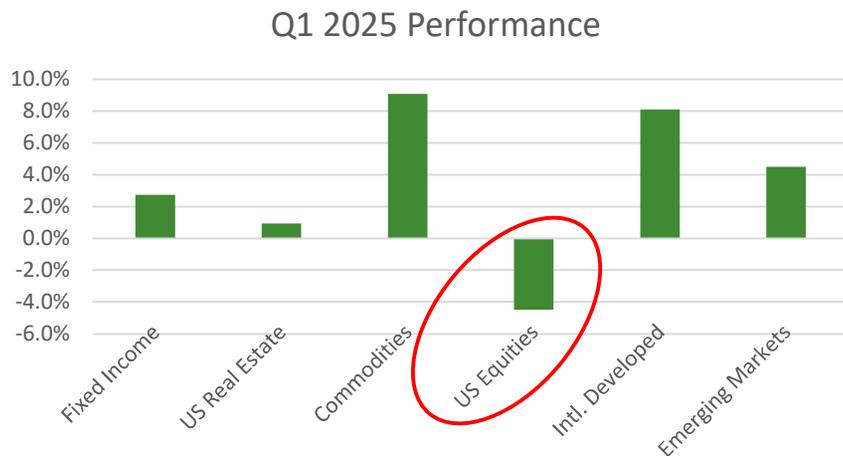


Stocks Are Down, Volatility Is Up

Last quarter will be remembered as the start of a significant market downturn, driven by massive and unprecedented US tariffs on virtually every country in the world. We do not yet know the extent of the downturn since we are witnessing it in real time, but market volatility is clearly continuing into the current quarter as well.

We do know two things that can lift our spirits during these volatile times. First, we know that the Bucket Strategy works, and that each of our clients who need income in the short-term has a well-stocked conservative bucket that is doing its job right now. The second thing we know is that diversification works, and times like these remind us of the importance of a portfolio’s asset allocation. While the headlines tend to focus exclusively on large US stocks (S&P 500, Dow Jones, NASDAQ), it is important to remember they only represent one asset class in a properly diversified portfolio.

The following chart shows how all the various global asset classes performed in the first quarter.



Source: Morningstar

While we do not know what the rest of the year will bring, last quarter is a great example of how divergent global financial markets can be. The current quarter has seen an across-the-board drop in equity markets so far, but the spread in the performance of the various asset classes remains significant.

Only time will tell exactly how the current crisis plays out: whether stock prices continue to fall and how long they take to recover. Market downturns are always unique and usually scary; each one typically feels “different” than others that came before, as though maybe this time there will not be a recovery. While we do not have a crystal ball to tell us what the future holds, we can gain perspective by remembering the past downturns that did, eventually, recover.

Year	Description	% Downturn
2008	Financial Crisis	-56.8%
2011	European Debt Crisis	-19.4%
2018	Trade War & Rising Interest Rates	-19.8%
2020	Covid-19	-33.9%
2022	Inflation & Rising Interest Rates	-27.6%
2025	Trade War	?

Source: YCharts

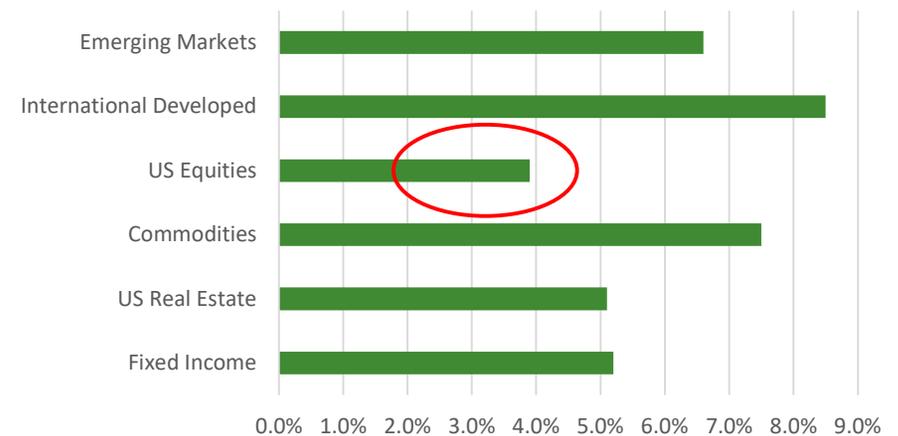
As the chart illustrates, we are now experiencing the 6th significant downturn of the past 20 years, beginning with the great recession of 2008. Two downturns were fueled by debt crises, two more by rising interest rates, and now two from trade wars. This is in no way meant to minimize the severity of the current crisis – it poses serious inflation & recession risks in the US and possibly globally. However, it is worth noting that over the past 20 years, even with these severe market downturns, the S&P 500 still managed to more than triple in value.

Many clients know that in recent years we have been shifting our portfolios to be underweight US stocks, and overweight International Developed & Emerging Markets equities. To be clear, the overwhelming success of that strategy so far this year does not mean we somehow foresaw the current crisis. In fact, Modern Portfolio Theory (MPT) demonstrates that investors cannot correctly and consistently predict short-term market movements, and the risks outweigh the benefits of even attempting to do so.

However, even if we cannot predict what the catalyst of the next market downturn will be or when it will occur, we do know that it will eventually rear its head. Furthermore, we know that when volatility spikes, the most expensive areas of the market are at the greatest risk. The following chart shows the relative expensiveness of different asset classes at the beginning of this year, prior to the market downturn.

Last October we referenced one of our key sources of macro research, Research Affiliates, because their models projected severe underperformance for the S&P 500 relative to other global markets largely due to how expensive the S&P 500 had become. To reference a more familiar research source, here are Vanguard’s Capital Markets team’s long-term projected returns from the beginning of the year, only weeks before the market downturn began.

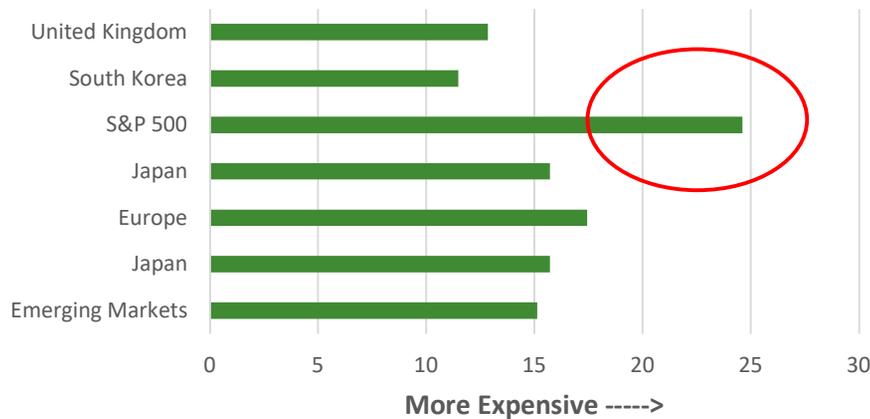
Vanguard: 10-Year Annual Projected Returns



Source: Vanguard

There is no doubt that we have entered a new period of market volatility that is impacting virtually all global markets. The first and most important defense is implementing the Bucket Strategy once we are withdrawing money so we can avoid selling low, sleep peacefully, and wait for the recovery. The second level of defense is diversification, as demonstrated clearly by the above charts. The third and final defense is a strategic asset allocation that can help avoid the most severe declines. Our job is to help our clients deploy each of these strategies, and we are pleased to see our portfolios hold up very well in the current environment.

12/31/2024 Trailing PE Ratio



Source: Sibilis Research

The chart shows US stock valuations as extreme outliers relative to global markets. As we have discussed several times in recent quarterly market commentaries, US stock prices were also expensive from a historical perspective. These high valuations can continue for extended periods of time, but as we are witnessing now, when a catalyst arrives to trigger a spike in volatility, the downturn can be severe.

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