Perspectives

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Keeping the Current Market Correction in Perspective

Jeff Hoffmeyer, CFA
Lead Analyst,
Asset Allocation

Over the last few months, equity markets have experienced sizable drops, making many investors wary about the future. Despite this, we encourage our clients to focus on the longer-term return patterns of their portfolios, since most are of a perpetual nature.

To reinforce these concepts, we have examined return patterns of four broad stock market indices:

- S&P 500 (U.S. stocks);
- Russell 2000 (U.S. small-caps);
- MSCI EAFE ("EAFE" – for international developed large-cap equities);
- MSCI EM ("EM" – emerging markets)

Looking at the table below, we see that while YTD performance is disappointing, longer term annualized returns are still strong, with 3-, 5- and 10-year performances all positive for each index.

Exhibit 1: Longer-Term Returns are Positive

Historic Returns	1Mo	YTD	3-Yr (Annualized)	5-Yr (Annualized)	10-Yr (Annualized)
S&P 500	-6.8%	-2.9%	10.5%	9.3%	13.5%
Russell 2000	-9.7%	-9.2%	8.6%	5.4%	12.7%
EAFE	-4.4%	-13.2%	3.7%	1.5%	6.2%
EM	-2.3%	-15.0%	9.3%	1.8%	7.5%

Source: Bloomberg; data through December 18, 2018

In volatile asset classes — particularly equities — these corrections do occur with relative frequency, but the elevated risk profile of equities ultimately pays off in the form of higher returns over longer-term investment horizons. Though corrections like the one we are currently going through can make it tempting to reduce equity exposures, we encourage our clients instead to rebalance back to targets. Our recent paper on rebalancing further confirms this recommendation.

Additionally, we examined the performance of these four indices after each fell by 10% or more. Not surprisingly, all indices outperformed their long-term averages coming out of these market corrections.

Exhibit 2: Annualized Returns After a Correction

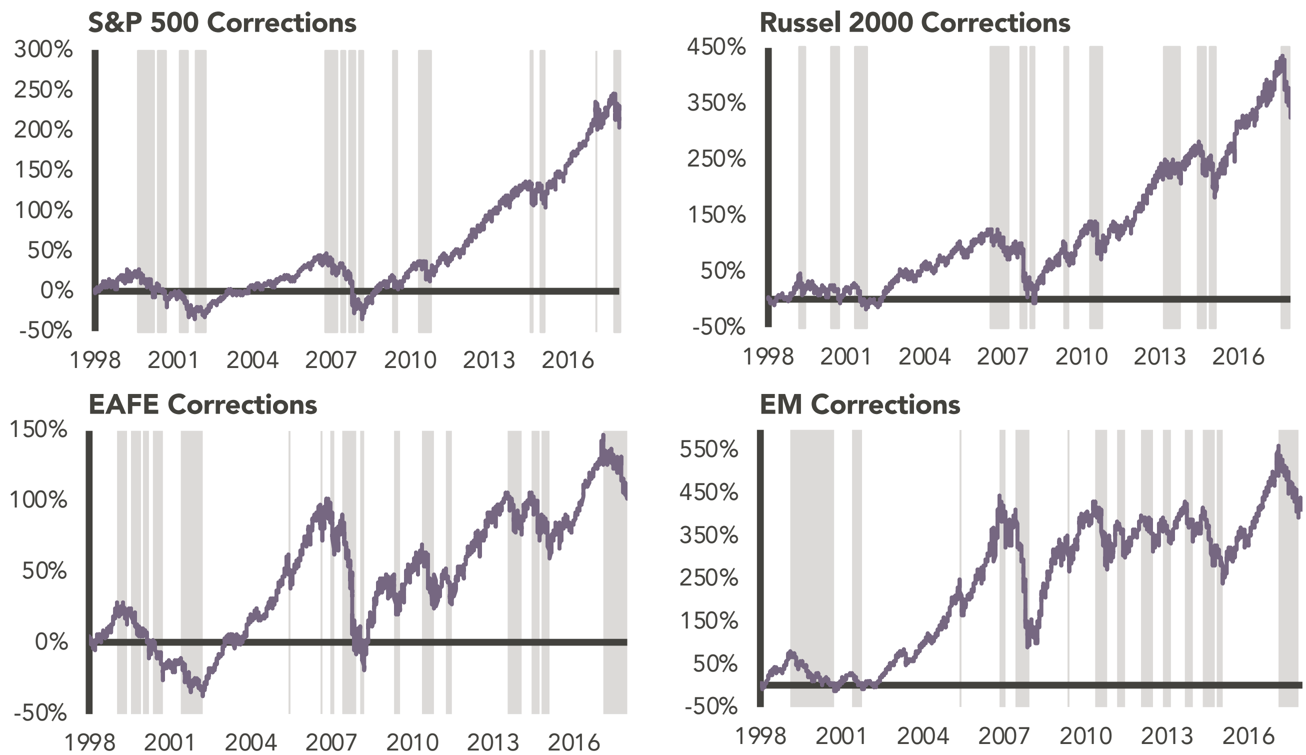
Forward Returns (Annualized)	1-Yr	3-Yr	5-Yr
S&P 500	13.1%	13.0%	12.6%
Russell 2000	26.5%	17.1%	17.0%
EAFE	13.1%	6.3%	8.5%
EM	22.4%	12.0%	12.9%

Source: Bloomberg; data since 1998

As shown in the table above there is, on average, a strong return in the subsequent year following a drop in the market; the 3- and 5-year figures are strong as well. Investors who do not panic and are willing to weather the storm gain the full benefit of the market's rebound.

To add some additional context to market corrections in the long term, the following charts show the growth of these four indices over the last 20 years, as well as the frequency which we see a 10% decline, highlighted in gray.

Exhibit 3: Corrections Are Not Uncommon



Source: Bloomberg

By taking a step back and looking at the long term, we can see that these corrections do occur with some regularity. During times of stress, it is easy to get nervous about performance and the possible risks, but it is important to recognize that these investments are made for the long term. Even with the recent correction, these asset classes have delivered strong long term returns to those willing to be patient.

PREPARED BY MARQUETTE ASSOCIATES

180 North LaSalle St, Ste 3500, Chicago, Illinois 60601
CHICAGO I BALTIMORE I PHILADELPHIA I ST. LOUIS

PHONE 312-527-5500
WEB marquetteassociates.com

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