

ViewPoints

Market Pullbacks – React with Discipline



Entasis
ASSET MANAGEMENT



Yesterday the Dow Jones Industrial Average (Dow) and S&P 500 Index declined over -4% and the day prior both fell more than -2%. Since we haven't seen a more than -4% daily loss in more than 5 years, it resulted in some headlines.

How should investors think about their portfolio in the context of a big daily move like that?

We suggest considering these four simple ideas.

First and foremost, **react with discipline**. Do not course correct a long-term plan based on a daily move. The analogy we always like to use is driving a car around curve. Look as far into the turn as you can. The closer you look in front of you, the more likely the drive will be abrupt, increasing your odds of a mistake. We establish a specific investment policy statement (IPS) with all of our clients before investing. The purpose of the IPS is to mutually agree on a long-term strategy that acts as an unemotional roadmap.

Second, **put results into perspective**. After we account for the market losses of the last two trading days, the Dow and S&P 500 are at levels last seen just a short couple months ago in early December. Ask yourself if you would have made a knee jerk reaction to sell then. Odds are the answer is no.

Third, **be prepared to play defense**. Do not time the market. One thing we have written about extensively in recent quarters is how the "investing herd" has been throwing huge sums of cash into passively managed Index Funds and ETFs. We always use passive management in our portfolios, but we always use active managers as well. The logic of the herd is that in times of market strength, active management has historically underperformed passive management. However, if you did not own any active managers yesterday your U.S. equity portfolio was down whatever the market was down. Active managers have the ability to position their strategies defensively in times of market stress. The herd that has stampeded solely to passive management has no defense.

Finally, **understand your biases**. We regularly talk to investors with portfolios heavily skewed toward "what is familiar." For some this is company stock, for others it is real estate, etc. For other investors, the U.S. equity market is familiar, (especially large-cap stocks like those found in the Dow or S&P 500) so portfolios end up biased to those areas. There is comfort in that strategy, but not logic. Understanding asset class correlations and diversifying your portfolio in an efficient way can provide a measure of protection in times of market volatility.



Bob Batchelor, CFA
Chief Executive Officer

Summary

- React with discipline
- Put results into perspective
- Be prepared to play defense
- Understand your biases

Entasis Asset Management
300 N Corporate Drive
Suite 220
Brookfield, WI 53045
262-794-5299
Info@EntasisAM.com



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