KOVITZ INSIGHTS

Turbulent Markets: Act Quickly and Do Nothing

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TURBULENT MARKETS

Many types of market disruptions require a particularly steady hand: Federal Reserve Rate Hikes, Natural Disasters, War, Market Crises and Other Events

As a human, your natural, ingrained response is to protect yourself from dangerous situations. This has been the key to survival since the beginning of time. The uneasy intuition that gives you head start on a hungry beast, or an impending storm could mean the difference between life and death. But with investing, this instinct can be detrimental. Peter Lynch famously said, "Far more money has been lost by investors preparing for corrections or trying to anticipate corrections than has been lost in corrections themselves."

In this report, we identify a few of the most common events which have historically caused temporary market disturbances. These events could easily deter you from staying on track with your long-term investment plan. But historical data suggests that doing nothing can be the best course of action.

FEDERAL RESERVE RATE HIKES

Many believe stocks do poorly when the Federal Reserve raises interest rates. Borrowing costs rise with increasing interest rates. This perception can deter people from taking on additional debt, thereby decreasing the amount they pump into the economy. The same is true with the cost of capital for companies, which would be used for business investment.

Using long-term data from Bloomberg and the Federal Reserve, we calculated the total returns for the S&P 500 during each rising and falling cycle since December 1969, and we found that the index has fared relatively well no matter the direction of interest rates. In the eight rising rate environments, the S&P rose an average of 32%, while it rose more than 50% during the eight falling rate environments. We also note that the math requires that rates maintain a certain direction for at least a year, so we would need the Federal Funds Effective Rate to maintain its current position through May for the chart to tick over to a falling rate environment.

NATURAL DISASTERS

Natural disasters take a measurable toll on both lives and property. Many assume that disasters also wreak havoc on the stock market, but historical data indicates that markets do not react as you might expect.

The last two decades saw Hurricane Katrina, Hurricane Sandy, and the devastating 2011 Tōhoku earthquake and tsunami, to name a few. In fact, the 2005 hurricane season set new records, with 27 named storms including 14 hurricanes, and more than $100 billion of losses, according to data from the National Oceanic and Atmospheric Administration. Yet markets seemed generally unbothered a short time after the disasters.

FIGURE 1

Rate Regime Equity Performance

From 07.31.26 through 09.30.19. S&P 500 trailing 12-month yield. The Russell 3000 Value yield series begins in 1995. Source: Kovitz using data from Bloomberg Finance, L.P.

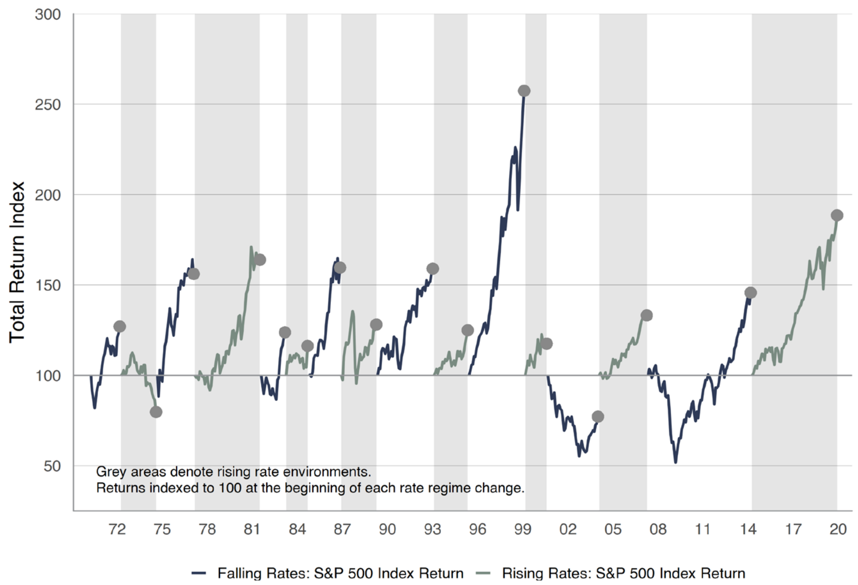
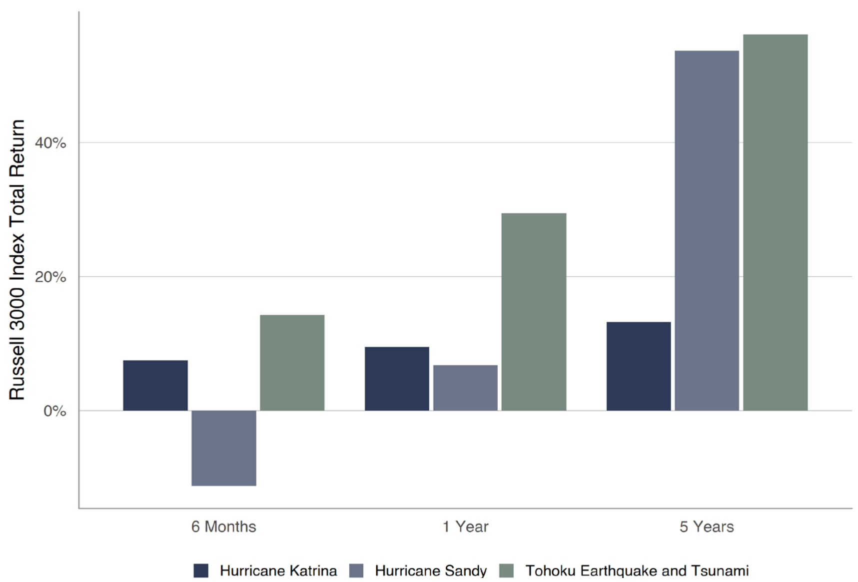


FIGURE 2

Post-Disaster Russell Returns

The start dates for Hurricane Katrina, Hurricane Sandy and Tohoku Earthquake and Tsunami are 08.29.05, 03.11.11 and 10.25.12, respectively. Source: Kovitz using data from Professors Fama and French



WAR AND CONFLICT

Unfortunately, we regularly see headlines related to terrorism. The threats are not only to your property and health, but to your investments as well. It's relatively common to hear that geopolitical conflict threatens the oil supply, entire economies and infrastructure, and thereby stock market. While we admit that the past isn't always prologue, historical data shows that the equity market is resilient as it perpetually climbs the Wall of Worry.

In Figure 3, data we compiled from Morningstar shows that equity and fixed income returns have generally recovered quickly after the start of a major military conflict.

FIGURE 3
Annualized Performance from beginning of Wars

Periods more than one year are annualized. Please see the important information section at the end of this report for index definitions. The start date for WWII is 08.31.39. The start date for the Korean War is 05.31.50. The start date for the Vietnam War is 10.31.55. The start date for the Gulf War is 07.31.90. Source: Kovitz using data from Bloomberg Finance, L.P.

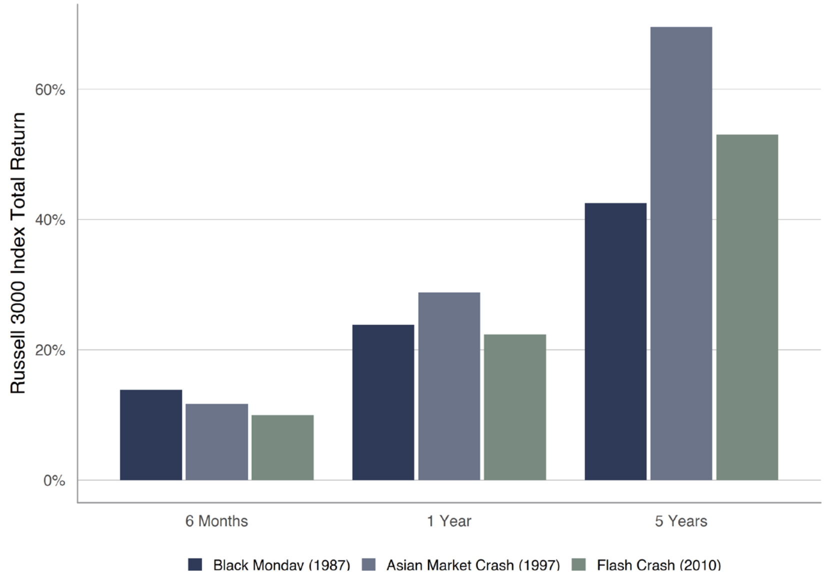
	Large-Cap Stocks	Small- Cap Stocks	Short-Term Bond	Int- Term Bonds	Long-Term Bonds
Gulf War					
1 Year	12.8%	5.9%	6.6%	10.3%	9.5%
3 Years	-8.0%	-17.3%	0.0%	4.7%	5.3%
5 Years	14.3%	4.3%	6.7%	8.2%	8.0%
Korean War					
1 Year	23.8%	26.5%	1.3%	-0.4%	-3.3%
3 Years	17.0%	14.0%	1.1%	0.9%	1.2%
5 Years	9.1%	3.7%	0.9%	1.1%	0.9%
Vietnam War					
1 Year	12.0%	9.9%	2.4%	-0.7%	-3.4%
3 Years	28.6%	25.4%	1.6%	1.0%	1.3%
5 Years	20.7%	13.9%	1.6%	1.4%	1.0%
World War II					
1 Year	0.3%	22.0%	0.0%	3.6%	3.3%
3 Years	16.6%	3.8%	7.6%	9.9%	11.6%
5 Years	3.8%	2.7%	0.1%	3.7%	4.5%

GLOBAL MARKET CRISIS AND OTHER EVENTS

Reactive investment behavior is not limited to war, natural disasters or monetary policy. Many other situations also cause individuals to abandon their investment strategy.

FIGURE 4
Post Market Crash Russell Returns

The start dates for Black Monday, the Asian Market Crash and the Flash Crash are 10.19.87, 06.30.97, and 10.02.18, respectively. Source: Kovitz using data from Professors Fama and French.



CONCLUSION

In the words of Warren Buffet, “Of course, the immediate future is uncertain; America has faced the unknown since 1776. It’s just that sometimes people focus on the myriad of uncertainties that always exist while other times they ignore them (usually because the recent past has been un-eventful). American business will do fine over time. And stocks will do well just as certainly, since their fate is tied to business performance. Periodic setbacks will occur, yes, but investors and managers are in a game that is heavily stacked in their favor.”

While we agree with Mr. Buffett's assertion, we also understand that staying focused on investment goals can be difficult. Dispassionately ignoring screaming headlines takes a firm resolve that few can master on their own. This is why a seasoned professional can be an invaluable asset when the old fight-or-flight feelings come a knockin'.

FOR MORE INFORMATION, PLEASE CONTACT:

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Kovitz Investment Group, LLC underwent an organizational change effective January 1, 2016, and is now Kovitz Investment Group Partners, LLC. KIG, an investment adviser registered under the Investment Advisers Act of 1940, manages equity, fixed income, and hedged equity portfolios for its clients. From January 1, 1997 to September 30, 2003, certain staff of KIG operated as the Kovitz Group, an independent division of Rothschild Investment Corp., and as Kovitz Investment Group, LLC from October 1, 2003 through December 31, 2015, and provided the same services as those listed above throughout the entire period.

Kovitz Investment Group (KIG) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Kovitz Investment Group Partners, LLC has been independently verified for the periods January 1, 1997 through December 31, 2018. The verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

Manager commentary represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, a guarantee of future results, or investment advice. This information should not be relied upon by the reader as research or investment advice. To determine if a strategy is appropriate for you, carefully consider the investment objectives, risk factors, and expenses before investing. The figures shown are presented to illustrate examples only.

The dividend-weighted portfolio data is from Eugene F. Fama and Kenneth R. French. The dataset is broken into five groups: non-dividend paying, top 30% of dividend payers, middle 40% of dividend payers, bottom 30% of dividend payers and all dividend payers (weighted 30% of top dividend payers, 40% of middle dividend payers and 30% of low dividend payers). Non-dividend payers are stocks that do not pay dividends. Dividend payers are stocks that pay dividends. The capitalization and factor-based (book value-to-price) portfolio data is from Eugene F. Fama and Kenneth R. French. The dataset is broken into four groups: large value, large growth, small value and small growth. A large value stock is a type of large-cap stock investment where the intrinsic value of the company's stock is greater than the stock's market value. A large growth stock is a growth stock of a company with a market capitalization value of more than $5 billion. A small value stock is a value stock of a company with a relatively small market capitalization. A small growth stock is a growth stock of a company with a relatively small market capitalization. The total return values presented in Figure 1 from Morningstar's Ibbotson Associates are grouped into small- and large-capitalization stocks.

The Russell 3000 index measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The Russell 3000 Value Index measures the performance of the broad value segment of U.S. equity value universe. It includes those Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values. The Russell 3000 Growth Index measures the performance of the broad growth segment of the U.S. equity universe. It includes those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values. A value stock is a stock that tends to trade at a lower price relative to its fundamentals (e.g., dividends, earnings and sales) and thus considered undervalued. A growth stock is a company whose earnings are expected to grow at an above-average rate relative to the market.

The S&P 500 index measures the performance of the largest 500 US companies representing approximately 75% of the investable US equity market. The S&P 500 Value Index measures the performance of the broad value segment of U.S. equity value universe. It includes those S&P 500 companies with lower price-to-book ratios and lower forecasted growth values. The S&P 500 Growth Index measures the performance of the broad growth segment of the U.S. equity universe. It includes those S&P 500 companies with higher price-to-book ratios and higher forecasted growth values. A value stock is a stock that tends to trade at a lower price relative to its fundamentals (e.g., dividends, earnings and sales) and thus considered undervalued. A growth stock is a company whose earnings are expected to grow at an above-average rate relative to the market.

Large-cap stocks are represented by the Morningstar-Ibbotson Associates SBBI Large Stock Total Return index. Small-cap stocks are represented by the Morningstar-Ibbotson Associates SBBI Small Stock Total Return index. Short-term bonds are represented by the Morningstar-Ibbotson Associates SBBI U.S. 30-Day T-Bill Total Return index. Intermediate-term bonds are represented by the Morningstar-Ibbotson Associates SBBI U.S. Intermediate-Term Government Total Return index. Long-term bonds are represented by the Morningstar-Ibbotson Associates SBBI U.S. Long-Term Government Total Return index. 20-5-003