RECENT MARKET DECLINE
A *MESSAGE* FROM HFG TRUST

The start of the fourth quarter for US stocks is quite contrasting with the first nine months of the year. We appear to have gone from optimism to worry in 48 hours. US stocks as measured by the S&P 500 were up 9%. In two days, US stocks have declined 5-6%, retreating to price levels of mid-July. We are not in the business of forecasting market returns in the short run. We also don't believe it's possible to predict whether this is a start to a greater trend, or one of the many turbulences investors experience over a market cycle. Day-to-day and year-to-year returns are truly random. However, many investors haven't experienced volatility since the market bottom in March of 2009. The balance of this article is to put into perspective the recent decline and examine how the decline compares from a historical perspective. We will discuss the topic of diversification and maintaining a disciplined investment process. We hope you find this informative and helpful.

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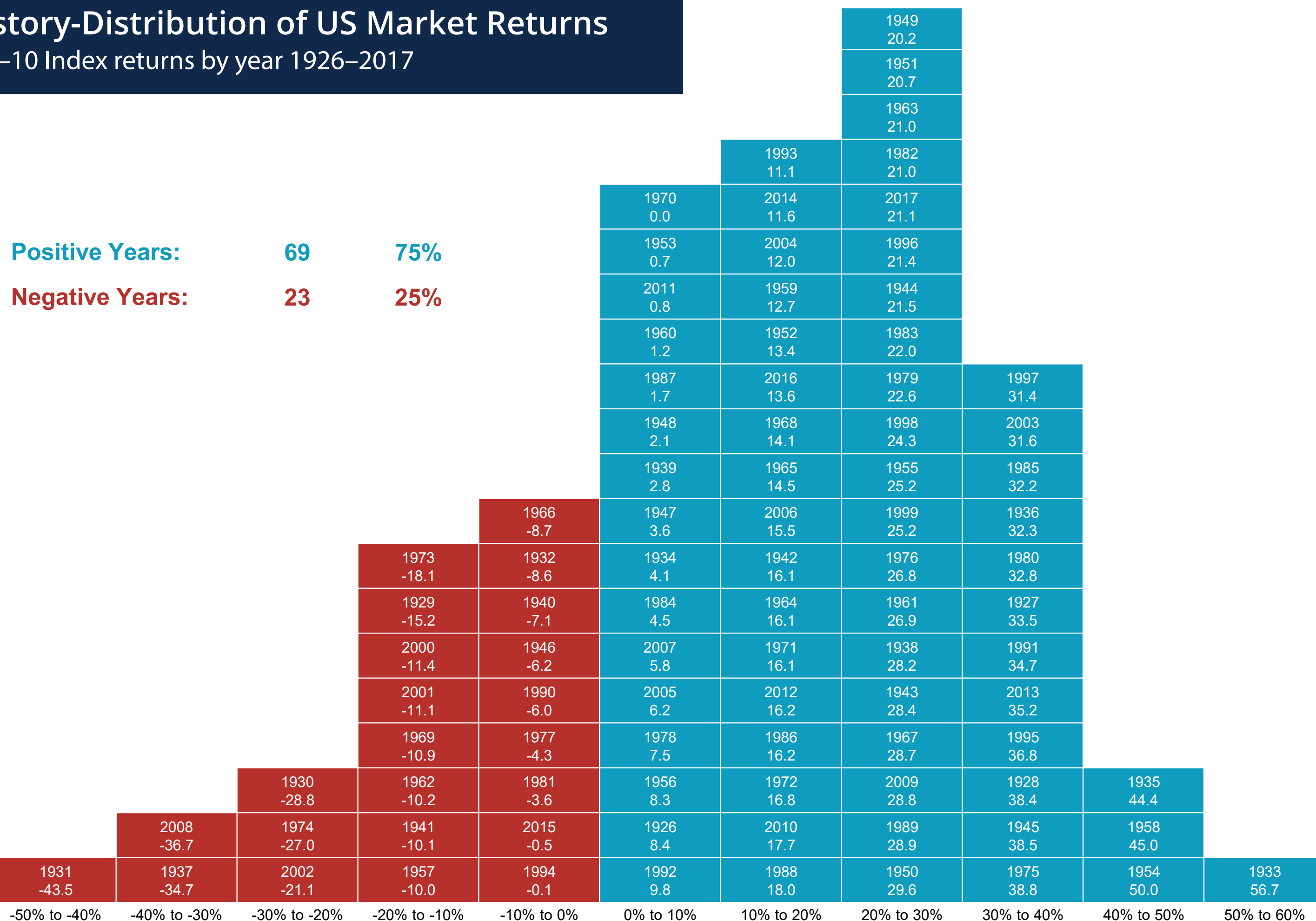
Our first slide illustrates the US market returns from 1926-2017. This encompasses 92 years of annual returns. Many of you are aware that the average return over this period is 10%. However, informing investors that stock market returns have been 10% can create an incorrect expectation. Although returns have averaged 10%, the distribution chart illustrates that only in 1992 did stocks return near the average. In all other years the returns were either above or below 10%. In fact, for 23 years US stocks had negative returns. The takeaway is investing in any stock market can create a pucker factor. It is very similar to watching a movie; you can't leave your chair and expect to see the end.

US Market History-Distribution of US Market Returns

CRSP 1–10 Index returns by year 1926–2017



In US dollars. CRSP data provided by the Center for Research in Security Prices, University of Chicago. The CRSP 1-10 Index measures the performance of the total US stock market, which it defines as the aggregate capitalization of all securities listed on the NYSE, AMEX, and NASDAQ exchanges. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

This chart illustrates market corrections of 10% or more dating back to 1926. It defines a 10% threshold as a decline of 10% from a previous high. It illustrates we have had a total of four declines of more than 40%. In each of these declines, investors were rewarded for their discipline and patience. If we accept the fact these events can't be predicted, our strategy should be one of preparation. We should construct your portfolio around a balance of stocks, bonds and real estate that allows you to withstand and endure what feels like a "roller-coaster" experience. Clients that maintain investment discipline and re-balance bonds into depressed stocks have the opportunity for above average market returns. Investors that panic are doomed to below average returns. The takeaway is that 10-20% declines are not common, however, they shouldn't be unexpected. To mentally prepare yourself for such turbulence, multiply 10-20% of your current portfolio to compute the dollar value of pain you will likely experience unexpectedly in the future.

A History of Market Ups and Downs

S&P 500 Index total returns in USD, January 1926–December 2017

Using a 10% threshold for downturns

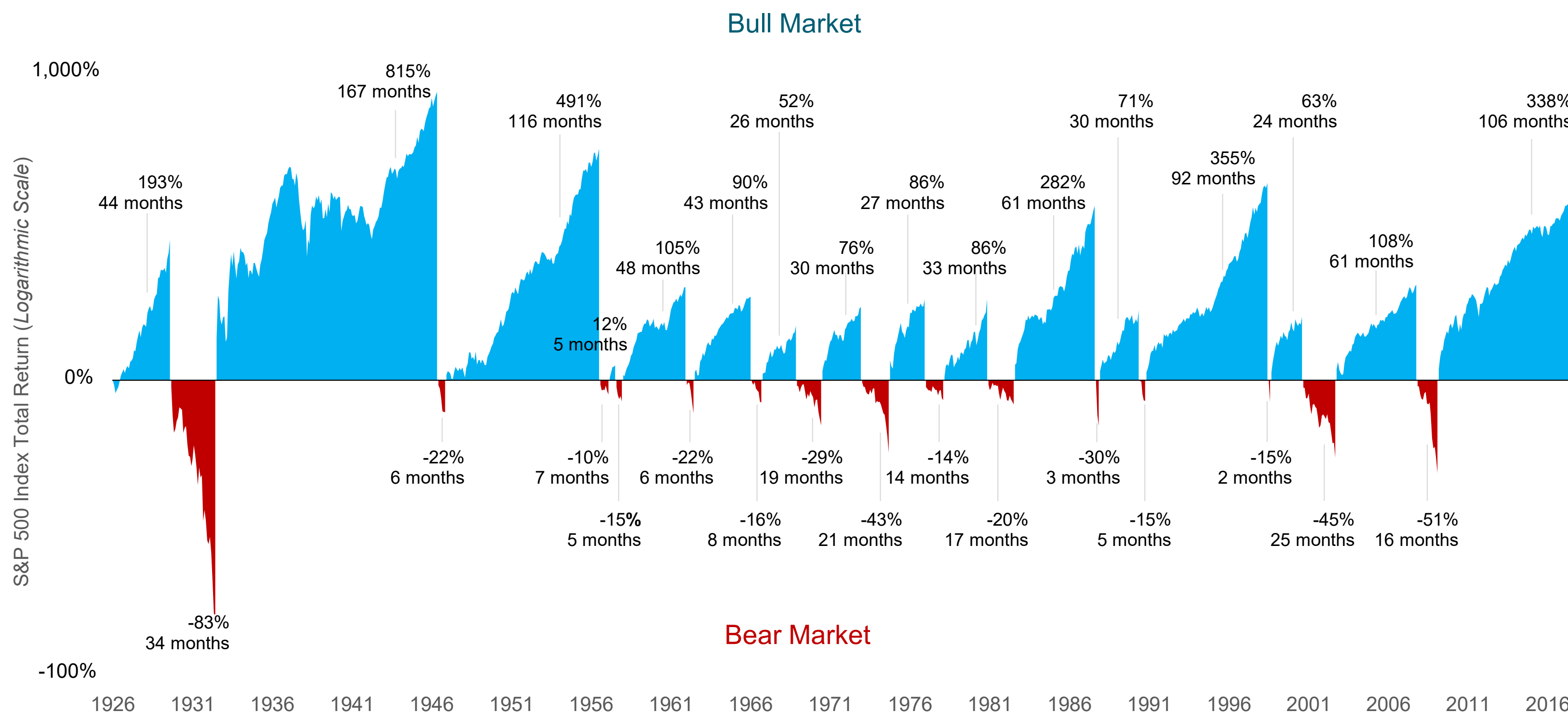
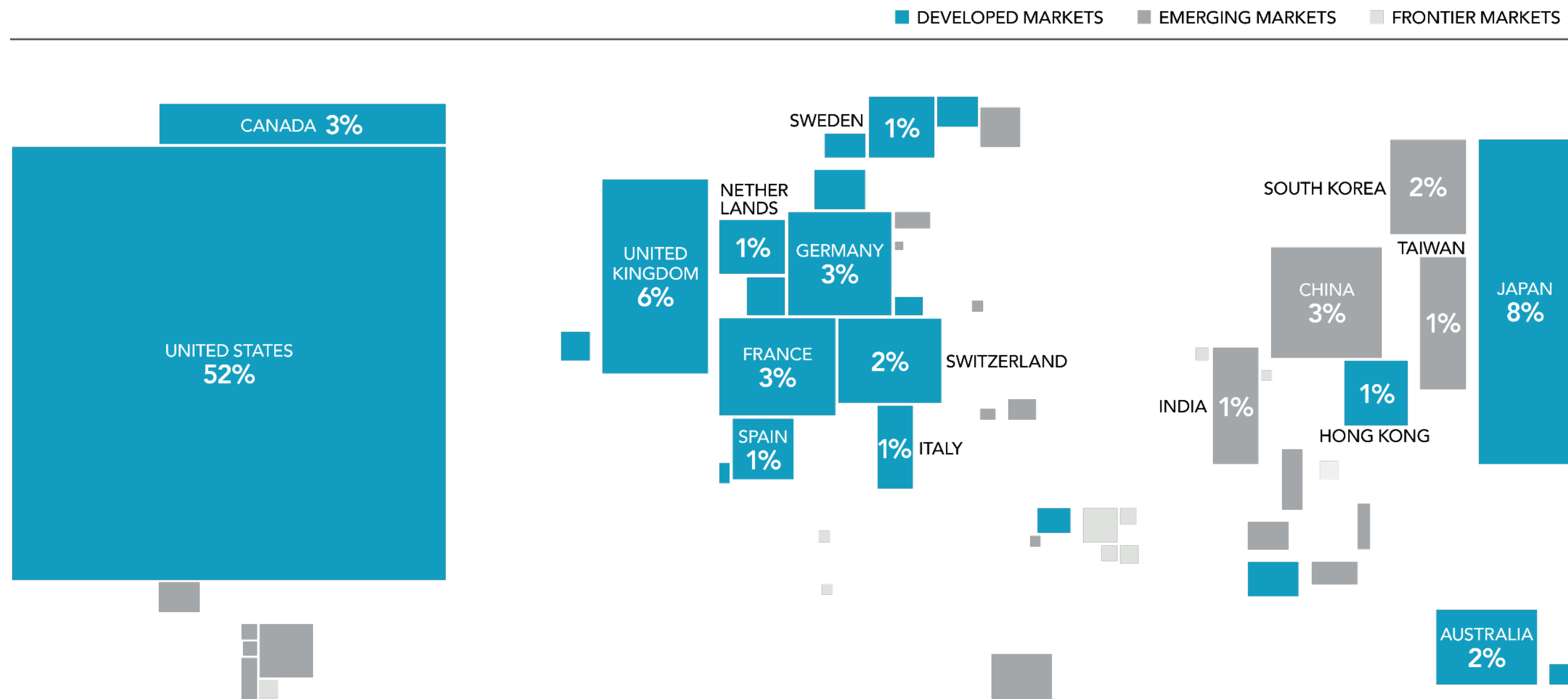


Chart end date is 12/31/2017, the last trough to peak return of 338% represents the return through December 2017. Bear markets are defined as downturns of 10% greater from new index highs. Bull markets are subsequent rises following the bear market trough through the next new market high. The chart shows bear markets and bull markets, the number of months they lasted and the associated cumulative performance for each market period. Results for different time periods could differ from the results shown. Past performance is no guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Source: S&P data copyright 2018 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Since the 2008-2009 market bottom, US stocks have out-performed international and emerging markets. For the average investor, riding the winning horse is logical. However, ignoring the benefits of a globally diversified portfolio can have its own risks. The US accounts for approximately 10% of the global population and 24% of the world's GDP, yet our stock market represents more than 50% of the market value of all global stocks. This appears to be an imbalance. To illustrate this further, Apple's market value is greater than all the stocks in many countries. There are more than 3,000 publicly traded stocks in the US, and there are more than 11,000 outside the US. An Oppenheimer economist stated that there are more than 100 million citizens in emerging economies moving into the global middle class. International markets can provide opportunity and diversification.

There's a World of Opportunity in Equities

Percent of world market capitalization as of December 31, 2017

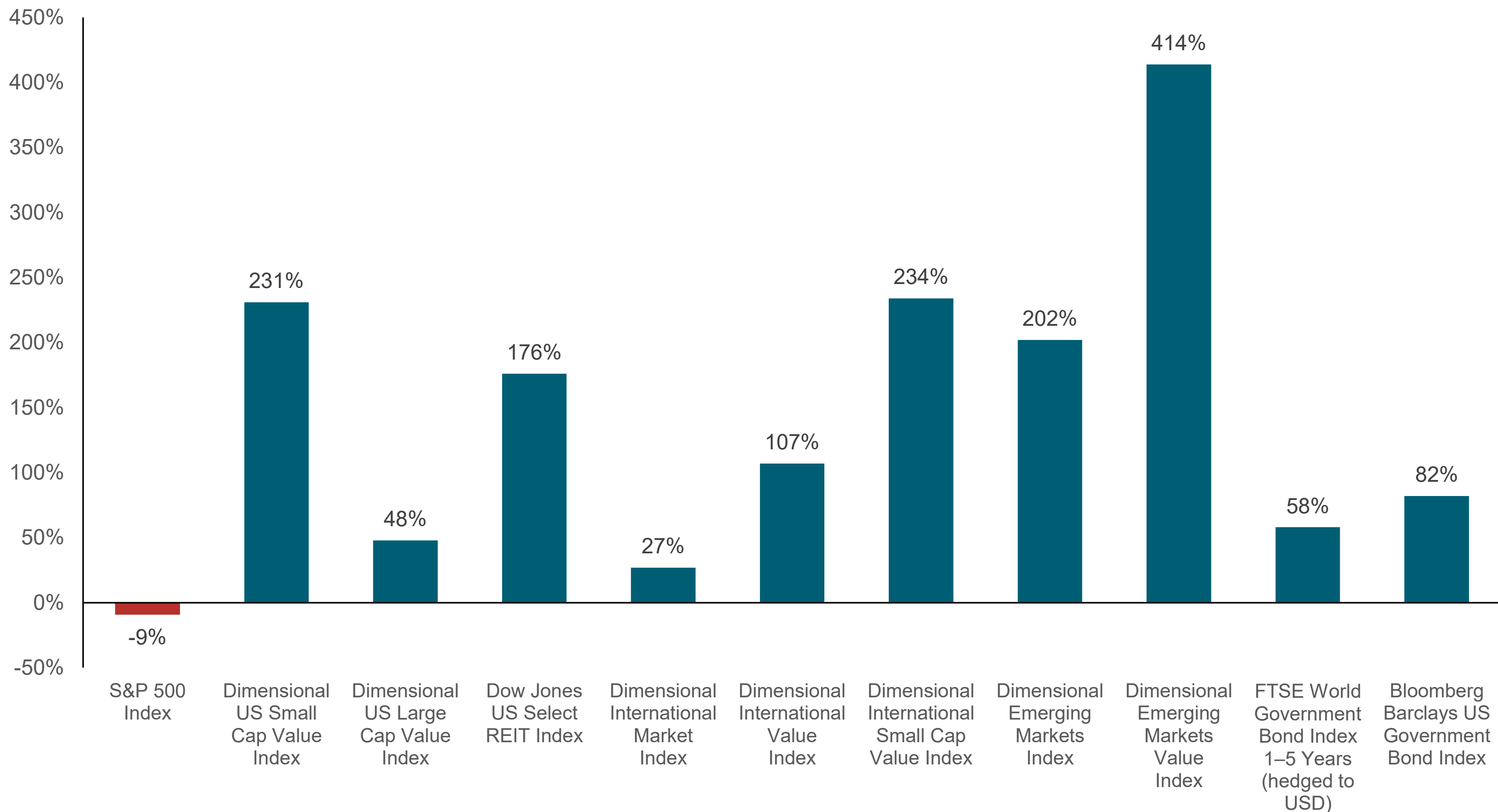


In US dollars. Market cap data is free-float adjusted and meets minimum liquidity and listing requirements. Dimensional makes case-by-case determinations about the suitability of investing in each emerging market, making considerations that include local market accessibility, government stability, and property rights before making investments. China market capitalization excludes A-shares, which are generally only available to mainland China investors. Many nations not displayed. Totals may not equal 100% due to rounding. For educational purposes; should not be used as investment advice. Data provided by Bloomberg.

We should be aware thour markets are not immune from under-performance. This table illustrates that from the beginning of 2000 to the end of 2009 the S&P 500 had a cumulative negative return of 9%. It also illustrates the returns on other global asset classes, which all outperformed the S&P 500 by significant margins.

A Look Beyond the S&P 500

Total Return (%): January 2000–December 2009



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Performance data represents past performance and does not predict future performance. Indices are not available for direct investment. Performance does not reflect the expenses associated with the management of an actual portfolio.

This chart illustrates the annual returns of 12 different asset classes. It includes US stocks, international stocks, real estate, and bonds. It illustrates there is no consistent winner year-to-year. The takeaway is that our clients' portfolio should be average year-to-year in order to be disciplined.

The Randomness of Returns and Yearly Winners

Annual Return (%)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Highest Return	62.6	34.2	34.5	36.0	39.8	8.8	79.0	28.1	9.4	20.1	38.8	32.0	5.8	31.7	37.8
	60.2	33.2	25.5	32.6	8.2	6.6	53.3	26.9	3.4	18.6	34.5	13.7	4.5	21.3	31.5
	56.3	29.9	21.1	29.6	7.9	4.7	51.4	24.9	2.3	18.1	32.5	13.5	1.5	17.3	28.6
	47.3	26.0	13.8	27.9	6.3	-28.9	37.2	24.5	2.1	17.9	32.4	4.9	1.4	12.0	21.8
	46.0	22.4	13.1	23.5	5.9	-33.8	28.5	21.2	0.6	17.8	28.3	4.2	1.0	11.6	20.9
	41.8	22.2	7.0	22.2	5.5	-36.8	27.2	19.2	0.4	17.5	26.0	1.9	0.9	8.4	14.6
	36.2	18.3	4.9	19.8	3.6	-37.0	26.5	15.5	-4.2	17.1	21.7	1.2	0.2	8.0	13.7
	30.0	16.5	4.7	18.4	2.5	-39.2	20.6	15.1	-5.5	16.3	1.2	0.2	-3.8	6.7	7.8
	28.7	10.9	4.6	15.8	-0.2	-44.3	19.7	3.8	-10.6	16.0	0.6	-1.8	-4.4	4.7	3.8
	2.0	2.7	3.1	4.3	-1.6	-45.6	2.3	3.7	-15.5	2.1	0.3	-5.0	-7.5	1.5	1.1
	1.9	1.3	2.4	4.1	-9.8	-47.8	0.8	2.0	-16.4	0.9	-0.1	-5.4	-8.0	1.0	0.7
Lowest Return	1.5	0.8	1.3	3.8	-17.6	-53.2	0.2	0.8	-18.2	0.2	-2.3	-5.6	-14.6	0.8	0.6

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
US Large Cap	28.7	10.9	4.9	15.8	5.5	-37.0	26.5	15.1	2.1	16.0	32.4	13.7	1.4	12.0	21.8
US Large Cap Value	30.0	16.5	7.0	22.2	-0.2	-36.8	19.7	15.5	0.4	17.5	32.5	13.5	-3.8	17.3	13.7
US Small Cap	47.3	18.3	4.6	18.4	-1.6	-33.8	27.2	26.9	-4.2	16.3	38.8	4.9	-4.4	21.3	14.6
US Small Cap Value	46.0	22.2	4.7	23.5	-9.8	-28.9	20.6	24.5	-5.5	18.1	34.5	4.2	-7.5	31.7	7.8
US Real Estate	36.2	33.2	13.8	36.0	-17.6	-39.2	28.5	28.1	9.4	17.1	1.2	32.0	4.5	6.7	3.8
International Large Cap Value	41.8	22.4	13.1	29.6	7.9	-44.3	37.2	3.8	-10.6	17.8	21.7	-5.6	-8.0	8.0	20.9
International Small Cap	62.6	29.9	25.5	19.8	3.6	-47.8	51.4	24.9	-15.5	17.9	26.0	-5.0	5.8	4.7	31.5
International Small Cap Value	60.2	34.2	21.1	27.9	2.5	-45.6	53.3	21.2	-16.4	20.1	28.3	-5.4	1.5	8.4	28.6
Emerging Markets	56.3	26.0	34.5	32.6	39.8	-53.2	79.0	19.2	-18.2	18.6	-2.3	-1.8	-14.6	11.6	37.8
One-Year US Fixed	1.5	0.8	2.4	4.3	5.9	4.7	0.8	0.8	0.6	0.2	0.3	0.2	0.2	0.8	0.6
Five-Year US Government Fixed	2.0	1.3	1.3	3.8	8.2	8.8	0.2	3.7	3.4	0.9	-0.1	1.2	0.9	1.0	0.7
Five-Year Global Fixed	1.9	2.7	3.1	4.1	6.3	6.6	2.3	2.0	2.3	2.1	0.6	1.9	1.0	1.5	1.1

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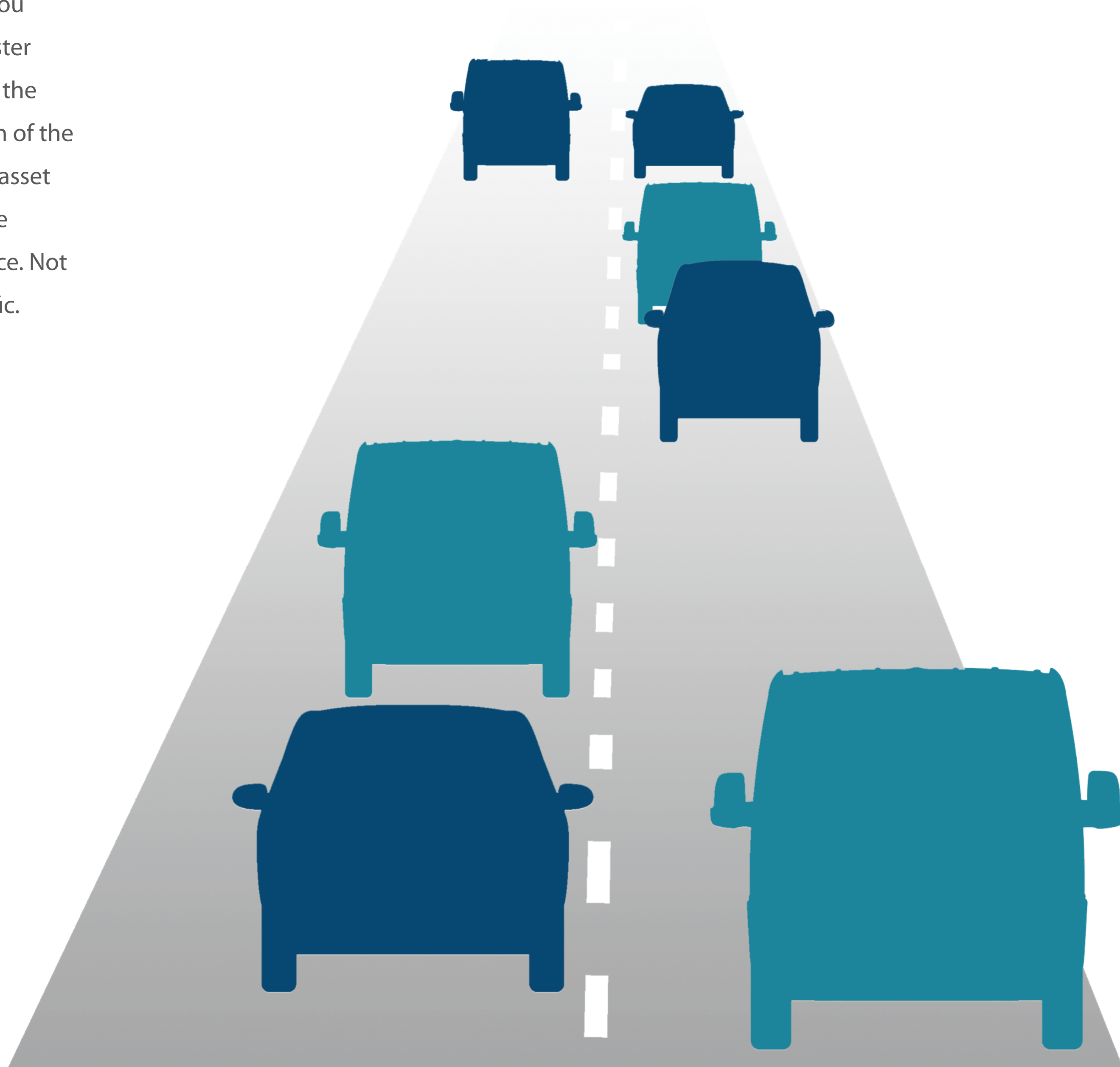
Picking the Fastest Lane

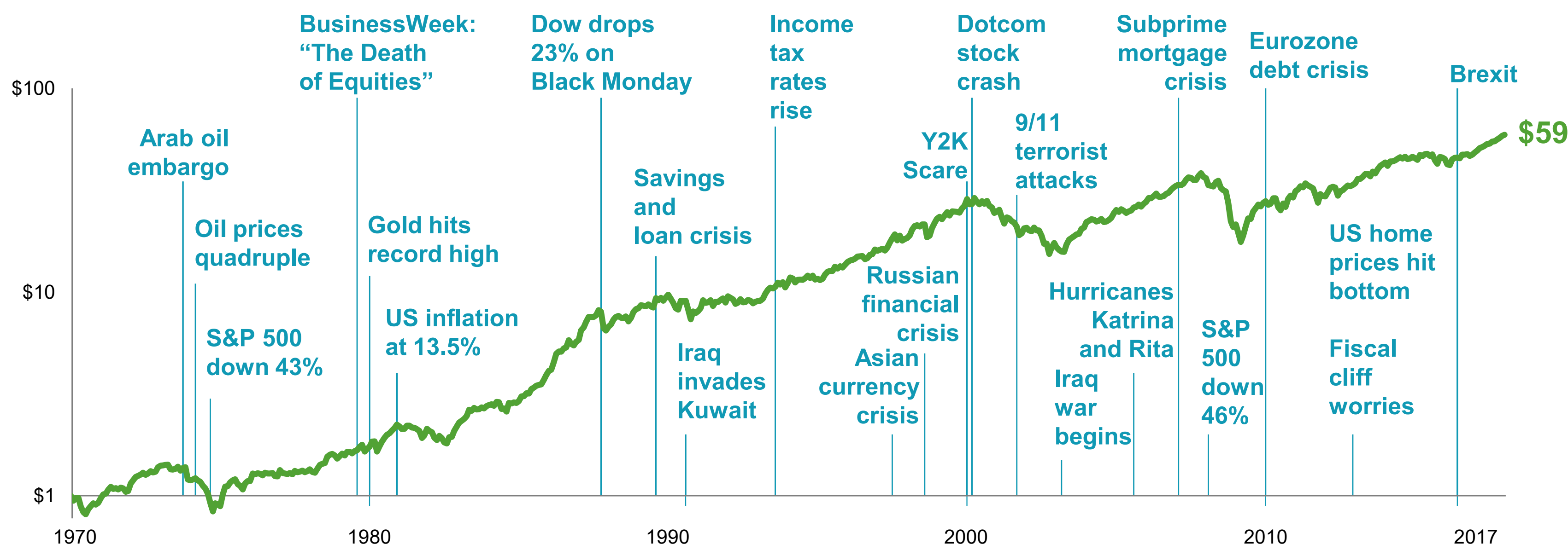
I'm sure most of you have had the experience of a traffic jam. I'm also sure some of you believe you know how to maneuver through the traffic faster than the average driver, right? I hope you see the similar feat of trying to anticipate the direction of the market in the short-run or anticipating which asset class will outperform this year as adding to the anxiety and stress of the investment experience. Not unlike the stress of weaving in and out of traffic.



This slide illustrates the historical road blocks which caused temporary market declines. All of these crises or events were real. However, unless there is global Armageddon, what we fail to see during the crisis are the underlying economics. The equity mutual funds we own aren't poker chips. They are a conduit to ownership of many great global businesses that provide goods and services we need to perform our jobs and live our lives. Investors who use a disciplined process to own these companies historically have been rewarded.

Markets Have Rewarded Long Term Investors

Growth of a dollar—M SCI World Index (net dividends), 1970–2017



A disciplined investor looks beyond the concerns of today to the long-term growth potential of markets.

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Pursuing a Better Investment Experience

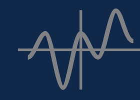
In closing, we encourage you to focus on what can be controlled. The three principles we live by are:

1

Create a plan centered on the client's needs and risk tolerance

2

Diversify globally and use multiple asset classes of stocks, bonds and real estate



3

Stay disciplined through market ups and downs

We believe the greatest risk to a portfolio isn't the market itself. Instead, it's the innate human emotions we feel such as fear and greed. Luckily, human genetics also provides us with superior reasoning skills. If you find your emotions taking over give us a call. It's our job to remain steadfast and provide reassurance. We are continually monitoring your plan, keeping it broadly diversified, and staying disciplined.

Investing involves risks including possible loss of principal. International investing involves special risks such as currency fluctuation and political instability. Investing in emerging markets may accentuate these risks. Diversification does not eliminate the risk of market loss This is for informational purposes only and is not to be construed as investment or tax advice. Talk to your financial advisor prior to making an investment decision.