Fall 2021

Correct About the Correction?

"Everything you've ever wanted is sitting on the other side of fear."
— George Addair

As we turn the corner on 2021, the current news cycle is relentlessly pounding on these themes:

- The threat of a U.S. government shutdown
- The rise of the Delta variant
- Solvency issues with a large real estate developer in China
- Increased probability of a less accommodative policy shift on the part of the Federal Reserve

These seemingly valid concerns would have us believe that the correction is finally here and it's time to act, to do something "strategic" or different.

A careful study of stock market data reveals that financial markets usually have a significant pullback every year. Pullbacks are as normal as a semi-predictable weather pattern. In fact, the U.S. stock market is going through a 5% pullback as this letter is being written in mid-October 2021. More than

70% of stocks in the S&P 500 Index have experienced at least a 10% sell-off at some point in 2021 and the number is even higher for smaller companies.

We are still recovering from the negative impact of the COVID-19 pandemic and many economic uncertainties remain. We were led to believe that the recovery would be immediate and "V-shaped," but the delta variant and lingering global supply chain issues spoiled that party. Growth expectations are somewhat reduced in the near-term and this has created some consternation in markets along with various side shows, such as the threat of a government shutdown. This is all normal activity in the stock market, which constantly adjusts to the fundamental environment.

Nevertheless, COVID-19 vaccines are becoming more widely available and the delta variant is expected to peak soon. People are starting to venture out, travel, see concerts, go to restaurants, and enjoy life.

The Only Thing We Have to Fear

As human beings we are driven by a strong survival instinct. We constantly read the tea leaves of what is happening around us, looking for clues that something is changing and for hints of potential danger. Once a potential threat is detected, our sympathetic nervous systems kick in, preparing us to run away from perceived danger or, in some cases, fight back or freeze.

On top of this "fight-or-flight" response, psychologists believe that we possess a "negativity bias," which is a hunger for consuming and remembering bad news. This bias is especially reinforced by recent news, which has led behavioral psychologists to coin the term "recency bias." Media plays into our biases, delivering news that is tailored to appeal to our built-in survival instincts and appetite for viewing tragedy. There is a saying coined by New York magazine writer Eric Pooley: "If it bleeds, it leads," referring to the unspoken motto of TV news. As a result, turning on your favorite news channel often comes with stories about the most negative incidents of the day. For investors, the stories often deal with existential threats that could topple the markets.

As famous investor Peter Lynch once said, "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves..." Our blood pressure rises as our sympathetic nervous systems engage and trigger a flight from the market response.

To make matters worse, social media amplifies these same concerning stories in the "fear echo chamber," increasing our stress levels even further.

7 Habits of Highly Effective Investors

Here are some recommendations from your Rebalance team for keeping calm in a world that is designed to keep us all fearfully engaged and for increasing your chances of long-term investment success.

1. **Tune Out.** It's good to stay up to date, but it is also important to realize that we are being fed stories to worry us, pull us in, and keep us concerned and engaged like a sabertoothed tiger at its favorite watering hole.

2. **Consider your time horizon.** Do you really need to react to today's news when you have a 10-plus or even 20-plus year time horizon? What will your portfolio look like when you need to start withdrawing 3% to 5% a year?

3. **Remember you're likely too late.** Whatever brilliant insight or idea you have about what will happen in the stock market, we guarantee it has already been considered by millions of professional investors worldwide who continuously weigh outcomes and make their bets accordingly. Your ideas are likely already "priced in" to stocks, so 90% of the time you are too late to make a change.

4. **Know that the stock market is cyclical.** There has never been a bear market that lasted long. Over time, the stock market appreciates.

5. **Ensure that you are prepared.** Worrying about a stock market correction is like worrying about earthquakes in California. Instead, prepare well in advance and realize it is impossible to seismically reinforce your home during an earthquake. Be ready by having sufficient cash reserves and the appropriate allocation so that you don't need to sell your risky assets (such as stocks) when they are down.

6. **Recognize noise versus fundamentals.** Stocks going up or down normally are dependent upon company earnings. When earnings streams are interrupted for fundamental reasons, stocks generally sell off. Conversely, they rise when earnings are expected to grow faster. If stocks move for other reasons, often that is just noise.

7. **Understand "recency bias."** We tend to give greater importance to recent events than more distant historical events. The big, rapid sell-off due to COVID-19 might still be front and center in our minds, making us extra nervous. Is this extra nervousness warranted simply because the sell-off was recent? History is full of significant corrections followed by stock market recoveries. Why would this be any different?

Are the best investors wired differently than everyone else? Probably not. Rather, they just learned so many lessons over time that they are able to override their instincts and stay the course. Rebalance advisors, in fact, are also human. Yet one of our major value-adds is helping you stay calm during difficult periods.

You can see the glass as half full or half empty, so why not choose half full? It's a good feeling and only requires you to occasionally turn off the TV or log off of social media. In the meantime, call us anytime you need some additional calming perspective.

World Markets Review

Third Quarter 2021

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q3 2021	**Stocks**				**Bonds**	
	-0.10%	-0.66%	-8.09%	-0.08%	0.05%	0.09%
Since Jan 2001						
Avg. Quarterly Return	2.4%	1.7%	2.9%	2.5%	1.1%	1.1%
Best Quarter	22.0% Q2 2020	25.9% Q2 2009	34.7% Q2 2009	32.3% Q3 2009	4.6% Q3 2001	4.6% Q4 2008
Worst Quarter	-22.8% Q4 2008	-23.3% Q1 2020	-27.6% Q4 2008	-36.1% Q4 2008	-3.4% Q4 2016	-2.7% Q2 2015

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Global Aggregate ex-USD Bond Index [hedged to USD]). S&P data © 2021 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2021, all rights reserved. Bloomberg data provided by Bloomberg.

The **Rebalance** Investment Committee works with two broad asset classes as the basic building blocks of our client portfolios: Growth and Income. During the third quarter of 2021 these asset classes performed as follows:

Growth Asset Classes

Large U.S. Stocks. Large company stocks were essentially flat for the third quarter after a difficult performance in September. Concerns about the pace of the reopening, continued supply chain issues, government budget battles, and financial trouble with a large Chinese developer (Evergrande Group) all weighed on stocks during the final month of the quarter. Large company performance is still extremely positive year-to-date.

Small Cap Stocks. Small company stocks sold off in the third quarter more than their large-cap counterparts. The pace of reopening is especially important to smaller companies, and this showed up in their Q3 performance. Despite lagging larger companies in the third quarter, small company stocks are still leading them year-to-date.

International Developed Stocks. The stronger dollar added weakness to foreign developed stock markets in the third quarter vs. their U.S. counterparts. Developed markets outside the U.S. are positive in 2021, but up around one half of U.S. large-cap stocks given the negative impact of dollar strength on returns. Manufacturing activity is at a five-month low in the Eurozone.

Emerging Market Stocks. Emerging markets also suffered due to dollar strength on top of vaccine bottlenecks and negative economic developments in China. Low vaccination rates in Asia, Latin America, and Africa have opened the door to the surging delta variant and a corresponding negative impact on economic activity and stock price performance.

Real Estate. The recovery in commercial real estate continued in the third quarter of 2021. Real estate stocks put in a positive performance based on this recovery, and the attraction of real estate as an inflation hedge. This positive third-quarter performance bolstered REITs as one of the top performing groups in 2021 year-to-date.

Income Asset Classes

U.S. Government Bonds and TIPS. The benchmark 10-year Treasury bond's yield rose 0.18% to 1.475% in September after the market sensed a change in Federal Reserve interest rate policy. The Fed's signal that it will reduce bond purchases as soon as November, coupled with rising oil and commodity prices, is leading to near term sell-off in government bonds. TIPS returns benefited from inflation-based price adjustments in the quarter.

U.S. Corporate Bonds. Despite low yields and tight spreads, U.S. investment-grade (higher quality) corporate bond prices rose slightly during the third quarter as credit markets continued to heal and liquidity conditions improved.

High Yield Corporate Bonds. U.S. high-yield bonds performed well versus their fixed income counterparts in the third quarter, although returns were low in absolute terms. Some of the negative influences impacting stocks also influence high-yield bonds.

Emerging Market Bonds. Dollar strength hit the emerging market bond category in Q3. Emerging market sovereign debt is often issued in U.S. dollars and suffers when the dollar strengthens vs. the local currency of the issuing country. This happens because the debt payments in dollars are effectively increased as the local currency weakens. Chilean and Brazilian currencies, for instance, fell 9% in the quarter.

Preferred Stocks. As a "hybrid" security that is part fixed income and part equity, preferred stocks are often influenced by forces influencing both stock and bond markets. In the third quarter of 2021, preferred stocks were impacted by the same forces pushing stocks lower. However, preferred stocks remain one of the best performing income-oriented categories in 2021 so far.

The Rebalance Investment Committee

The **Rebalance** Investment Committee meets several times a year to review our client portfolio options, asset class selections, and overall economic factors. The Committee's goal is to curate client portfolios that generate the most investment return for the least amount of risk.

The Rebalance Investment Committee meeting in New York, April 2019 (left to right: Scott Puritz, Burton Malkiel, Jay Vivian, Charles Ellis, Mitch Tuchman, and Sally Brandon)

The last, slight modifications we made to our portfolios as per our committee's recommendations were in April 2021. Our income portfolios, for investors seeking more of their total return from income and also less volatility, were rebalanced toward more dividend-paying stocks, both in the United States and internationally.

In the equities portion of our growth portfolios, we rebalanced between our funds to be more consistent with the global equity benchmark and to provide investors returns that come more from capital appreciation than income. For example:

- Emerging markets had grown to 12% of the benchmark from 8% last year, so we added to their exposure.
- Smaller company U.S. stocks had a large run-up since COVID so it was an advantageous time to reduce our small-cap exposure and reallocate to the broad U.S. market.

Rebalance and its clients are fortunate to have such respected and savvy financial experts guiding key investment decisions.

Professor Malkiel is an emeritus Princeton University economics professor, a former board member of The Vanguard Group, and the author of the investment classic *A Random Walk Down Wall Street.*

Dr. Ellis was for three decades the managing partner of Greenwich Associates, the leading strategic advisor and consultant to large institutional investors around the world. He was Chairman of the Investment Committee of the famed Yale Endowment, and he has served on the governing boards of The Vanguard Group, Yale, Harvard, NYU Stern, Exeter, the Whitehead Institute, and the Robert Wood Johnson Foundation.

Jay Vivian is the former Managing Director of the IBM Retirement Funds, responsible for over $100 billion in IBM investment funds for more than 400,000 employees worldwide.

We thank them for their input and wisdom.

Very truly yours,

Your **Rebalance** Team