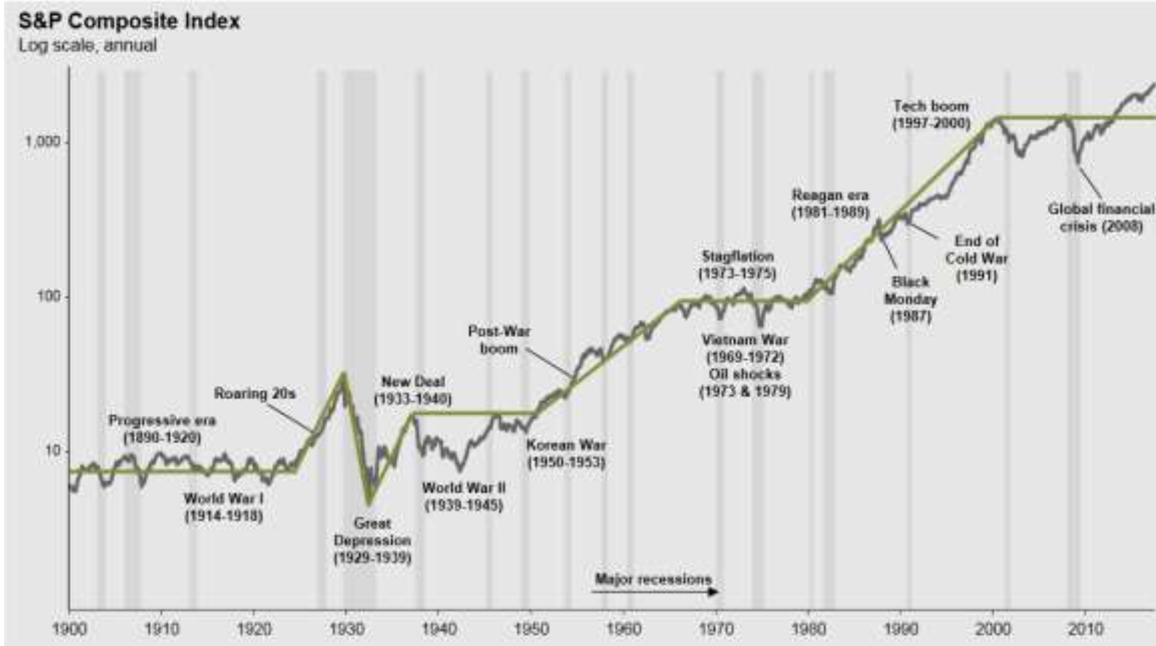
Don't Time the "Fire and Fury"

While geopolitical risks always exist, sometimes these risks appear on the front page of newspapers as world leaders display a more public dialogue for various reasons. Other times, these risks are more hidden as tensions between nations remain concealed from public view. Regardless of how visible these risks appear, they are always there. Currently, the dialogue between the United States and North Korea is very public and contentious. The two countries are hardly allies and, if you remember, George W. Bush even included North Korea in the "axis of evil" with Iran and Iraq over 15 years ago. More recently, Donald Trump said that North Korea "best not make any more threats to the United States" or "they will be met with fire and fury like the world has never seen." North Korea countered by threatening to launch test missiles that would land in the waters off of Guam, a U.S. territory. In addition, North Korea has been testing intercontinental ballistic missiles that may have the capacity to reach the United States. Again, North Korea did not develop these capabilities overnight and the risks that North Korea poses to the United States and its allies have existed for a long time. While the investment implications may pale in comparison to other grave concerns a conflict between these nations may pose, it is important to consider them.

Clearly, global markets are not ignoring this potential conflict. August 10th was the eighth largest one day percentage increase in the VIX, a common measure of market risk and volatility, since 1990. So the market is clearly reacting to this uptick in rhetoric and test missile launches. Defensive asset classes such as gold and bonds have risen in value, sending bond yields lower. In addition, equity markets have pulled back. Some investors may be inclined to sell equities and/or buy defensive assets, while others may see some of these pullbacks as a buying opportunity. Timing these opportunities can be difficult though. Knowing when to sell or when to buy during market volatility is a tough task. Volatility will create opportunities and some will get the timing right. Keep in mind, one could get the first side of the equation right and sell before a bottom, but one still has to get the second side of the equation correct and know when it's time to buy back into the market. This was a problem for many investors in 2008, as some sold and never returned, missing the market rebound. Nine years later, some investors may still be waiting for another pull back to buy. Inevitably, there will be investors that time a pullback correctly and we will read about them, but these will be the exceptions and we will not read about the ones who timed it incorrectly. A good analogy of this could be a friend that likes to gamble. We are likely to hear about their big wins, but less likely to hear about their big losses. We see evidence of this in investor returns year after year as mutual fund returns outperform investors invested in them. Meaning, investors tend to get the timing wrong. They buy a mutual fund after it has already gone up and they sell a mutual fund after it has already gone down.

While it is easy to get distracted from long-term objectives, both return as well as risk objectives, it is important to not stray too far from these goals. Taking too much risk with a short time horizon can cause one to retire with not enough assets. Likewise, taking too little risk with a long time horizon can result in the same situation. Volatility can often be short lived and, as we discussed, hard to time. Below is a chart of the S&P 500 over time. You can see different eras, both good and bad, overlaying the graph. A long-term investor who stayed invested through the volatility benefited from staying invested. Conservative investors with a shorter time horizon should hold less equity. If there is a pullback, they have less time and ability to gain from a rebound as they may be withdrawing assets. We continue to believe that one should stay close to stock, bond and cash allocations consistent with long term objectives. Staying diversified within both fixed income and equities is important, and we also recommend supplementing portfolios with lower correlated alternative assets and styles to buffer both equity and fixed income risks. While we recommend being relatively shorter in duration on the fixed income side, we still recommend having exposure to interest- rate sensitive bonds for times such as this.



Source: FactSet, NBER, Robert Shiller, J.P. Morgan Asset Management.
Data shown in log scale to best illustrate long-term index patterns.
Past performance is not indicative of future returns. Chart is for illustrative purposes only.
Guide to the Markets – U.S. Data are as of June 30, 2017.

Source: J.P. Morgan

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