WELLS FARGO ADVISORS

Navigating Volatility: The Long-Term Perspective

Portfolio Perspectives

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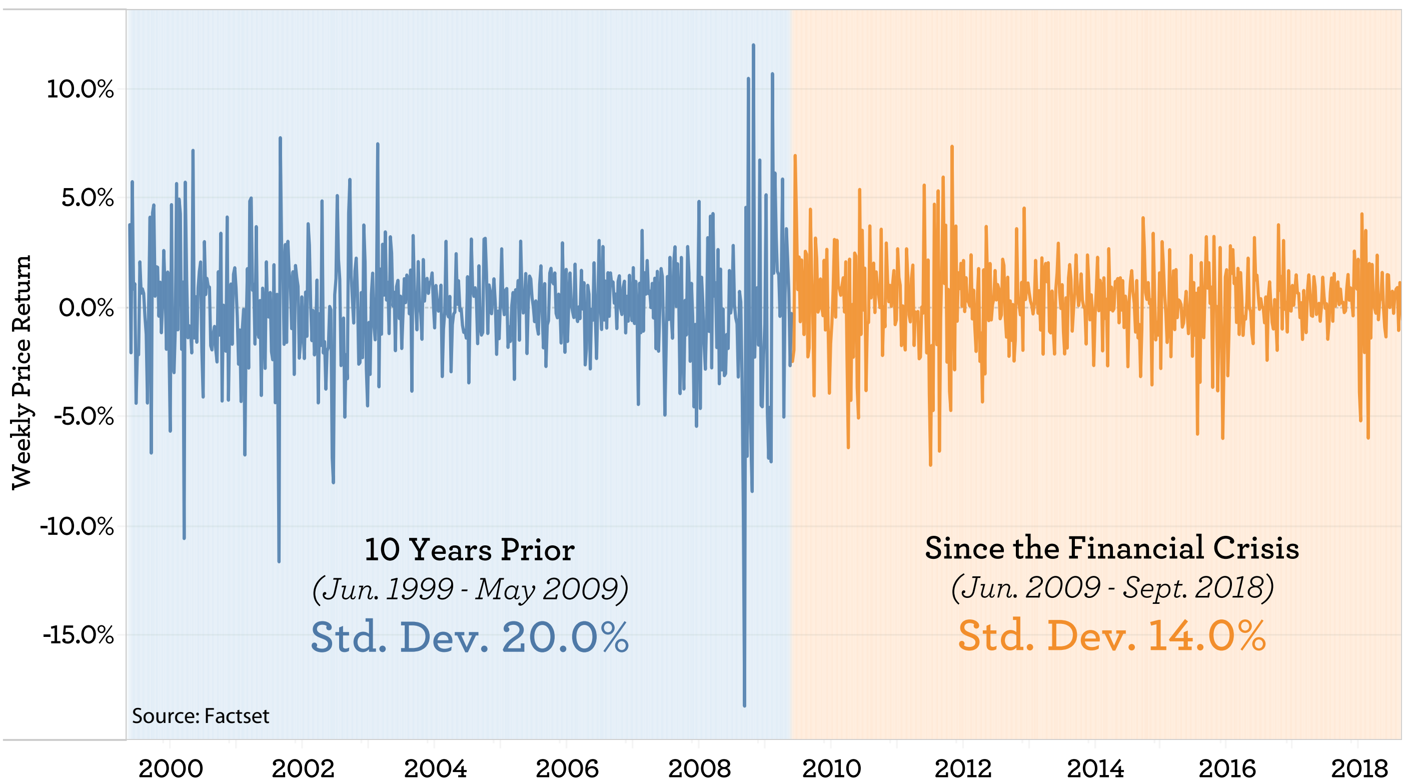
Since the financial crisis of 2007-2008, investors have enjoyed a period of robust stock returns and the longest bull market on record. The last decade has also been characterized by abnormally smooth and consistent returns due to a lack of volatility. Historical data, however, suggests that investors should avoid complacency. The Wells Fargo Investment Institute (WFII) has recently cautioned that as the current expansion matures, this stretch of calm may give way to more volatility in stock market performance. Therefore, it is time to consider how your financial goals could be impacted by a changing market landscape.

S&P 500 Index Volatility (Jun. 1999 - Sep. 2018)



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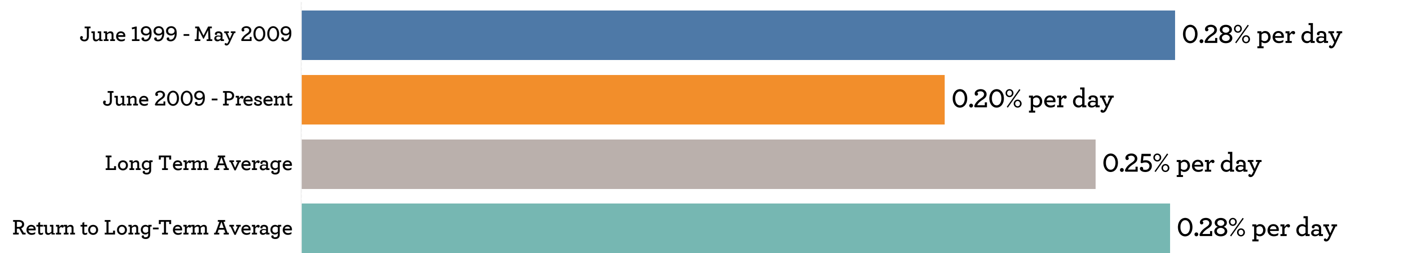
Volatility is Normal

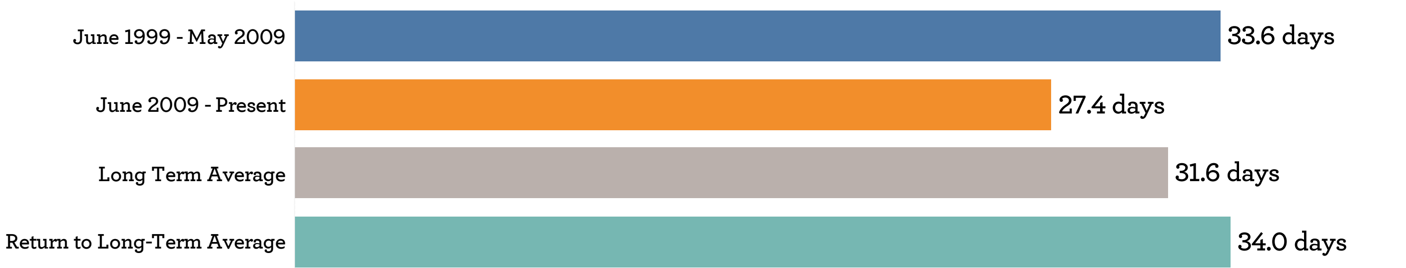
The concept of 'mean-reversion' relates to the idea that trends tend to converge with their long-term averages over time. Sharp daily swings in the S&P 500 Index (whether they be up or down) can have a notable impact on investor psyche, as they are widely covered by the news media. If these events occur more frequently, investors can feel greater uncertainty about their portfolio. Moreover, market volatility sometimes leads to investors making reactionary changes in their investments that have the potential to derail their plan. This, in turn, could affect the likelihood of achieving long-term financial goals. The following charts show what investors could experience if the S&P 500 Index reverts to its historic levels of volatility.

Return to Long-Term Average: Describes a hypothetical 10-year period that would bring market volatility back in line with its historical averages.

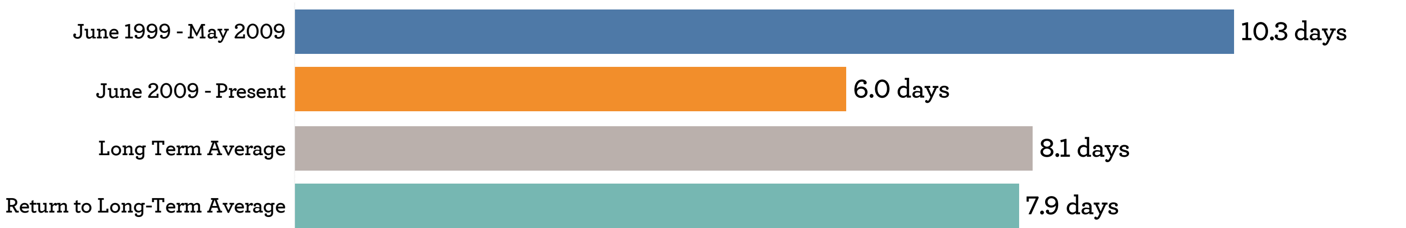
Average S&P 500 Daily Movement



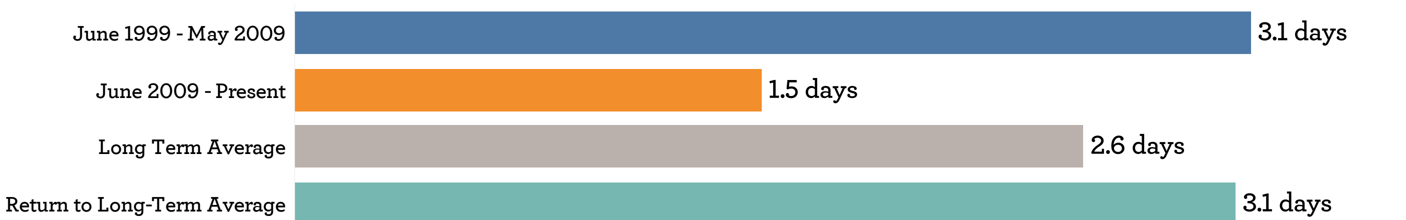
Average Number of 1% Daily Moves in S&P 500/Yr



Average Number of 3% Daily Moves in S&P 500/Yr



Average Number of 5% Daily Moves in S&P 500/Yr

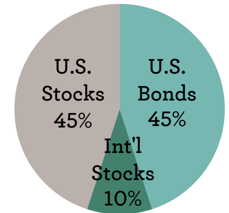


All Charts Source: Factset

Time in the market, not *timing* the market

Although increased levels of volatility can be concerning, investors should be careful not to interpret larger swings in the market as a sign to run for the exit. Taking a long-term approach to investing is likely to lead to better outcomes than trying to time the market. To illustrate this point, below is a hypothetical scenario comparing two portfolios starting each with $1 million just before the '08-'09 financial crisis:

Both investors Blue and Orange began with a three-asset class portfolio consisting of 45% U.S. Stocks, 45% U.S. Bonds, and 10% International Stocks. Investor Orange sat down with a financial advisor, and decided to remain invested in the market during the fall of 2008 when volatility spiked. Investor Blue, on the other hand, exited the market just before the worst of the financial crisis and stayed out for two years.



The Importance of Staying Fully Invested

Portfolio Value

$2.0M
$1.5M
$1.0M

Orange ends with $500,000 more than Blue

Orange experiences the worst of the financial crisis, but also the subsequent recovery

Blue experiences a decline and exits the market for two years

1,418
735
1,187
1,426
2,003
2,126
2,914

S&P 500 Index

2008 2010 2012 2014 2016 2018

$1.5M Investor Blue

$2.0M Investor Orange

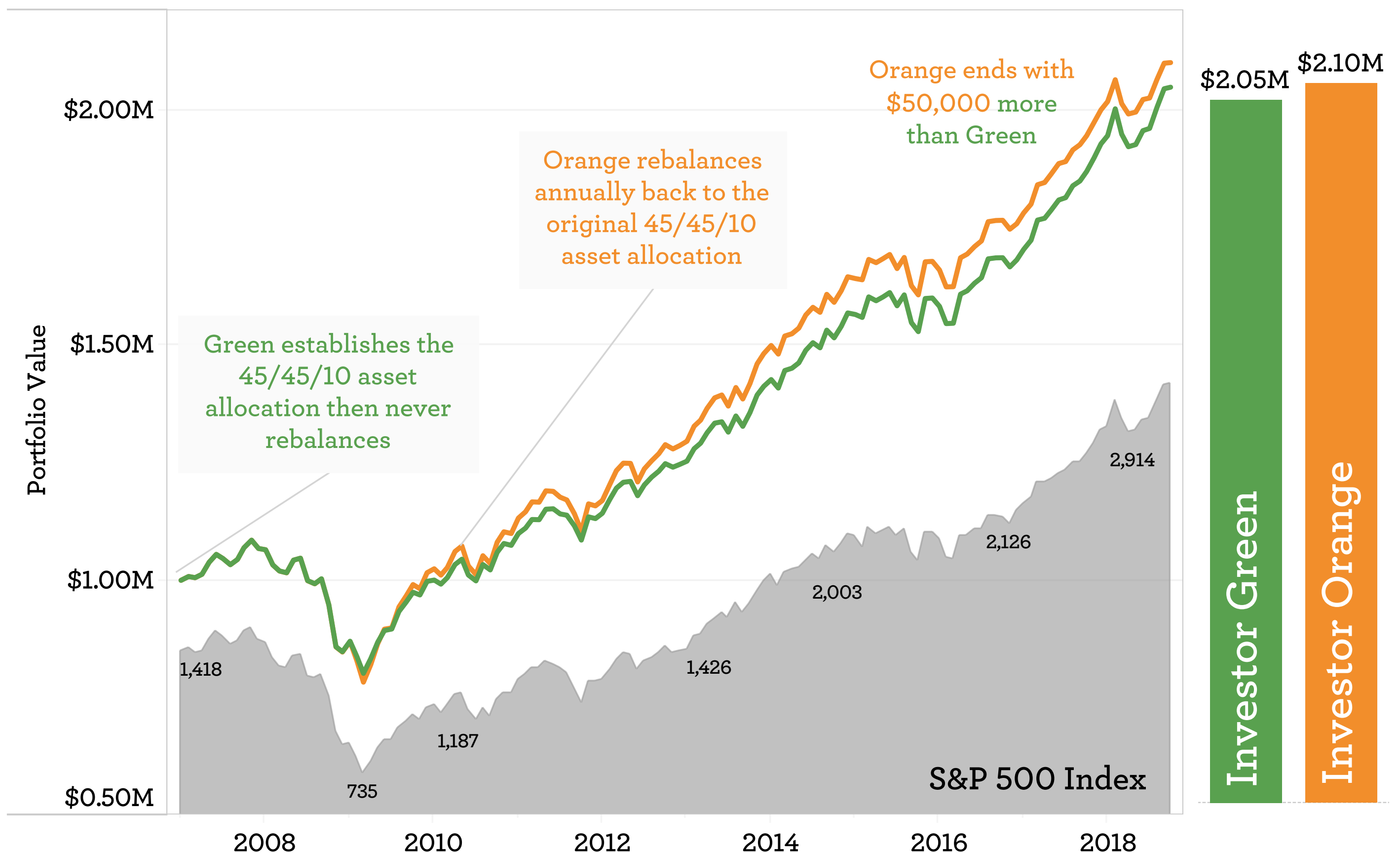
This information is hypothetical and is provided for informational purposes only. It is not intended to represent any specific return, yield, or investment, nor is it indicative of future results. See disclosure section for important information related to charts.

Through the end of September 2018, Investor Orange would have a portfolio worth $2.0 million. Investor Blue's portfolio would have an ending value of $1.5 million. The disparity in the results is striking. Although Blue did not experience the worst of the financial crisis, as did Investor Orange, Blue missed gains on the way up by not being fully invested. By sticking to a plan, Investor Orange is left with over 30% more assets for retirement than Investor Blue.

Set it and forget it? Not so fast

In addition to staying invested, it is also important for investors to ensure that their portfolios don't drift too far from their plan. Take, for instance, Investor Orange from the previous example compared to a new Investor Green. Investor Green stayed invested throughout the downturn. But unlike Investor Orange, Green adopted a "Set It And Forget It" approach, and did not rebalance his portfolio back to his original mix of 45 % U.S. Stocks, 45 % U.S. Bonds, and 10% International Stocks. Investor Orange sat down with a financial advisor annually and rebalanced her portfolio each year back to the 45/45/10 mix . Let's look at the results of Orange's portfolio with annual rebalancing versus no rebalancing over the same period between 2007-2018.

The Importance of Maintaining Your Allocation



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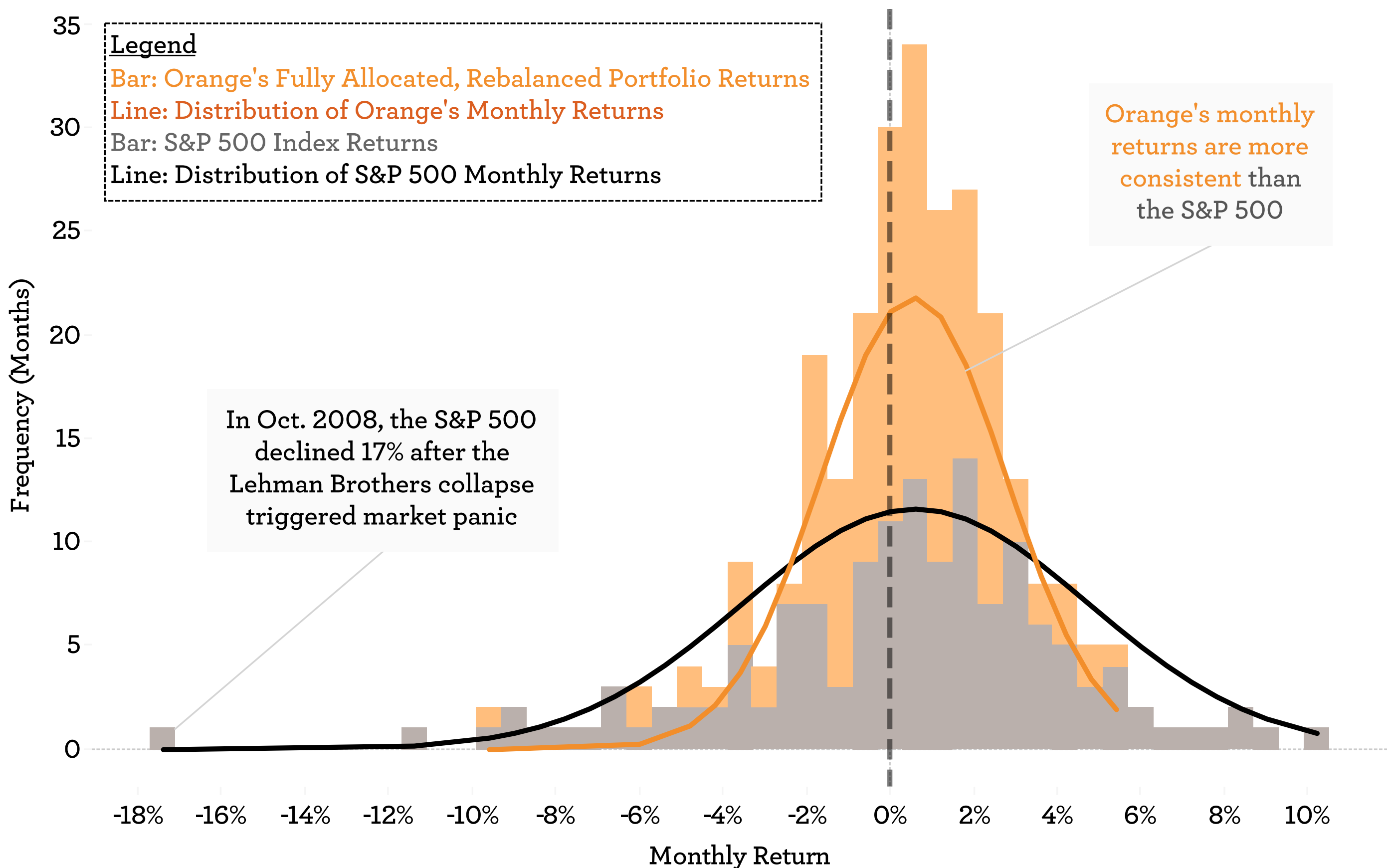
Initially, the two portfolios experience similar performance. But over time, Green's portfolio began drifting more and more away from his target. After a decade, Investor Orange's careful adherence to rebalancing pushed her portfolio $50,000 higher than Investor Green's.

The previous two examples show that a portfolio which is not well-allocated nor maintained periodically through rebalancing can ultimately underperform. Your financial advisor has the tools available through your Envision® Plan to help keep your portfolio on track in an effort to provide the best chance of achieving your financial goals.

Slow and steady...

The combination of asset allocation and periodic rebalancing provides more consistent results. The chart below shows Investor Orange's monthly portfolio returns compared to those of the S&P 500 Index. The spread of the black and orange curves depicts the consistency of returns over time. Consistency contributes to better likelihood of achieving the financial goals set out in your Envision® Plan.

Monthly Returns Comparison - Efficient Portfolio vs. S&P 500 (Jan. 2007 - Sep. 2018)



Bringing it all together

Although the future is uncertain, investors can take action now to prepare for higher volatility. Laying the groundwork involves establishing a plan, implementing it with the help of a trusted advisor, while also monitoring the plan and periodically making adjustments. Financial goals become more achievable, market volatility less menacing, and investors more at ease knowing they have given their portfolio the time and attention it requires, so that funds will be there for them when they need it.

"Change is the law of life. And those who look only to the past or present are certain to miss the future."

- John F. Kennedy

Talk to your financial advisor to see what adjustments, if any, you may want to make to your plan or your portfolio to keep you prepared for the future.

CHART INFORMATION

All portfolios (Investor Blue, Investor Orange, Investor Green) are represented by 45% S&P 500 Index, 45% Bloomberg Barclays Aggregate Bond Index and 10% MSCI World ex U.S. Index.

All portfolios are hypothetical and for illustrative purposes only. Hypothetical results do not represent investment returns or actual trading. Index returns reflect general market results, assume the reinvestment of dividends and other distributions, and do not reflect deduction for fees, expenses or taxes applicable to an actual investment. Past performance does not guarantee future results.

The Importance of Staying Fully Invested:
Investor Blue who exits the market, does so for the 24 months between Dec. 31, 2008 and Dec. 31, 2010.

The Importance of Maintaining Your Allocation Chart:
Investor Orange, who rebalances back to the original 45/45/10 asset allocation does so once annually on Dec. 31 of each investing year.

DISCLOSURES

All investing involves risk, including loss of principal. Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments. An investment in the stock market should be made with an understanding of the risks associated with common stocks, including market fluctuations. Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets. Investments in fixed-income securities are subject to interest rate, credit/default, liquidity, inflation and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and principal. This risk is higher when investing in high yield bonds, also known as junk bonds, which have lower ratings and are subject to greater volatility. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns.

The investment(s) discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Additional information is available upon request.

INDEX DEFINITIONS

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

The MSCI AC World ex USA Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets, excluding the USA. The Index consists of 45 country indices comprising 22 developed and 23 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. The emerging market country indices included are: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

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