CLEARPOINT

clearstead

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ADAM P. FELTEN, PORTFOLIO MANAGER

IMPLEMENTING AN INVESTMENT PLAN: IS TIMING A CRITICAL COMPONENT?

BY ADAM P. FELTEN, PORTFOLIO MANAGER

From 2019 through 2021, the U.S. stock market provided a refuge for investors as accommodative fiscal and monetary policy helped lead to outsized returns. In 2022, however, both stock and bond markets have been challenged by inflation, rising interest rates, and economic uncertainty. Despite these challenges, corporations have reported to be well capitalized, and earnings have been resilient, with 75% of S&P 500 companies beating earnings estimates in the 2nd quarter of 2022.[1] Given dueling schools of thought on the outlook for the economy and global markets moving into 2023, the question remains, is timing a critical component in an investment plan for clients with recent liquidity events, outsized cash balances, or those looking to rebalance their portfolios and purchase equities?

THE RISK OF VOLATILITY

Implementing an investment plan takes willingness to accept certain inherent risks to generate returns in excess of risk-free securities. These include principal risk, interest-rate risk, and liquidity risk, among others. Many risks can be mitigated by properly diversifying among various asset classes, industries, and global markets.

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Administration and Private Client teams with Haven Hobson and Connie Allen.

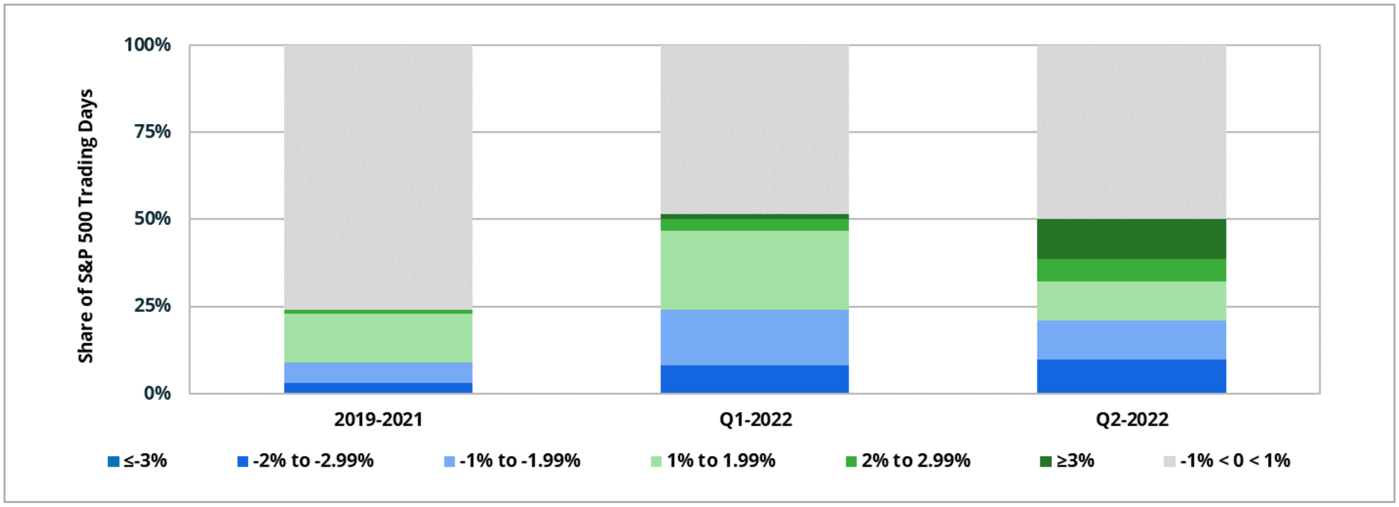
Haven Hobson joined Clearstead as an Accountant - Billing. Haven has a Bachelor's degree from Cleveland State University, majoring in Accounting. Prior to joining Clearstead, Haven was an Accounting Associate II at the Ohio Catholic Federal Credit Union.

Connie Allen joined Clearstead as a Client Planning Associate, Tax. Connie has a Bachelor's degree from David N. Myers College, majoring in Accounting. She recently worked in Tax and Compliance with Chromaflow Technologies and has worked in the trust field with The Private Trust Company and KeyBank.

These changes underscore the firm's commitment to building its investment consulting practice, promoting the next generation of leadership, and maintaining a rigorous investment process.

However, in times of heightened volatility, asset classes have historically become more correlated, or move in a more similar direction and magnitude. Ultimately, this can reduce the benefits of diversification. In comparison to 2019 through 2021, 2022 has been marred by daily volatility resulting in a traditional 60% stock / 40% bond portfolio returning a -19.62% nominal return as of the end of August.[2] As shown in the chart below, less than 50% of S&P 500 trading days through the second quarter of the year have been within a +/-1% move.

LARGE SWINGS HAVE DOMINATED THE MARKET IN H1-2022



Source: Bloomberg LP, Clearstead, daily data as of June 30, 2022. Past performance is not an indicator of future results.

Heightened periods of volatility produce another risk for which investors need to account, making it difficult to have conviction on when to begin a new investment plan. Periods of volatility will typically lead investors to second-guess an initial implementation plan. This thinking can be detrimental to achieving long-term return objectives and possibly permanently impairing investment capital.

THE "LSI" VERSUS "DCA" APPROACHES

Historically, there have been two primary approaches to implementing an investment plan. The lump sum investment ("LSI") entails making all purchases in one period and immediately assuming the risks inherent to investing. The alternative to the LSI strategy is the dollar-cost averaging ("DCA") approach. Dollar-cost averaging involves investing a set dollar amount over regular intervals, typically monthly or quarterly, for a period of time. The goal of a DCA investment plan is to reduce the volatility of the initial principal investment by evenly spreading out purchases. This plan may be helpful in reducing short-term market turbulence but can detract from returns in the event of a prolonged market move to the upside. This is due to the delaying of purchases and subsequently holding an excess amount of cash on the sidelines earning less than broad market indices. Choosing between an LSI or DCA approach may be heavily influenced by an investor's beliefs on the short to near-term prospects of the market.

While the decision between implementing an LSI or DCA approach is important, a more critical decision is when to begin an investment plan. For example, the illustration on the next page depicts investing a $1,000,000 portfolio at two different points of the 2008 Financial Crisis and the results of holding each investment for four years. In this example, the DCA approach outperformed during the beginning of the market turbulence in November of 2007 as purchases in a declining market are delayed. On the other hand, the LSI approach significantly outperforms during the recovery in March of 2009 as all dollars are invested at the beginning of the period when the market sharply corrects.

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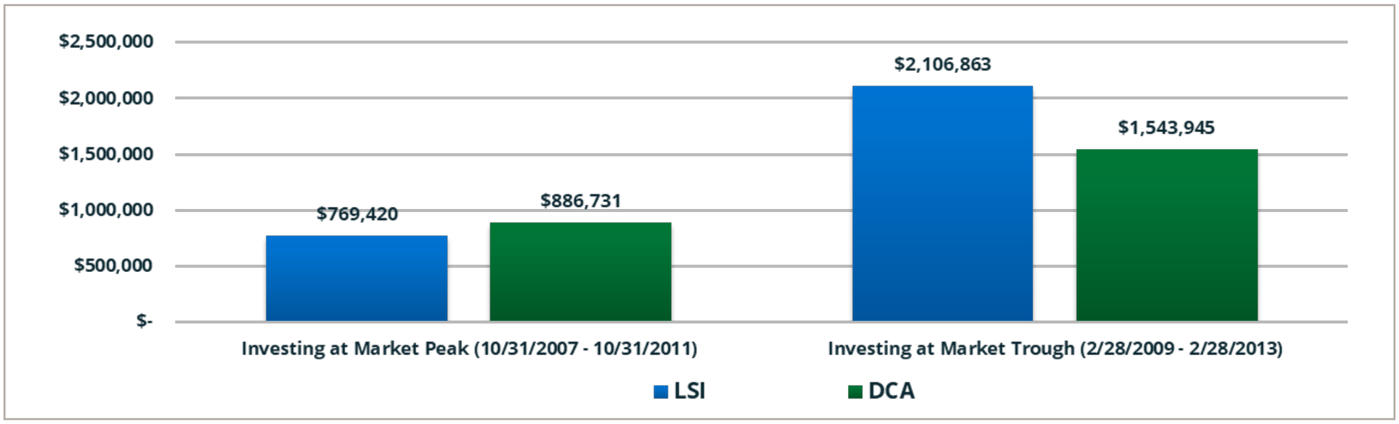
LSI vs DCA: INVESTING $1,000,000 DURING THE GREAT FINANCIAL CRISIS



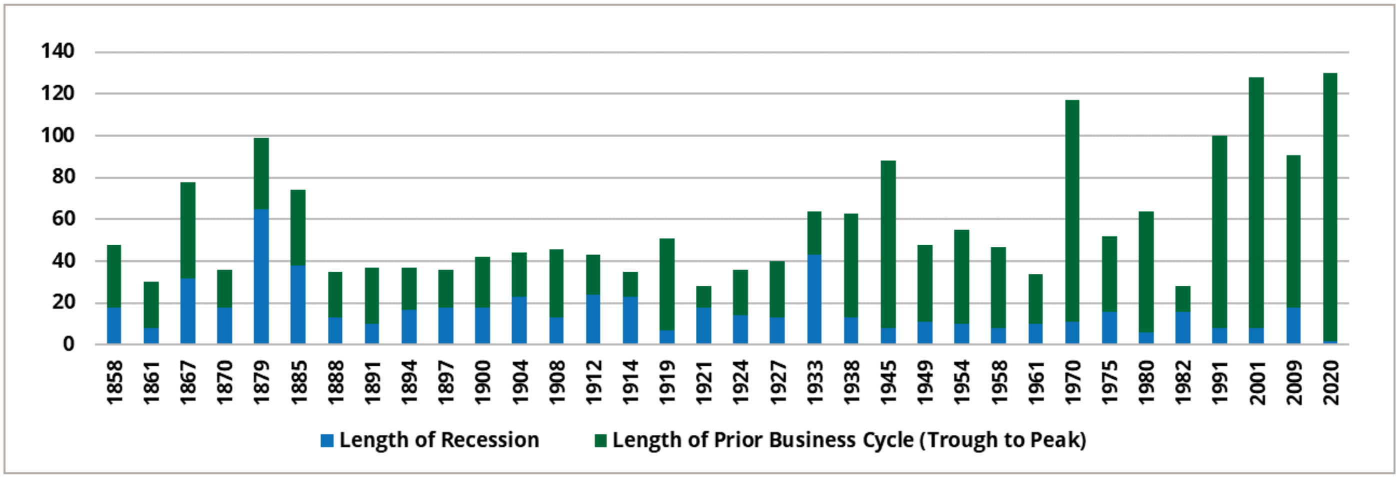
Source: Clearstead, Bloomberg LP, MSCI ACWI Total Return. Past performance is not an indicator of future results.

As one may expect, the difference in start date for the investment plan alters the course of this portfolio for years to come. Timing can be a critical component in this situation, but the likelihood of correctly identifying a "market peak" and "market trough" and then acting on these suppositions is small.

CAPITAL MARKET AND ECONOMIC EXPECTATIONS PLAY A ROLE

When making the decision between implementing an LSI or DCA investment plan, a major variable worth considering is the stage of the business cycle and the economic climate. Historically, stocks have done well in the early stages of an economic expansion as interest rates are typically lower and corporate earnings begin to rebound. On the contrary, stocks can lag during the late stage of a recovery and recessionary periods as inflation tends to increase and interest rates rise. Since 1928, the median annualized return for the S&P 500 during a period of economic expansion is +14.47% as opposed to -2.88% during a period of recession.[3] While it may sound simple to determine, no business cycle is the same, and accurately judging both the phase and anticipated duration of the cycle is quite difficult. As shown in the chart below, historic business cycles have ranged from 25 to 128 months with the average cycle lasting 64 months. To further complicate matters, stock indices are historically leading indicators, suggesting that a recovery in stock prices could have already started while the economy remains in a recession.

U.S. BUSINESS CYCLES (MONTHS)



Source: Clearstead, National Bureau of Economic Research, as of 7/25/21. Past performance is not an indicator of future results.

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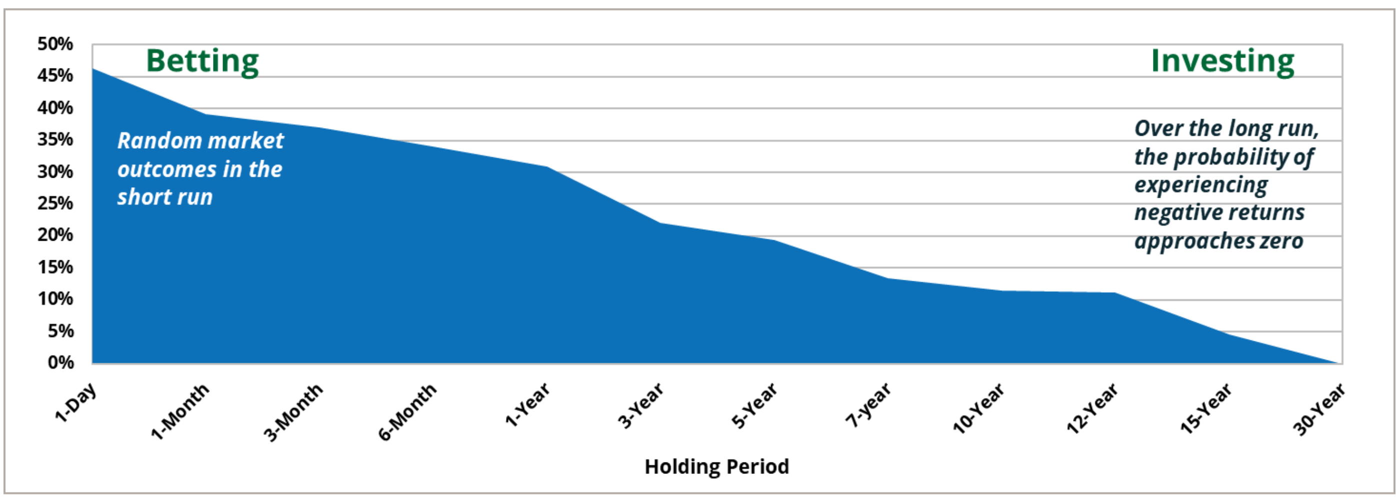
Despite the difficulty in forecasting the exact stage of the business cycle, a general understanding of the economic and market environment may help drive strategic allocation decisions and avoid adding to investments with a greater probability of underperformance in a given market. For instance, as noted in our June 2022 *ClearPoint*, Clearstead has shifted our view on equity markets and meaningfully worked towards adding more dividend income into portfolios as we believe price-to-earnings ratio expansion could make it increasingly less likely to drive returns in the same way it has over the past 10 years. Acting in a strategic fashion while implementing an investment plan may help mitigate principal risk by choosing investments that have historically had success in a specific environment.

INVESTING FOR THE LONG-TERM

Unfortunately, there is no sure-fire answer to choosing between an LSI or DCA approach. A paper written by Vanguard Research in 2012, titled *"Dollar-Cost Averaging Just Means Taking Risk Later,"* found that 66% of the time the LSI approach has historically produced higher rolling 10-year investment returns using a 60% equity / 40% bond portfolio.[4] Some may think this approach is intuitive since the market has tended to move higher over time with stocks and bonds outperforming cash. Although this may be the case historically, the future remains uncertain, and actual results may be different depending on current market trends.

Clearstead's advice is to take a thorough look at an investors' time horizon, risk tolerance, and short-term liquidity needs. If he or she is comfortable with the market environment, and liquidity needs are minimal, an LSI approach has historically been a good choice. An important ingredient in any plan is having a long-term mindset. We believe that over the long-run, stocks will continue to provide positive inflation-adjusted returns; and, as shown below, while it is difficult to predict the potentially irrational market moves over the short-term, historically having a long-term investment mindset has led to a higher probability of investment success.

PROBABILITY OF EXPERIENCING NEGATIVE EQUITY RETURNS



Source: Clearstead, Bloomberg LP, http://www.econ.yale.edu/~shiller/data.htm, All periods greater than 1-day are monthly rolling total returns and inflation adjusted from S&P 500 1871-2021, 1-day total return data from 1928-2021 not inflation adjusted.

Sources:

(1) FactSet; Earnings Insight; 08/05/22, https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_080522A.pdf.
(2) *http://www.lazyportfolioetf.com/allocation/stocks-bonds-60-40/ "Historical Returns as of 8/31/22; uses index VTI for equities and index BND for bonds".*
(3) Data from NBER, derived from Holding Period Return during month coincident with either Recession or Expansion.
(4) https://static.twentyoverten.com/5980d16bbfb1c93238ad9c24/rJpQmY8o7/Dollar-Cost-Averaging-Just-Means-Taking-Risk-Later-Vanguard.pdf "Dollar-cost averaging just means taking risk later"

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MARKET BENCHMARK RETURNS

September 30, 2022		1M	3M	12M	YTD
US Large Cap	S&P 500	-9.2%	-4.9%	-15.5%	-23.9%
US Small Cap	Russell 2000	-9.6%	-2.2%	-23.5%	-25.1%
Developed Intl	MSCI EAFE	-9.4%	-9.4%	-25.1%	-27.1%
Emerging Intl	MSCI Em Mkt	-11.7%	-11.6%	-28.1%	-27.2%
Real Estate	NAREIT	-13.2%	-11.2%	-17.4%	-28.3%
Core Fixed	BarCap Agg	-4.3%	-4.8%	-14.6%	-14.6%
Short Fixed	BarCap 1-3Yr	-1.2%	-1.5%	-5.1%	-4.5%
Long Fixed	BarCap LT G/C	-8.3%	-9.0%	-27.4%	-28.9%
Corp Debt	BarCap Corp	-5.1%	-4.9%	-17.9%	-18.1%

Source: Bloomberg

The performance data shown represents past performance. Past performance is not an indicator of future results. Current performance data may be lower or higher than the performance data presented.