

Expert Perspective

September 2022

2022 market decline continues We are here for you!

Introduction

The path to financial success is a journey. And, though each client journey is unique, what they often have in common is that they're long—at times over rough terrain—with various distractions along the way.

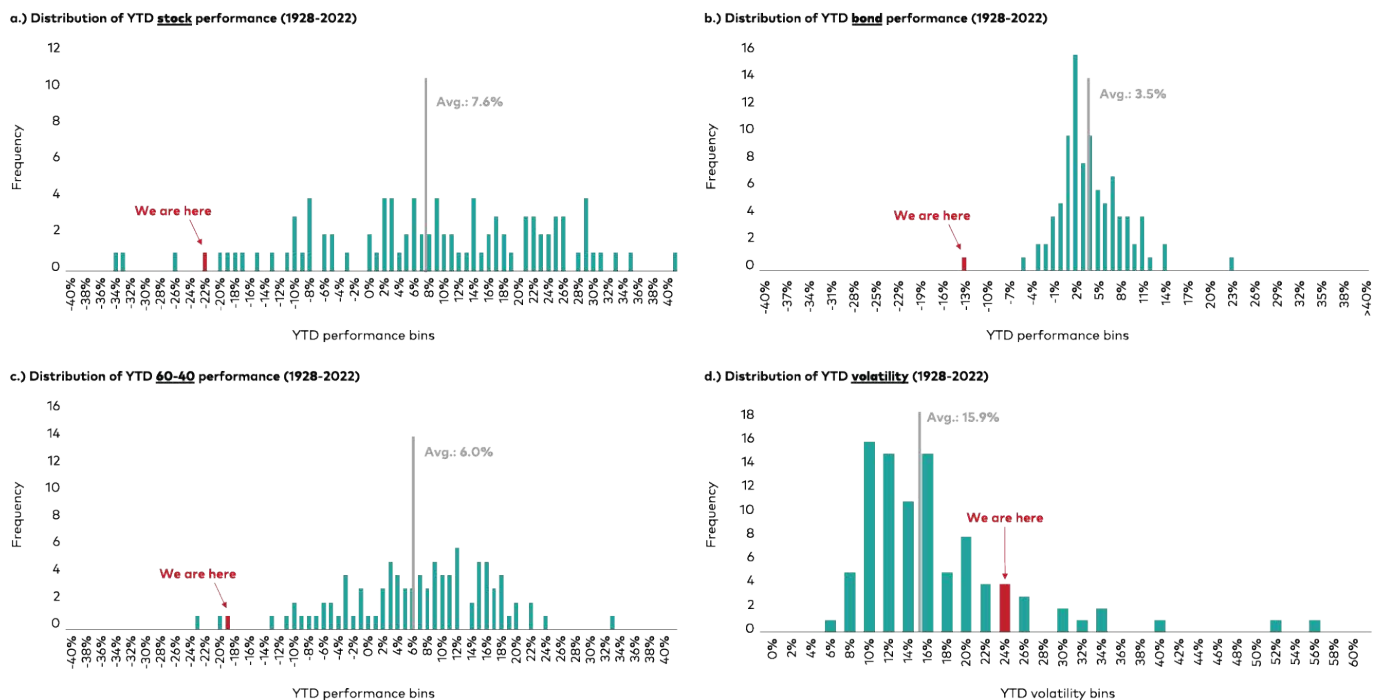
The year 2022 has served as a stark reminder of why so many investors seek a trusted advisor to help them navigate their financial journeys. Amid such rough patches, investor emotions can easily crowd out wisdom and long-term thinking. However, with an advisor by their side, clients can improve their chances of staying on the path they've charted and reaching their long-term destination.

Ultimately, staying the course is hard, but Vanguard Financial Advisor Services™ is here for you—every step of the way.

Through almost three quarters, 2022 market performance is among the worst we have seen

Through September 23, 2022, returns of stocks and bonds have been bad. Stocks are down over 22% and bonds have declined over 13%. In addition to the negative returns, volatility has been high and inflation has risen to levels not seen in 40 years. As shown in the figures below, stocks, bonds, and a balanced 60/40 portfolio are all having one of their worst starts to the year since 1928.

Figure 1: Cumulative performance and annualized volatility from January through September going back to 1928



Notes: Figures 1a. through c. show the cumulative performance from January through September each calendar year going back to 1928. "We are here" performance is 2022 year-to-date through September 23. Figure 1d. shows the annualized volatility for the first 183 trading days of stocks each year.

Sources: Figures 1a. –c.: Stocks: S&P 90 Index from 1928 through 1956; S&P 500 Index from 1957 through 1970; Wilshire 5000 from 1971 through April 22, 2005; MSCI US Broad Market Index through June 2, 2013; CRSP US Total Market Index thereafter. Bonds: IA SBBI U.S. Intermediate-Term Government Bond Index through 1972; Bloomberg U.S. Government/Credit Intermediate-Term Index from 1973 through 1975; Bloomberg U.S. Aggregate Bond Index thereafter. Figure 1d.: S&P 90 Index from 1928 to 1956; S&P 500 Index from 1957 through September 23, 2022.

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Decision horizon is not the same as holding period horizon

Recent performance has been disappointing, to say the least. However, it's important to not let emotional responses to portfolio volatility and drawdowns distract from your client's long-term financial objectives. Most investors, including professional asset allocators, did not see the inflation or market declines coming. In looking at the Vanguard Investment Advisory Research Center Risk Appetite, we see risk appetite was running at five-year highs in the spring of 2022. So dollars invested in the capital markets were invested aggressively relative to their past positioning.

Ultimately, most investor objectives require a portfolio that is reasonably expected to earn a positive real return. This return requirement coupled with what is often decades-long time horizons necessitates some amount of risky assets in the portfolio. In difficult market environments such as these, portfolio performance can be stressful, but the trade-off to temporary emotional discomfort is the greater likelihood of meeting long-term return objectives.

As Figure 2 below shows, the probability of achieving real returns increases with the holding period horizon. While the future may not represent the past, when looking at the past, since 1928, neither stocks nor a 60/40 balanced portfolio have experienced a 20-year period with negative real returns. Going forward, the markets have been good at pricing in real returns that align with the risks and volatility. If this were to continue, we would expect risky assets to outperform lower risk assets.

However, to realize those results, advisors must keep their clients from shortening their holding horizon to match their decision horizon. Decision horizons are shorter and often based on loss aversion, emotions, and recency versus long-term thinking. While allowing clients to act on shorter decision horizons may avoid some near-term volatility, the reality is that they are likely introducing a much greater and permanent risk into the portfolio: goal risk, which is the risk of falling short of their long-term financial objectives.

Figure 2. Success improves with holding period horizon

| | 1-year | 3-year | 5-year | 10-year | 20-year |
|--|---------------|---------------|---------------|----------------|----------------|
| Probability stocks have positive real return | 70% | 78% | 80% | 87% | 100% |
| Probability bonds have positive real return | 65% | 71% | 72% | 74% | 76% |
| Probability 60/40 has positive real return | 71% | 80% | 86% | 90% | 100% |

Notes: Periods analyzed are rolling monthly periods from January 1928 through August 2022.

Sources: Stocks: S&P 90 Index from 1928 through 1956; S&P 500 Index from 1957 through 1970; Wilshire 5000 from 1971 through April 22, 2005; MSCI US Broad Market Index through June 2, 2013; CRSP US Total Market Index thereafter. Bonds: IA SBBI U.S. Intermediate-Term Government Bond Index through 1972; Bloomberg U.S. Government/Credit Intermediate-Term Index from 1973 through 1975; Bloomberg U.S. Aggregate Bond Index thereafter.

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Vanguard Financial Advisor Services is here to help

While we don't know what the future will bring with the markets, we do want you to know that Vanguard Financial Advisor Services is here for you. Today, our offer includes custom portfolio analysis and consultations, low-cost high-quality funds, access to product specialists, turnkey model portfolio solutions, personalized indexing, and, most recently, investment research, through the launch of our Investment Advisory Research Center.

While we know 2022 has been extremely challenging, and we do not know what the future holds, please know we are here to help you and your practice navigate what may come. Often a second voice using a research-driven message can help. Please let us know what you need and how we can help.

Special thanks to David Walker and Ted Dinucci for contributing to this article.

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