Performance Chasing and Retirement Investing

The process of accumulating capital for retirement is often measured against a benchmark such as the S&P 500. This makes sense in that the index represents the cumulative equity wealth of a broad segment of leading companies in the U.S. and global economies. However, realistically, investors buy and sell at different times, own stocks that can vary along the risk spectrum, may tactically allocate using cash, and can include assets such as bonds in their portfolio. These differences, plus the cost of investing, can often obscure an investor’s return in comparison to the S&P 500, which is always fully invested without any cash or allocation among other asset classes, such as small or foreign stocks, and incurs no investment cost. It is for these reasons that a long-running analysis of investor behavior suggests that the “average” U.S. investor in equity funds has earned about two-thirds of the S&P 500 return over the past 25 years.

The research firm performing these studies, Dalbar Associates, cites ill-timed buying and selling—often surrounding market peaks and valleys—as the chief culprit for the underperformance. While investors’ mistakes during the accumulation period may result in the consequence of less retirement capital, the effect of poor returns during the decumulation stage of retirement could undermine the amount and longevity of necessary income. The goal of most retirement savings is to provide a periodic maximum sustainable withdrawal to last throughout an expected lifetime. Since we don’t know how long an individual (or spouse) will live, or the rate of return our savings will achieve, assumptions are made. For example, most financial planners use a 30-year horizon for a person aged 65. Historically, an allocation assumption of 50% stocks and 50% bonds has produced investment returns to sufficiently fund an annual withdrawal beginning at 4% of retirement savings subsequently increasing by 3% in each year thereafter.

One challenge of retirement investing is the investment horizon is often longer than the mindset of the retiree. With more time to monitor financial news, investors can become anxious about market volatility and investment performance. For example, 2020 has produced extreme market volatility, wide performance differences between technology and dividend stocks, and long-term bonds that have eclipsed the S&P 500. Performance chasing describes the tendency to increase a portfolio’s weighting to market sectors with recent strong performance. This behavior places greater emphasis on short-term historical results rather than long-term performance prospects. Unfortunately, repeated attempts at performance chasing can inevitably lead to zigzagging at inopportune times that could further deteriorate asset values and exacerbate the planned drawdown of wealth to fund retirement income.

Given all that has happened in 2020, investors frustrated with investment returns should ask themselves if making a change is appropriate. No doubt the likelihood of a market downturn, economic recession, and other drawdown scenarios were all considerations when the investment plan was implemented, but how have recent experiences been any different? From a long-term standpoint, does it make sense to reduce dividend stocks in favor of high growth technology shares? With interest rates and bond yields at generational lows and nearing zero, does it make sense to allocate more to fixed income than stocks?

Income, Growth, Stability

We believe, the best plan for retirement decumulation is one that is thoughtful, incorporates sound principles, and is well suited to each investor’s unique circumstance. Furthermore, the plan should focus on the goal of producing income, growth to fund future income, and stability to help mitigate a prolonged market downturn. In our view, this goal can most likely be achieved through a diversified portfolio that includes dividend and growth stocks, bonds, and allows tactical flexibility. However, perhaps the most important element of any well-conceived plan is the commitment to stick with it. Retirees will no doubt encounter periods when specific segments of the market perform better or worse relative to others however, over a reasonable investment horizon, these performance dichotomies tend to even out.
Disclosures

Important Disclosures

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The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 9.9 trillion indexed or benchmarked to the index, with indexed assets comprising approximately USD 3.4 trillion of this total. The index includes 500 leading companies and covers approximately 80% of available market capitalization. Indices are unmanaged, do not include fees and expenses, and it is not possible to invest directly in an index. All investments involve risk, including loss of principal, and there is no guarantee that investment objectives will be met. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager. Equity investments are subject generally to market, market sector, market liquidity, issuer, and investment style risks, among other factors to varying degrees. Fixed Income investments are subject to market, market liquidity, issuer, investment style, interest rate, credit quality, and call risks, among other factors to varying degrees. Changes in market conditions or a company’s financial condition may impact the company’s ability to continue to pay dividends. Companies may also choose to discontinue dividend payments. Diversification does not ensure a profit or protect against loss.

*Total assets combines both Assets Under Management and Assets Under Advisement as of September 30, 2020. Assets Under Management represents the aggregate fair value of all discretionary and non-discretionary assets, including fee paying and non-fee paying portfolios. Assets Under Advisement represent advisory-only assets where the firm provides a model portfolio and does not have trading authority over the assets.

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