The HOW Matters NOW…

For more than a decade, investors in passive strategies have benefitted from an unrelenting move higher in the price of equities. To that end, many have questioned whether diversification was still relevant.

And now we get a gut check / gut punch in early 2020…

Owners of equities have been faced with a quick and almost undiscriminating selloff these past 4 weeks. Meanwhile, investors in fixed income and cash (including municipals, mortgages, and treasuries) have largely fared much better. The diversified portfolio has again proved its merit. Investors have been faced with a gut-check on WHY they own equities.

Looking forward, over the next few months, we anticipate continued volatility. We suspect the data coming out of the upcoming earnings season will be very "messy." Investors will likely hear lingering discussions about the economic impact of the Coronavirus long after its peak viral effect has been felt. With Russia and Saudi Arabia failing to agree on output terms, oil prices now face historic downward pressure. The yield on the 10-Year Treasury nearly broke thru the 0.4% level recently (compared to1.919% on 12/31/19) before stabilizing around 1.0%. Couple these factors with the 2020 election and one can expect choppy times ahead.

What does the path forward for equity investors look like? HOW do we recommend one proceed?

Volatility can be an investor's friend. For the first time in a while, we believe the next leg of the market will be marked by a clear performance differentiation between quality and "exposed" companies. One example of this may be owning solid balance sheet companies versus weaker ones. Another might be identifying companies whose geographic revenue stream is largely bent toward the US.

Ultimately, it means **ACTIVE MANAGEMENT**! Rather than blindly owning everything in the index, it means that we believe security selection and skill again will bring value to an investor. It also means reevaluating **HOW** one owns equity exposure.

Investing in equities inherently involves risk and the potential for loss of principal. While the illustration below is not a recommendation to buy MSFT (and doesn't include any fees or expenses), consider the various ways one might choose to have exposure to MSFT looking forward:

Investor A

- Buys 100 MSFT at $136/share
- If MSFT goes straight up $15 to $151, the investor has a +$15/share gain
- If MSFT retreats to $121, the investor has an unrealized -$15/share loss

Investor B

- Enters a GTC order to buy 100 MSFT @ $131
- If MSFT goes straight up $15 to $151, the investor has yet to purchase shares
- If MSFT retreats to $121, the investor owns shares at $131 and has an unrealized -$10/share loss

As you can see, there are several ways one might gain exposure to MSFT. The above is by no means exhaustive. One can own MSFT in an actively managed account, an index fund, an ETF, and much more. We simply believe HOW it's owned matters greatly and should be carefully evaluated.

Consider a second example (for illustrative purposes only) for the client seeking to simply gain exposure to the S&P 500 (you cannot directly invest in an index, but can gain exposure to its movements through a variety of instruments):

Investor A

- Owns exposure to the S&P 500 index over the next 12 months (via ETF or fund)
- Receives a dividend of ~2%
- Receives the full price movement over that span (whether up or down) with no limits

Investor B

- Owns exposure to the S&P 500 index over the next 12 months (via buffered ETF strategy)
- Receives no dividend
- Receives a 15% buffer against loss (meaning another 15% drop would result in a return of principal, less fees)
- Receives upside exposure to price movement, to a cap of ~11%

These are just a couple of examples of the ways we can help investors consider the **HOW** that best fits their eye. Having exposure to equities, for most investors, is appropriate. We would simply argue that **HOW** you have that exposure matters as much now as at any point in recent memory.

And what about bonds?

For 2+ weeks, the US Treasury has dropped tremendously, to new all -time low yields. Accordingly, prices of those securities have appreciated tremendously. We recently closed our long-dated Treasury ETF (TLT) position for more than a 9% gain in less than 3 weeks. Fear is certainly being heavily priced into the markets. Headlines are driving each day's market movement.

We believe that being strategically positioned in bonds is most often appropriate. We believe tactical shifts to bonds (which has been a prevailing trade these past 2+ weeks) can prove challenging. In our estimate, holding some cash will allow us the ability to reallocate to equities in the weeks or months ahead.

Among our greatest concerns for investors is that once calm and order are restored (however long that may be), investors could face the daunting task of buying discounted assets. History has shown that this can prove more difficult than many acknowledge. Oftentimes buying is best done when it feels the least comfortable! Buy Low/Sell High is arguably the simplest concept in investing…and one even seasoned investors struggle to follow.

As investors look for the "bottom", we would urge caution. Rather than trying to find the right time to own equities, we would emphasize the best ways to do so for your risk/reward profile. **HOW matters!** Perhaps this recent selloff is another wobble in a long equity Bull market? Perhaps it's much more. We cannot say with certainty.

What we can say with high conviction is that the ownership of equities has been a long-term driver of building wealth. History has shown that owning quality companies matters. History has shown that timing the market is a "fool's game." History has revealed skilled managers who have consistently added value thru their security selection. In this respect, we believe history is due to repeat itself!

www.headinvestmentpartners.com | Jonathan.Hayes@hip3.net | (865) 999-5332