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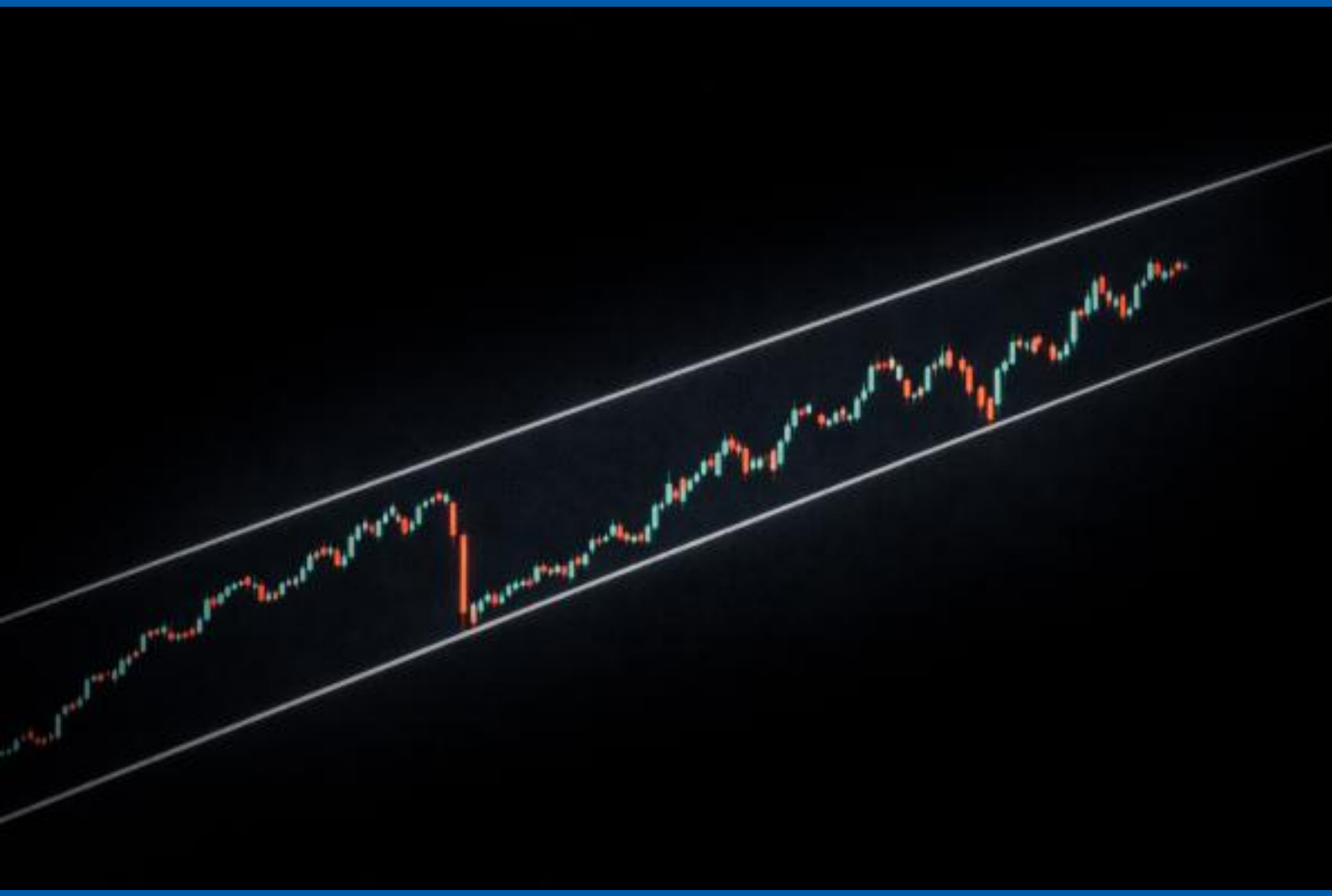

Volatility is a Feature, Not a Bug

By Dan Babington, Portfolio Manger & Responsible Investment Lead at TAM Asset Management Ltd

As the conflict in the Middle-East has escalated, March is proving a period defined by fear and uncertainty. In the absence of wisdom as to how this conflict will unfold, I believe it best to assess it through the eyes of an investor in stock, bond and commodity markets. Market falls like this can feel exceptional in the moment, particularly when they are tied to such troubling developments. But while the cause of each sell-off is different, the pattern of investor reaction is often familiar. For that reason, it can be helpful to step back and view the current move not as something unprecedented, but as part of the volatility that has always accompanied long-term investment.

To illustrate this, since 1955 the S&P 500 has returned 145,108%, meaning a mere $100 invested would now equate to $145,208. When making adjustments for inflation, which is the steady rise of goods and services over this time, the return is still 11,864% or just under 7% per year on average.[i] However, this frankly stellar headline number houses a litany of worrisome days, many weeks of mire and some months where it felt like the world as we knew it was coming to an end. Investors over this period will have learned that it is **time in the market rather than timing the market** which leads to the outcomes investors hope for. However, this aphorism must be dusted off more

frequently than you may think. The last 70 years of data suggests there was a lot of pain on the way to the promised land:

Over 46% of trading days were negative: out of the 252 trading days per year, around 116 will likely be red on average.

Small pullbacks are normal: the S&P 500 experienced a 5% or greater decline 79 times since 1955, or roughly every 10.6 months.

10% corrections are surprisingly regular: the S&P 500 has had 27 declines of 10% or more since 1955, about every 2.6 years.

15% drawdowns still happen periodically: there were 14 declines of 15% or more since 1955, or about every 5 years.

20% bear markets are less frequent but still part of the cycle: there were 13 declines of 20% or more since 1955, about every 5.4 years.

Therefore, history suggests that over the next five years you should expect to encounter multiple pullbacks, including five 5% declines, at least one 10% correction, and potentially even a bear market (20% decline). Yet the market is much more likely than not to finish each year in positive territory than not.

Unfortunately, markets never behave exactly as expected but what we know for sure is that volatility, in some capacity, is unavoidable. The key question then is how portfolios are built to withstand it. TAM utilises the knowledge that years of investing in the stock market have granted us. This is then combined with a variety of tools to deliver an investment solution prepared for short-term volatility as well as long-term opportunity. To illustrate how we do this, our three most critical mantras are outlined below:

Be Diversified: When broad equity markets are in varying degrees of turmoil, money will often flow somewhere else.

In 2008, while the S&P 500 fell 36.6%, 10-year U.S. Treasury Bonds rallied 20.8% while gold returned 4.3%. Even within the S&P 500, the classic defensive sectors consumer staples, utilities and healthcare posted the smallest average losses. In Q1 2020 (Covid-shock) every S&P 500 sector was down but consumer staples, health care and utilities again held up better, as did technology in this case. Gold (+5.4%) and broad bonds (+3.1%) were again positive. In 2022, as Russia invaded Ukraine, bonds didn't work as a diversifier and fell with stocks. The clear winners, however, were commodities with energy up as much as 60% while gold was slightly positive.

The latter is an inflationary shock, which most closely resembles the fallout of the growing conflict in the Middle East, providing a playbook for active managers to consider. TAM has allocations to broad commodities, within select portfolios, which includes strong energy performance at present as well as standalone allocations to gold bullion. We also work with highly experienced, trusted bond managers who have the flexibility to rotate between government and corporate debt across varying durations to adjust to the situation that's unfolding.

Be Open: In a constantly evolving world, TAM's approach allows us to quickly assess whether new information has meant our assumptions are now outdated and adjust our clients' portfolios to protect against new risks. Having strong opinions but loosely held means we have conviction but are not wedded to our viewpoints. This can lead to opportunity as the early stages of a sell-off can often be driven by emotion or the indiscriminate selling of one position to help fund another. We endeavour to take advantage of any opportunities which have arisen.

Be Resilient: In moments such as these, it is paramount to remember that volatility is uncomfortable, but it is not unusual. It also works both ways and in fact, market declines often precede large rebounds. Emotional decisions, in reaction to short-term shocks can cost dearly on an investment journey. The past thirty years of S&P 500 returns portray this clearly:

Time in the market matters: being fully invested from 1 July 1995 to 30 June 2025 delivered an average annual return of 8.4%.

Missing even a few strong days can materially reduce returns: missing just the 10 best trading days reduced that average annual return to 5.4%.

The cost of mistiming the market rises quickly: missing the 30 strongest days lowered returns further, to an average of only 2.1% per year.

Missing too many of the market's best days can destroy long-term wealth: missing the top 50 days turned long-term growth negative, with the average annual return falling to -0.6% before inflation.

When headlines are concerning and the outlook is bleak, we are wired to be anxious, but history suggests that patient money is smart money. An optimal strategy therefore is to build a portfolio which is proactive, utilising the benefits of diversification and being prepared for different types of shocks. Then where clear dislocations emerge, be opportunistic. The goal therefore is to garner the known benefits of long-term investing while smoothing the journey as much as feasible. That is TAM's perennial aim for our clients and it is the playbook we are using as we parse the current headlines.

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[i] Index chosen due to data availability. Author recognises solely using US index is not fully reflective of global investor returns over stated period.

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