EYE ON THE MARKET

Filtering Out the Noise: Beyond Headphones

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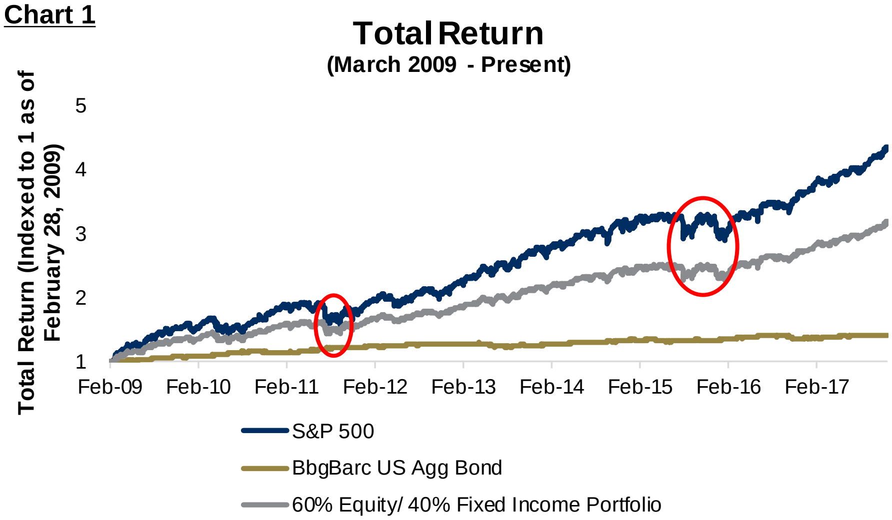
Technological advancement has transformed the way in which we consume information, whether it be through traditional sources such as local newspapers and television, or through the countless devices that are now accessible and affordable to most consumers. The amount of information being pushed through our computers, tablets, and phones; and the speed at which this information is delivered has made a significant impact on how we make decisions. For investors, information "overload" and market "noise" can lead to impulsive investment choices that adversely affect an otherwise sound financial plan. Eye on the Market ("EotM") firmly believes that developing and sticking to a long-term plan is critical to financial success and filtering out the noise along the way.

A Hazy Shade of Winter

With the U.S. equity markets reaching record-highs, it's difficult to ignore the return potential of an all-equity portfolio relative to a more balanced approach. That being said, this is a dangerous comparison without taking market risk and asset correlations into consideration.

Chart 1



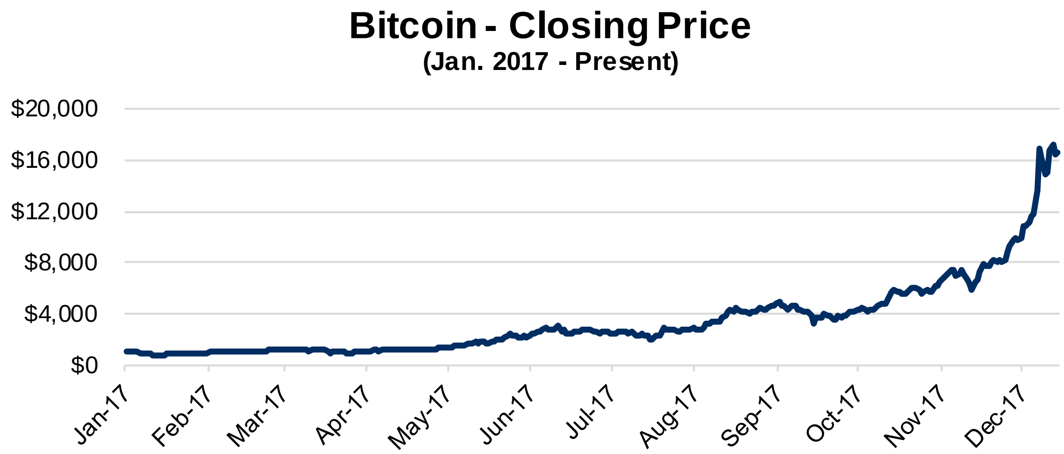
Source: Morningstar Direct & Raymond James

The circled areas on Chart 1 represent periods of time that the equity markets declined in excess of 10% over the last nine years. The S&P 500 declined by 18.5% during 2011 and 10.5% in 2016. The blended portfolio of 60% stocks and 40% bonds, on the other hand, only participated in 65% of those drawdowns. EotM would encourage investors to keep this in mind, as it is during periods of market decline that fear takes hold. By remaining focused on one's long-term asset allocation, an investor is likely to be able to weather the volatility and manage through it.

This time is different, or is it?

Chart 2 illustrates the skyrocketing price of Bitcoin over the last year. EotM is not advocating for or against cryptocurrencies, but as a student of the market, it does seems that such a dramatic price increase is reminiscent of past periods – the Dutch tulip mania (1630s), the South Sea bubble (1720), Japanese asset price bubble (1991), and the most recent dot.com bubble (late 1990s).

Chart 2



Source: Coindesk.com,.

Investor behavior has not changed over time, as there is a persistent fear of missing out. This has led to episodes of extreme speculation. As a point of reference, Benjamin Graham differentiated between investing and speculation in *The Intelligent Investor*:

> "An investment operation is one which, upon thorough analysis promises safety of principal and an adequate return. Operations not meeting these requirements are speculative."

To that end, if an investor were to purchase an asset that has appreciated quickly over a short period of time, how much margin of safety are they providing themselves?

EotM returns to its original point that developing a long-term investment approach is key to meeting long-term financial objectives. By remaining disciplined, the investor will be able to filter out the noise of the market, and remain focused on her goals, not the "hot" idea of the day, week, or year.

Focus on the goal

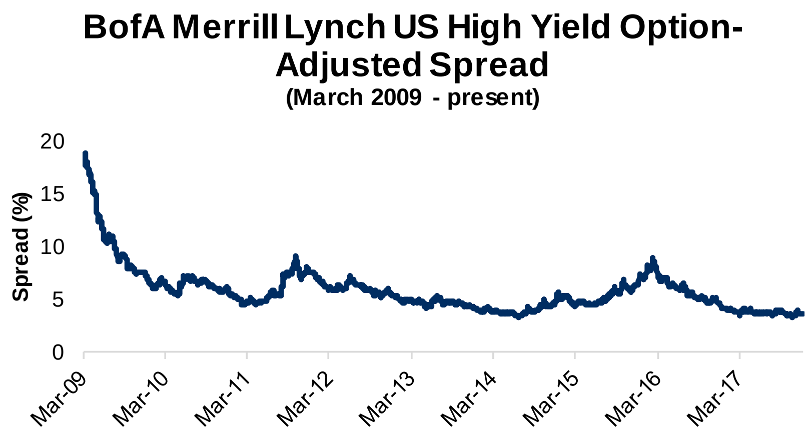
A Google search of "focus on the goal" yielded over 400 million search results, implying that many individuals are seeking guidance on this topic. In order for a portfolio to properly achieve its goal, an investor needs to be disciplined and patient. She also needs to understand each of the pieces of her portfolio and how they fit together.

EotM has discussed repeatedly why an investor would allocate to fixed income: income generation, protection from equity markets risk (as indicated in Chart 1), or some combination of the two.

In this extended period of low interest rates, many investors are opting for higher-yielding securities to generate income for their portfolios. Chart 3 shows that the difference between high-yield fixed income and U.S. Treasuries of comparable maturities remains compressed. This indicates that investors are not requiring additional compensation, in the form of yield, to hold these significantly riskier securities.

As our investor focuses on her goal, she needs to remember that the credit risk associated with high-yield fixed income is likely to be more associated with equity market risk. Allocating heavily to higher yielding securities could present a challenge to her long-term goals during equity market declines, as high-yield bonds are likely to participate in that market drawdown as well.

Chart 3



Source: St. Louis Federal Reserve & Raymond James.

Take a deep breath

With the myriad of news sources and range of views, EotM would encourage its readers to put on their noise-canceling headphones, and tune out the distractions. By developing a well thought out financial plan and reassessing her risk/return profile on a periodic basis, an investor is far more likely to have financial success with minimal surprises along the way.

SIDE NOTE

Many family holiday traditions have been passed down over time. One such from my childhood was leaving on the television station showing a yule log burning in a fire place. It was originally filmed at Gracie Mansion, the official residence of the Mayor of New York City. Regardless of your tradition, EotM wishes everyone a happy and healthy holiday season.