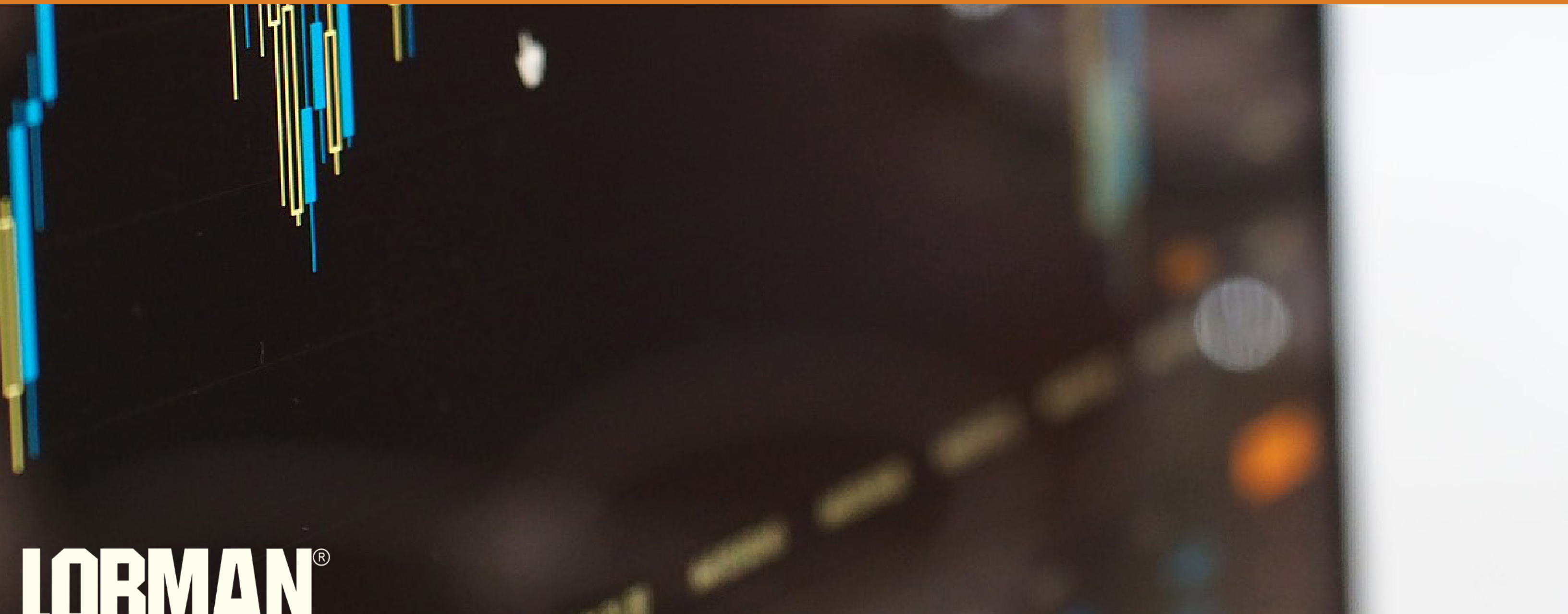
What to Expect During the Next Stock Market Decline ... and Subsequent Recovery

Prepared by:
Craig L. Israelsen, Ph.D.
7Twelve® Portfolio



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Craig L. Israelsen, Ph.D.
7Twelve® Portfolio
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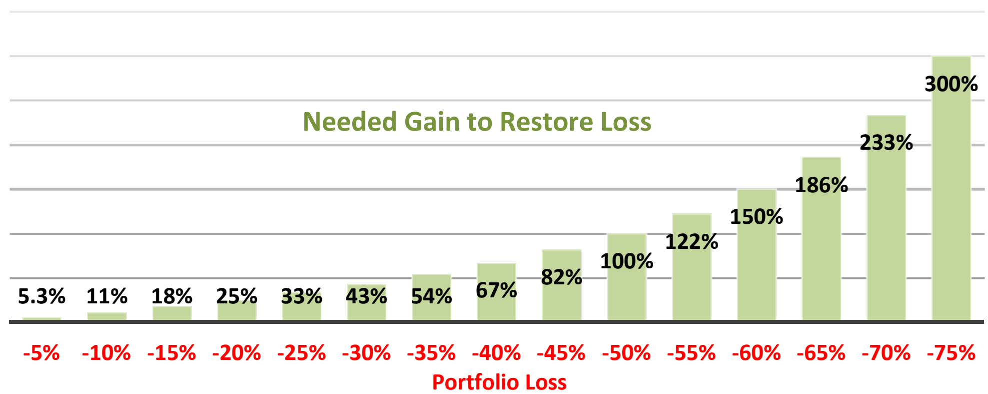
Portfolio losses don't play fair—it takes a proportionally bigger gain to break even.

As shown in the graph below, as the loss gets bigger, the needed gain to restore the loss increases at an increasing rate. For example, a portfolio loss of 35% requires a 54% (technically 53.8%) cumulative gain to restore the portfolio to its value prior to the loss. **Translation: the primary goal of a diversified investment portfolio should be to provide a reasonable rate of return while minimizing the frequency and magnitude of losses.**



Remember 2008? The S&P 500 Index (a popular index measuring the overall performance of large US companies) lost 37% that year. However, a diversified portfolio of US stock, non-US stock, real estate, commodities, bonds, and cash fared better with a loss of only 27.6%. From the graph above we can see that a loss of 35% (similar to the loss of the S&P 500 Index in 2008) requires a 54% gain to break even whereas a loss of 25% requires only a 33% gain to break even. In other words, a diversified investment portfolio made the road to recovery quicker.

Probability of Recovery Within 36-months*

Loss	Needed Gain to Break Even	S&P 500 Index	Diversified Portfolio (Equal Mix of 7 Mutual Funds)
-5%	5.3%	83.4%	87.5%
-10%	11.1%	80.4%	83.6%
-15%	17.6%	77.8%	80.9%
-20%	25.0%	75.6%	67.7%

**Probabilities of recovery calculated using historical rolling 36-month cumulative returns from 1980-2016.*

Stock markets go up and down, real estate markets go up and down, bond markets have ups and downs….every type of investment experiences ups and downs. It's important that investors have a steady hand on the wheel during periods of market volatility. Don't over-react to declines in your investment portfolio—it will recover.

Based on my analysis of performance over the past 37 years, there is a 6% chance the US stock market (the S&P 500 Index) will lose up to 15% in a 12 month period. Interestingly, there is only a 3% chance that a well-diversified portfolio will experience a 15% loss during a 12 month period. Diversification lowers the likelihood of experiencing nasty portfolio losses.

But, losses will occur at some point for every investor. The question is how quickly will your portfolio recover? Let's say your diversified portfolio experiences a loss of 15%. The good news is that there is an 80.9% chance that it will fully recover within 36 months (see table above). So, before panicking remember that successful investors are steady through the storm. **Be that investor.**