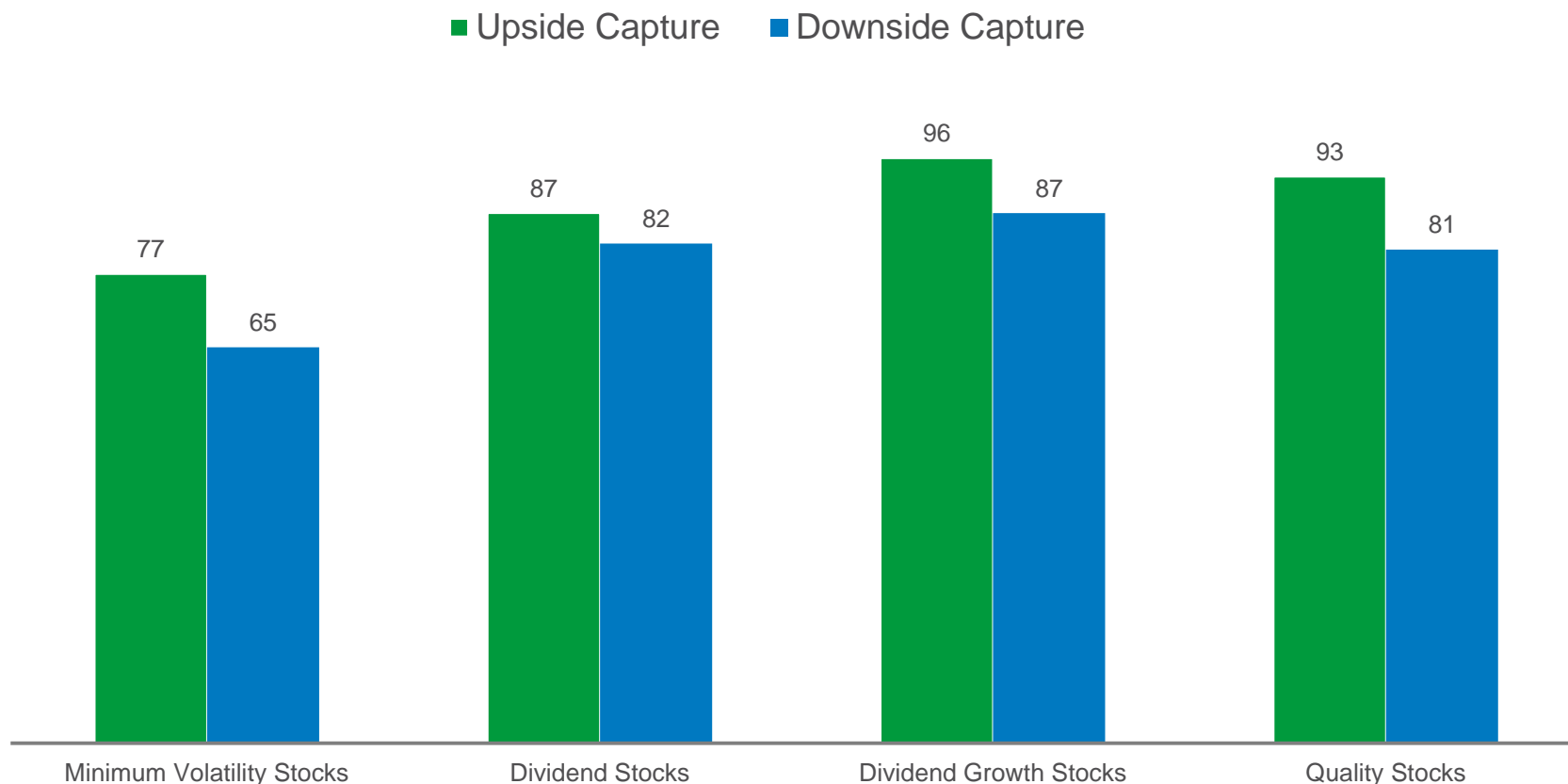
One-Year Periods when the S&P 500 Lost Money Since 1980



Taxable Intermediate Term Bonds are represented by the BbgBarc U.S. Aggregate Bond Index. Municipal Bonds are represented by the Bbg Barc Municipal Bond Index.

# Strategies to Potentially Improve Stock Portfolios

## Upside / Downside Capture Ratio Over the Last 10 Years (Versus the S&P 500 12/31/16)



Source: Morningstar as of 12/31/16. Minimum Volatility Stocks are represented by MSCI USA Minimum Volatility Index, Dividend Stocks are represented by MSCI USA High Dividend Index. Dividend Growth Stocks are represented by Russell 1000 Dividend Growth Index and Quality Stocks are represented by MSCI USA Quality Index

# Is Your Portfolio Suffering from S&P Envy?

## Adding Downside Risk Mitigation back into your Portfolio

### Fixed Income

- ▶ Intermediate Term Bonds
- ▶ Municipal Bonds

### US Stock Strategies

- ▶ Dividend Growth
- ▶ Minimum Volatility Strategies

### Multi Asset Strategies

- ▶ Global Flexible Strategies
- ▶ Multi-Asset Class Income Strategies

# Is Your Portfolio Suffering from S&P Envy?

## Next Steps

- ▶ Set up a review with you financial advisor
- ▶ Review a proper benchmark for your portfolio objective
- ▶ Identify Risks in your portfolio today
- ▶ Review Downside Risk Mitigation Ideas for Your Portfolio

## Important Notes

**Principal risks:** Stock and bond values fluctuate in price so the value of your investment can go down depending on market conditions. International investing involves special risks including, but not limited to currency fluctuations, illiquidity and volatility. These risks may be heightened for investments in emerging markets. Fixed income risks include interest-rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in bond values. Credit risk refers to the possibility that the bond issuer will not be able to make principal and interest payments. Non-investment grade debt securities (high yield / junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities. Asset allocation strategies do not assure profit and do not protect against loss. Derivatives entail risks relating to liquidity, leverage and credit that may reduce returns and increase volatility.



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## Optimal Capture Ratio Formula

B1= Bear Market Return

B2 = Bull Market Return

$$= -(B1+B2) / (2*B1*B2)$$

Example: Bear Market = -50%, Bull Market = +100%

$$-(-50\%+100\%) / (2*-50\%*100\%)$$

$$-50\%/-100\% =$$

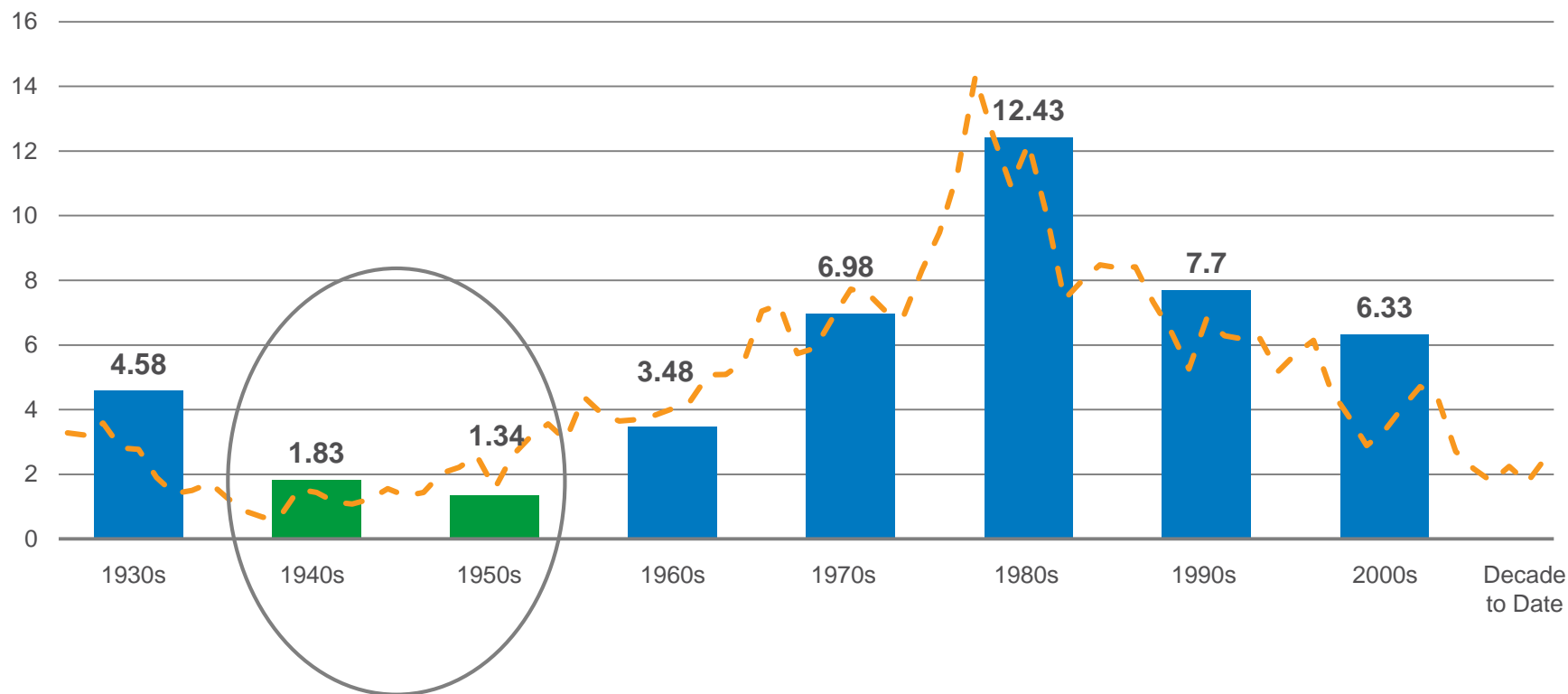
**50% Optimal Capture Ratio**

# Low Interest Rates Equals Low Bond Returns

.....bond returns have mirrored interest rates and many don't remember the low returns of the 1940's and 50's

**Today's Low Interest Rates Resemble the 1940s and 1950s**

Interest Rates and Bond Returns, %



Source: Morningstar as of 12/31/15. Past performance does not guarantee or indicate future results. Interest Rates and Bond Returns represented by IA SBBI IT Govt Index from 1926– 1975 and the Barclays US Aggregate Index from 1976–2014. Index performance is shown for illustrative purposes only. It is not possible to invest directly in an index.