Financial Services Advisory
GROW WISER®

# When Red Lights are Flashing, Time to Apply the Brakes

**August Market Review From Your Portfolio Management Team—September 4, 2015**

Anyone who has ever driven a car has most certainly run into this situation:  you're cruising along a road, at the speed limit, mind you, when you spot what looks to be flashing red lights ahead. Whatever the situation, it's still off in the distance, not close enough yet to warrant a reaction, but it has your attention. You might even take your foot off the accelerator.

The lights continue to flash red, and as you get closer, you notice the road might be blocked. Now you start applying the brake to slow your speed. The closer you come to the roadblock, the more pressure you apply to your brake until the seriousness of the situation comes into full view, and it's necessary to come to a full stop. Now you're looking for the nearest exit.

FSA manages your portfolios in similar fashion. On the morning of August 24th, when the Dow Jones Industrial Average opened down 1,000 points, it seemed that the entire interstate of the stock market was slamming on the brakes at the same time. But we had already let our foot off the accelerator the week before and had begun to apply some pressure to the brakes. By the time the sell-off began on August 20th, the portfolios were already anywhere from 20% to 50% in money markets. In our Market Review from last month, we spoke of the "internal" correction that had been occurring over the past few months with fewer stocks carrying the S&P 500 index to new highs – the first glimpse of flashing red lights.

The S&P 500 proceeded to shed 12% off its July high before the velocity of the correction began to slow in the last week of August. By the end of August, portfolios were positioned as shown in the table below:

| Strategy | Stocks | | Bonds | Money Markets |
|---|---|---|---|---|
| **Tactical Growth** | 25% | | 5% | 70% |
| **Core Equity** | 35% | | 15% | 50% |
| **Conservative Growth** | 30% | | 20% | 50% |
| **Income & Growth** | 25% | | 30% | 45% |
| **Income** | N/A | | 60% | 40% |

Note: Your specific portfolio may differ to some degree from these averages, as our portfolios are individually managed.

## Fear and the Markets

We have read that President Obama was recently briefed after the stock market fell 10%, but it is highly unlikely he would have been advised if the market had *risen* 10%. Why? Fear of losing our hard-earned money is a more powerful emotion than fear of leaving gains on the table. The 12% market drop we saw in August is the largest we've seen since 2011. The table below shows the year-to-date gains in the S&P 500 before and after each correction we've seen in the past three years since 2011:

| **Start** | **End** | **S&P Gain YTD Before Drop** | **Market Drop** | **S&P Gain YTD After Drop** |
|---|---|---|---|---|
| 04/03/2012 | 06/04/2012 | 13% | -10% | 3% |
| 05/21/2013 | 06/24/2013 | 18% | - 6% | 11% |
| 09/19/2014 | 10/16/2014 | 10% | - 7% | 2% |
| 07/21/2015 | 08/25/2015 | **4%** | -12% | **- 8%** |

Source: Newfound Research

What's different about this year is how little the equity market had gained, only around 4%, going into the August drop. It seemed easier for investors to stomach the 6% to 10% corrections in 2012 through 2014 because the sizable gains going into each correction still left investors somewhat cushioned with 2% to 11% gains after the damage was done. As of August 25th, a near-term bottom to the stock market, the S&P was down a sizeable 8% year-to-date. Despite a rally in the last days of August, the month ended with the S&P 500 still down almost 3% for the year. The Dow was down over 5% for the year, making the August correction harder to stomach.

## How FSA Manages Portfolios

Naturally, the question on the minds of investors as we move into September is *where do markets go from here?* Attempting to *predict* the future is a futile endeavor, but *preparing* for the future is quite doable. Besides the FSA Safety Net® we have under each position in the portfolios, we continuously monitor the health of the markets as a whole.

So what activity can you expect to see in your portfolios? No doubt most of you noticed a marked increase in selling last month as FSA let up on the gas and began to apply pressure to the brakes. If the equity market weakens further from here, we will press harder on the brakes and continue moving out of equities and raising cash. One thing to keep in mind: most serious corrections in equity markets tend to occur over a period of months or years, not weeks, allowing time for diligent investors to get out of the way. But if this current market angst turns out to be nothing more than a normal, healthy pullback, we will look for new opportunities.

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