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More Market Turmoil

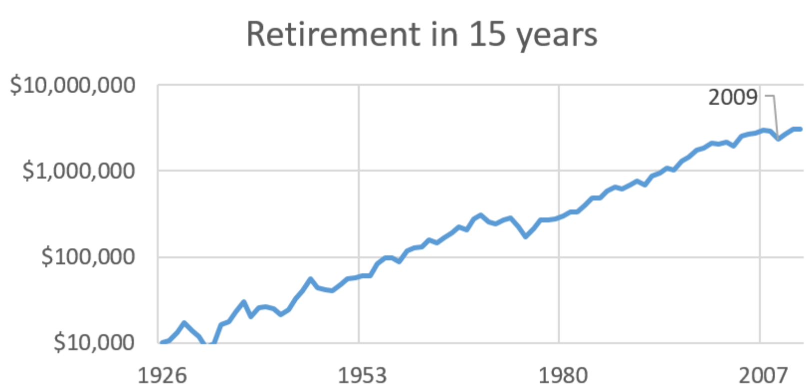
It was a great day for bonds today! In other much less followed news, the stock market stumbled.

Over the past 6 months, the Vanguard S&P 500 ETF (VOO) has dropped about 11%, including dividends, and Vanguard's intermediate term government bond ETF (VGIT) has gained 2.3%. A 60%/40% mix of the two, respectively, would have lost about 5.4%.

In the short run, investors should anticipate a 33% chance of losses in any year, and, depending on the asset allocation, the losses could be substantial. This is not a big concern, and here's why: the portfolios are going to be invested for a long time. Consider an optimally diversified portfolio for a hypothetical person that will retire in 15 years. The historical gains of an initial $10,000 as if it were invested in 1926 are shown below (fees are excluded). The portfolio is designed to produce 40 years of income, so the average time invested will be about 27 years ((15+40)/2). Notice that the vertical grid lines are set to 27 years for perspective.

When looking at this portfolio with a 27 year horizon, the crashes and disasters just don't look that big. One might even miss the crash of 2009 (a 37% loss in the S&P 500) if it was not marked. Sure, there are real risks and there's no guarantee of future returns, but one should be prepared for losses and take them in stride. Furthermore, through a regular discipline of rebalancing, assets that have lost money are purchased while prices are low to bring the allocation back to normal. This means regular buying of depressed assets. Think of it like a sale at Macy's!

While such turmoil is unpleasant, we have to do our best to weather the storm and have confidence that our portfolio is right for the long term.



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