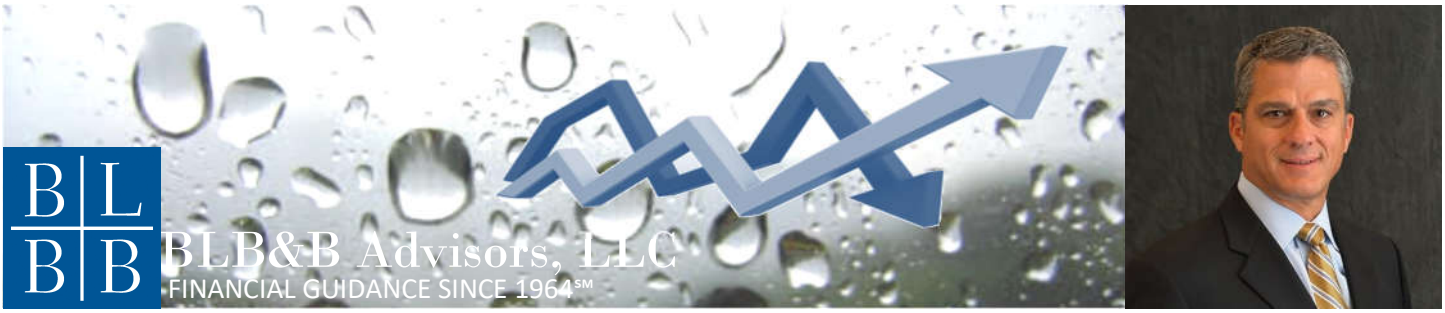

Weatherproofing your financial portfolio for market volatility

Over the last several months, the dreaded "R" word has crept into the news. As you would expect, economists and market analysts are on both sides of the fence as to whether a recession or market correction is on the horizon. Recently Robb Parlanti, CFA, a 30-year market veteran and financial advisor here at BLBB Advisors, was asked to write a guest blog on this topic for our friends at the accounting and consulting firm of Drucker & Scaccetti. Below is that Q&A exchange:

Q: *I am worried financial markets will fall significantly. What can I do to prepare myself?*

Robb: It is important to keep 3 things in mind:

1) Financial markets regularly go through up-and-down periods. While it can be unsettling, investors are generally best served by remaining calm, staying the course, and not succumbing to any feelings of panic.

2) History shows us that market corrections, where market indices fall by 10% or more from recent highs, happen about once a year. Bear markets, where market indices fall by 20% or more from recent highs, occur about once every 3 – 4 years. They are a normal part of market activity. History also shows us that corrections last on average about 14 weeks while bear markets tend to last about 14 – 15 months.

3) Maintaining an appropriate asset allocation mix inside your portfolio can help insulate you from market volatility and help you financially weather difficult market periods.

Q: *Should I sell out my portfolio if the financial markets start to drop?*

Robb: My short answer is "no." We follow a famous market tenet – "Time in the market is more important than timing the market" – Unknown

Attempting to "time the market" by getting in or out based upon your beliefs as to what market returns <u>might be</u> at some unknown point in the future is a high-risk strategy. Particularly in times of market stress, it can be tempting to give in to your fears and emotions, sell everything, and go to cash. However, after a period of market stress has passed, it is common for market timers to realize they ended up selling at or near market lows and then are sitting in cash. To make matters worse, market timers also tend to miss the early stages of market turnarounds because they are nervous about reinvesting. The market timing mentality and the emotions that go along with it are often key reasons why investors frequently underperform the market and fail to meet their investment goals.

If you find yourself tempted to time the market, keep in mind this quote from famed investor Peter Lynch, "Far more money has been lost by investors preparing for corrections than has been lost in the corrections themselves."

Q: *Is it possible to prepare my portfolio for a correction or bear market?*

Robb: The short answer is "Yes!" You can prepare your portfolio for periods of negative market performance by working with a financial advisor to build and maintain a comprehensive and dynamic financial plan that is fully integrated into the management of your assets and your financial life.

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Q: *What is a financial plan?*

Robb: A financial plan is an understanding of your long-term goals and short-term needs combined with strategies designed to protect and grow your assets and support these goals and needs. Consider employing a goals-based approach to planning. We help our clients identify various personal and financial goals they hope to achieve such as:

- Maintaining their current lifestyle
- Not outliving their assets in retirement
- Sending their children and grandchildren to college
- Retiring early
- Managing risk
- Leaving an inheritance and/or a philanthropic legacy

First, we evaluate your current financial status and circumstances. Next, we identify and prioritize your personal and financial goals. Lastly, we assess the likelihood of achieving these goals over time and in different market and economic environments. We also coordinate with your other trusted advisors – your estate attorney, tax advisor, insurance advisor, etc. – to ensure that all aspects of your financial life are managed and in sync with each other. Keep in mind, your goals and circumstances may change over time but your financial plan should also evolve and adapt accordingly. A financial plan also helps identify your appropriate asset allocation mix without unduly exposing you to risk.

Q: *How can a financial plan help me prepare for a financial market downturn?*

Robb: One of the key components of a financial plan is an overall assessment of both your financial and emotional ability to tolerate volatility in financial markets.

Understanding how your portfolio might perform and what your finances might look like if we entered a sharp market downturn enables you to make better financial decisions and helps you resist the temptation to sell should financial markets plummet. Also, because a financial plan includes provisions for your liquidity needs over the coming 12 – 24 months and beyond, you should be well positioned to ride out periods of market volatility. Financial planning introduces some structure and discipline into this inherently nebulous and unpredictable arena and helps remove your emotions from the equation.

Q: *What else can I do to prepare myself for a possible down market?*

Robb: After financial planning has identified an appropriate asset allocation, it is important to monitor how your assets are allocated over time and to rebalance when needed. Keep in mind that your asset allocation mix is responsible for a majority of the return and risk exposure in your portfolio.

Rebalancing your portfolio means adjusting your holdings to ensure your desired asset allocation mix is maintained over time. Failing to rebalance could leave you overexposed to some asset classes, underexposed to others, increase your portfolio risk, and reduce your portfolio returns.

Q: *A good financial plan and not panicking seem to be the key to preparing for the unexpected, correct?*

Robb: Exactly:

- Have a financial plan and anticipate staying invested for the long run.
- Stay the course with a well-constructed and diversified portfolio that can withstand the inevitable market downturns. Emotions have ruined more portfolios and financial plans than most other mistakes.
- Market declines are often healthy – they reset expectations and ultimately have led to recoveries and wonderful long-term opportunities to buy stock in excellent companies at very favorable prices.
- Stay well informed, but unemotional and disciplined, with portfolio changes and financial moves.
- Consider adding to your portfolio after precipitous declines to take advantage of others' irrational selling.

It doesn't take much to make the markets nervous. Talk of recession puts investors on edge, no doubt. If you have any questions about the Q&A above or would like to discuss specific circumstances, please do not hesitate to contact your BLBB financial advisor at 215-643-9100 or via their email.