Investment Insights
Getting Invested

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Highlights

- Stock markets globally have sold off 10%–20% from recent highs, driven by Russia's invasion of Ukraine combined with higher inflation and interest rates. Bond returns are slightly negative this year, and the Fed is poised to start raising rates on March 16.
- Investor cash balances remain elevated at $5 trillion. Sentiment has turned decisively negative.
- While the current environment is unique, history offers valuable lessons for getting invested. Determining the most appropriate target allocation is an important first step in the process, and moving to that target allocation sooner rather than later offers the best odds for success.

We are saddened and horrified by the images coming out of Ukraine. The unnecessary loss of life is top of mind. Our thoughts are with the people in Ukraine in this terrible human tragedy.

A Dubious Time to Invest?

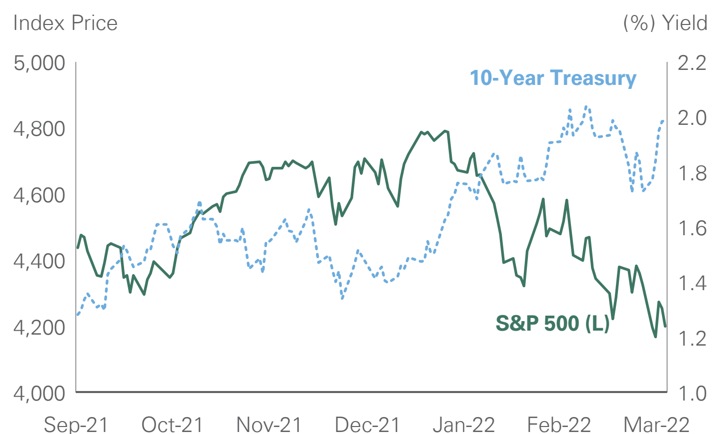
The headlines are scary: Russia has invaded Ukraine, oil prices are above $100 a barrel, and inflation in the U.S. is running at nearly 8%, a 40-year high. The Federal Reserve is set to begin a historic unwind of ultra-loose monetary policy in about a week, and interest rates have already started to move higher. From these headlines, it seems clear that the recent increase in market volatility is here to stay.

Fundamentals Today

While speculation about the war between Russia and Ukraine is currently weighing heavily on financial markets, in the long run, fundamentals are the dominant driver of stock prices. Fundamentals include inflation, interest rates, valuations, but also the health of the global consumer, economy, and corporate earnings.

Recent inflation readings have been uncomfortably high. In our view, both structural and cyclical forces are at work. On the shorter-term or cyclical side, we are starting to see some easing in supply chain bottlenecks and labor disruptions caused by COVID-19. Average hourly earnings have stabilized a bit in recent employment reports. This all suggests inflation could be peaking soon even though we don't expect inflation

Exhibit 1: Yields Up, Stocks Down



As of March 11, 2022.
Source: Bloomberg

to fall quickly. The Fed will likely raise interest rates on March 16, and when all is said and done, we believe that 2022 will see four or five rate hikes. The market has a similar view, so much of this expectation is already priced into the bond market (the 10-year Treasury, which was at 1.34% in early December, is currently at 2.1%.

Even after the Fed raises rates this year and into next, we would expect interest rates to remain low relative to history. Interest rates and monetary policy won't be as stimulative as they have been the last two years, but they should be stimulative enough to support economic growth for the next few years.

Valuation metrics for the U.S. stock market based on price-to-earnings measures are slightly elevated, but if interest rates remain reasonably low, as we expect, valuations should stay elevated. Valuations of high-quality companies based on free cash flow instead of earnings look more attractive. The Omicron wave of COVID-19 is receding into the background, and although a new variant could emerge, economies globally have been resilient. We believe the U.S. economy will continue to expand in 2022 with real GDP growth around 3.5%-4%. In this environment, companies in the S&P 500 are expected to grow their earnings and revenues in 2022 by 8%-9%.[1]

Risk to This View

Oil prices above $100 are inflationary and act as a large tax on consumers. The longer oil stays high the bigger the economic drag on consumption in the short run. The Fed has a difficult job. It needs to be tough on inflation, but if it raises rates too quickly or severely, it runs the risk of putting the economy in a recession. Higher interest rates along with a faltering economy and stubbornly high inflation have historically been a bad combination for the stock market. While this scenario remains a risk that we will continue to monitor, our base case is that the economy and corporate earnings will be able to grow over the next few years and prove resilient in the face of higher rates and inflation.

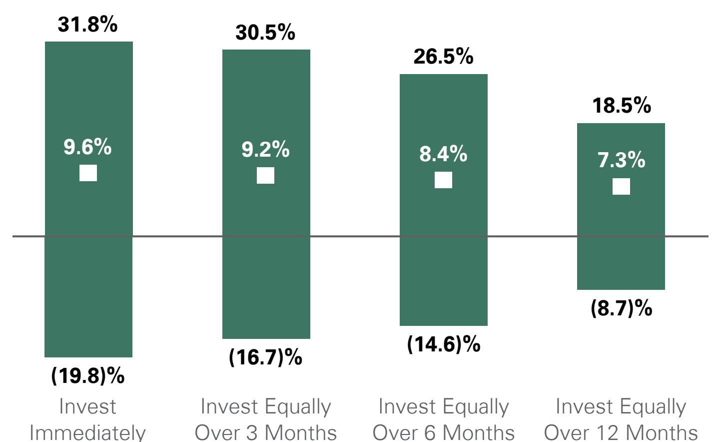
What History Tells Us

There are countless strategies for deploying money, including going "all in" at once, trying to time the market, or dollar-cost averaging over a period of time. In Exhibit 2, we compare investing all at once versus three different dollar-cost-averaging approaches (investing equally over three, six, and 12 months). We do this looking at the returns of the U.S. stock market over roughly the last 50 years, a period that included a lot of bull and bear markets.

Looking at all of the data, it becomes clear to us that there is no one right answer, but there are definitely some wrong answers and a lot of interesting tradeoffs. In Exhibit 2, the bars show the range of annual returns for different entry strategies for moving cash into the stock market. As you move from left to right and take longer to get invested, your return on average falls (as shown by

Exhibit 2: Hypothetical Comparison of Getting Invested Over Different Time Frames (100% Stock Allocation)

Key Takeaway: As an investor takes longer to get invested, the average return falls. Delaying entry to the stock market has historically lowered returns in big up markets but provided some protection in big down markets.



Data from January 1, 1967, to December 31, 2021. Returns reflect the total return. The final asset allocation is 100% stocks. Stocks are either invested immediately or equally over a certain number of months (for example, over three months, 25% is invested at the beginning of each month for four months, leaving the portfolio fully invested by the end of month three/beginning of month four). The remaining investment value that is not yet invested in stocks is assumed to be held in cash. The following indices were used to measure returns: S&P 500 (stocks), Global Financial Database USA Total Return Daily T-Bill Index (cash) until end-1980 and Citigroup 3-Month U.S. Treasury Bill Index thereafter. Data is monthly. Numbers shown reflect the 5%, median, and 95% outcomes.

Source: Bloomberg, Citigroup, Global Financial Database, Standard & Poor's

[1] Source: Factset as of February 28.

the number in the middle of the bar, which is the median return). This is intuitive — the longer you are holding cash instead of being invested, the lower your return, since stocks outperform cash more often than not. Also, as you would expect, delaying entry has historically lowered your return even more in a big up market but provided better protection in a big down market, as shown by the top and bottom of the ranges (defined as the top 5% and bottom 95% of outcomes over this period).

Investing over 12 months cut the median return by 2.3% as compared to getting invested immediately, and it cut the upside from 31.8% to 18.5%. That said, in a really difficult market, a hypothetical portfolio was down only 8.7% as opposed to 19.8% had the investments been made all at once.

The Importance of Asset Allocation

The first study assumed that cash was moving into a target asset allocation of 100% stocks. For most investors, however, their target allocation is not 100% stocks and instead includes other lower-risk investments, such as bonds. For comparison, we ran the same historical study — but this time using 70% stocks/30% bonds as the target allocation (Exhibit 3).

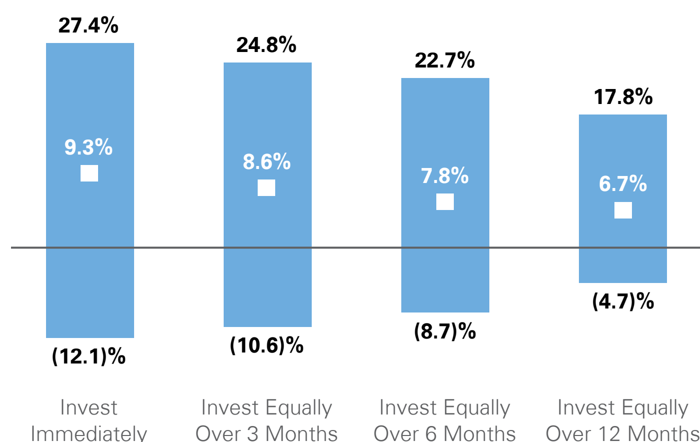
Now that the target allocation includes a healthy dose of bonds, the downsides are much less pronounced for all of the different entry strategies. Dollar-cost averaging did again improve the performance in very difficult markets (and hurt the performance in strong up markets), but the prospects of investing all at once are less daunting. In comparing investing all at once versus staging in over 12 months, is it worth giving up 2.6% on average to cut the downside from roughly 12% to 5%? That is a question investors should consider for themselves.

Does It Make Sense to Invest in Bonds Today?

The second study considered a portfolio with 30% allocated to bonds. But with the combination of low and rising interest rates and high inflation, should investors still be investing in bonds?

Exhibit 3: Hypothetical Comparison of Getting Invested Over Different Time Frames (70% Stock, 30% Bond Allocation)

Key Takeaway: Versus a 100% stock allocation, the downside scenarios for a 70/30 portfolio are less pronounced for various entry strategies.



Data from January 1, 1967, to December 31, 2021. Returns reflect the total return. The final asset allocation is 70% stocks and 30% bonds. Bonds are assumed to be invested immediately. Stocks are either invested immediately or equally over a certain number of months (for example, over three months, 25% is invested at the beginning of each month for four months, leaving the portfolio fully invested by the end of month three/beginning of month four). The remaining investment value that is not yet invested in stocks is assumed to be held in cash. The following indices were used to measure returns: S&P 500 (stocks), Global Financial Database USA Total Return Daily T-Bill Index until end-1980 and Citigroup 3-Month U.S. Treasury Bill Index thereafter (cash); Global Financial Database USA 10-Year Term Index Total Return thereafter (bonds). Data is monthly. Numbers shown reflect the 5%, median, and 95% outcomes.

Source: Barclays, Bloomberg, Citigroup, Global Financial Database, Standard & Poor's

Stepping back, we continue to expect stocks (and alternative assets such as venture capital, private equity, and real assets) to be the primary driver of returns in an investor's overall portfolio. That is not, nor has it ever been, the role of bonds. Bonds are meant to be the defensive asset that shines when the economy and stock market are struggling. Cash can be a helpful defensive asset as well, but only for short horizons. Over longer-term periods, bonds, with their higher yields, have been a higher-returning choice (Exhibit 4). And the longer the holding period, the more likely bonds outperform cash.

With low and rising yields, we don't expect great returns from bonds, but we do continue to believe that an intermediate-duration bond portfolio will play its role as the risk-dampening component of an overall portfolio.

Exhibit 4: Bond vs. Cash Performance Over Time

Key Takeaway: For long-term investors, bonds are the preferred asset class as compared to cash.

Rolling Return	% of Times Bonds Outperform Cash	Return Difference – Bonds v. Cash (%)
1-Year	75%	2.8%
3-Year	96%	3.0%
5-Year	98%	3.0%
10-Year	100%	3.1%

Source: Bloomberg from 1/31/1979 through 2/28/2022. Bonds proxy is the Bloomberg Intermediate US Aggregate Bond Index, a broad-based flagship benchmark that measures the investment grade, U.S. dollar denominated, fixed-rate taxable bond market with less than 10 years to maturity. The index includes Treasuries, government-related and corporate securities, MBS, ABS, and CMBS. Cash proxy is the three-month Treasury bill. Return difference is the difference in average annualized return of bonds v. cash.

Final Thoughts

Even though, on average, getting invested immediately has historically been the most financially rewarding approach, it is easier said than done. If dollar-cost averaging helps someone get invested in his or her target allocation over a short period of time (ideally three to six months, but not to exceed a year), then it is a useful tool in an investor's tool kit. Dollar-cost averaging is a bit like an insurance policy — on average, it has historically cost an investor some return, but occasionally it pays off nicely. For those investors who are extremely hesitant to invest new money in their target asset allocation today or within the next three to six months, this may be a sign that their target is too aggressive. Perhaps reducing the target allocation to stocks by 10 to 20 percentage points might be the catalyst to transition more quickly.

Although we aim to make the process of getting invested more of a science and less of an art, in part by studying history and trying to understand its lessons, we recognize the emotions involved. When the market has been volatile and heading lower, as it has in 2022, investing can be uncomfortable. But for long-term investors, we believe today's entry point is a good one. Regardless of the exact details of your specific plan, we suggest you put the plan in writing and try to keep it simple. The more complicated the plan, the tougher it is to execute. Once you have made the decision to implement your plan, avoid the temptation to constantly reevaluate each of your entry points with the swings of the market — doing this can be counterproductive. And remember that getting invested is always emotionally difficult — for everyone.

As always, we continue to actively manage the risk in our clients' portfolios. Today's asset allocation recommendations are roughly in line with our clients' long-term targets. Within stocks, we continue to favor the U.S. market with an emphasis on high-quality companies in the technology, healthcare, and consumer-oriented sectors. We are underweight Europe and emerging markets, which are both more vulnerable to economic disruption from the Russian invasion of Ukraine.

For clients investing new money today, we recommend moving to target asset allocations over a relatively short time period, either immediately or over the next three to six months.

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