Advice & Research
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WELLS FARGO Advisors

A Study of Market Declines

Why staying the course may be prudent in the long run

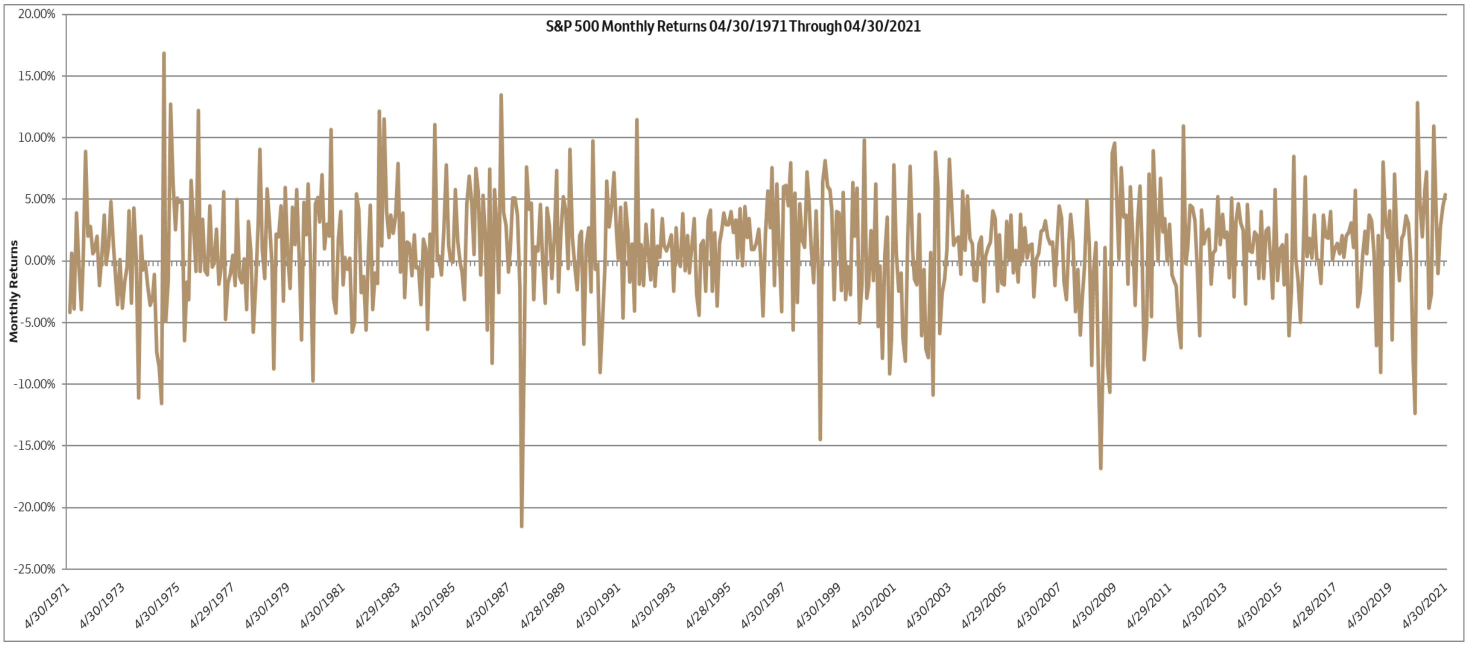
In finance, everything that is agreeable is unsound and everything that is sound is disagreeable. Winston Churchill, 1926.

- When markets decline significantly, it can be unnerving *(it is not the suggestion of this report that we are necessarily due for a correction in the near term—rather it serves as an all-weather primer as to how a staying-invested/mostly-invested strategy may fair—in both advancing and declining markets over time).*
- Although past performance cannot guarantee future results, history illustrates that staying the course may be prudent. Longer holding periods, historically, have led to better results.
- We illustrate a hypothetical case of an investor who invests just before the three largest calendar-month corrections over the past 50 years and examine the results.
- While we suggest at least annual reviews of your portfolio(s), a major swing in either direction may be another reason for an additional review, and realignment of your portfolio.

When the financial markets experience declines it can, indeed, be unnerving. While the domestic equity markets have moved sharply upwards during the past months, slightly more than a year ago we were reminded that large declines do sometimes occur as equity indices dipped precipitously in February and March 2020, as COVID-19 gained a foothold in the US. However, pulling all of your money out of investments because of a fear of a possible market correction may not be the best course of action.

The following chart (Figure 1) illustrates the monthly total returns over the past 50 years ending April 2021 for the S&P 500 Index.

Figure 1



Sources: Bloomberg and Wells Fargo Advisors

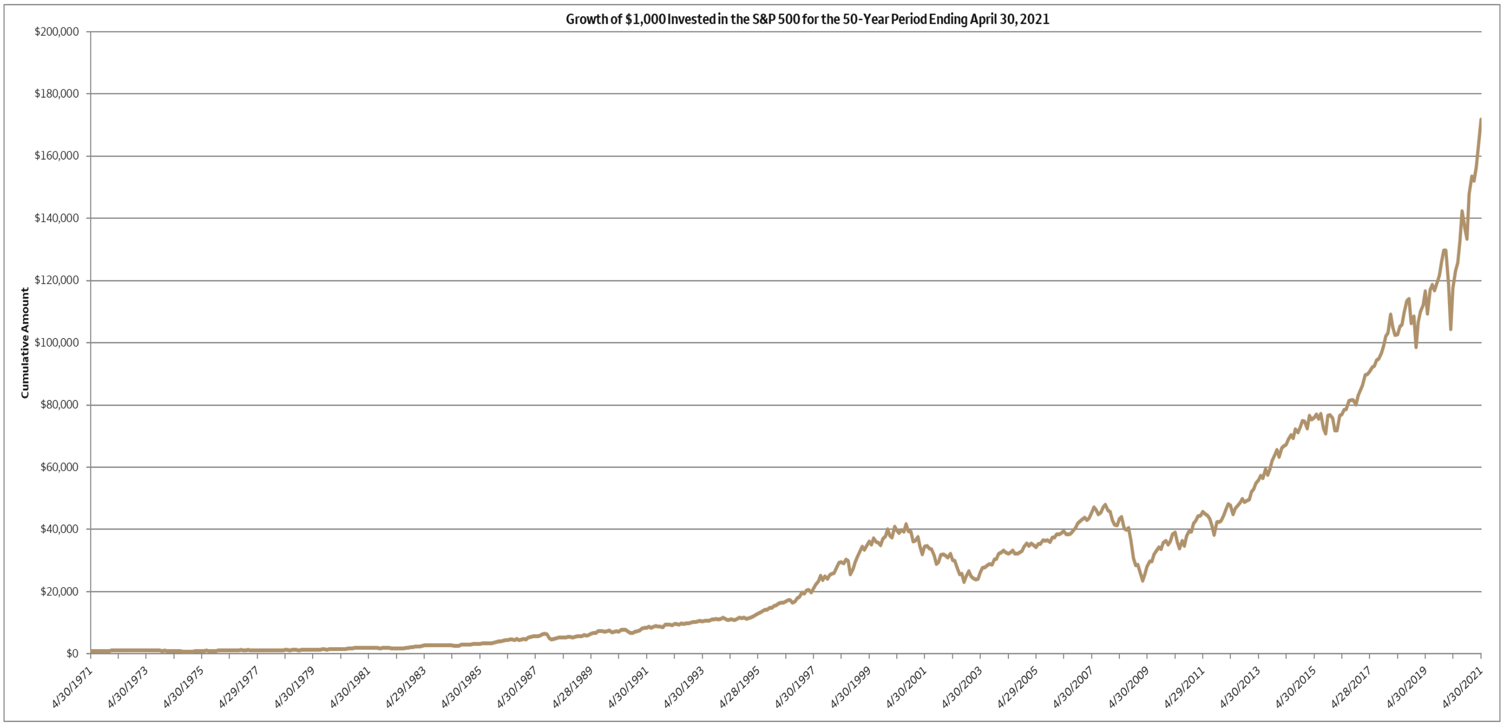
Past performance cannot guarantee future results. An index is unmanaged and not available for direct investment.

Market Snapshot

As demonstrated in the above chart, the stock market can be volatile at times. Over the past 600 months through April 2021 (50 years), the S&P 500 Index has declined by more than 5% during 50 calendar months (the last one was March 2020), more than 10% during eight calendar months (March 2020 also was the last one), more than 15% during two calendar months (the last being October 2008) and more than 20% for one calendar month (October 1987).

So, does this mean that the S&P 500 and other equity markets are a virtual minefield? In our opinion not really, from the standpoint of investors who have remained in the market over long periods of time—at least historically speaking. Suppose we take the S&P 500 Index returns from figure 1 and create another chart (Figure 2) that illustrates how those returns theoretically could have accumulated over time, starting with a $1,000 investment.

Figure 2



Sources: Bloomberg and Wells Fargo Advisors Total Returns assuming reinvestment of dividends.

This information is hypothetical and for illustrative purposes only. Index returns reflect general market results, do not reflect actual portfolio returns or the experience of any investor, nor do they reflect the impact of any fees, expenses or taxes applicable to an actual investment.

Despite occasional frightening moments, the market, as measured by the S&P 500, has returned 10.8% annually over the 50-year timespan (past performance cannot guarantee future results—also one cannot invest directly in an index).

Do longer holding periods increase my likelihood of experiencing positive returns?

History suggests that has been the case. We calculated the number of times the market experienced positive or negative returns for rolling (overlapping) one-year, three-year, five-year and ten-year periods. By rolling, or overlapping, we mean for example (using the one-year example), April 30, 1971 through April 30, 1972, and then May 31, 1971 through May 31, 1972, and so on. As shown in Figure 3, the market experienced positive total returns during about 80%, 86%, 90%, and 95% of the rolling one-year, three-year, five-year, and ten-year periods, respectively. In fact, all of the 24 rolling ten-year periods (out of 481 periods) during which the markets had negative returns had one thing in common—they were rolling ten-year periods that included the 2008-2009 market crash, a period of time that some might argue could have been an anomaly.

Figure 3

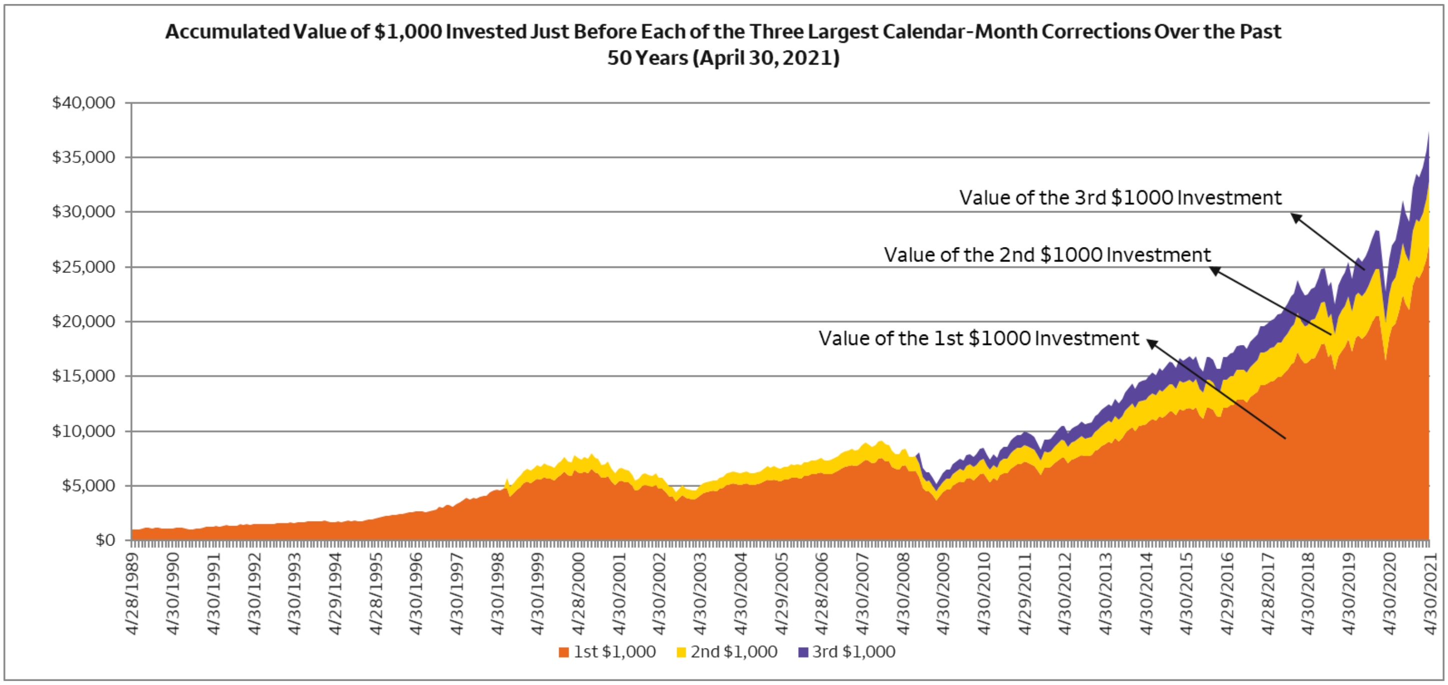
Based on total returns	One-Year Periods	Three-Year Periods	Five-Year Periods	Ten-Year Periods
Number of Overlapping Periods	589	565	541	481
Number of Overlapping Periods with Positive Returns	474	484	487	457
Number of Overlapping Periods with Negative Returns	115	81	54	24
Percentage of Time Returns were Positive	80.48%	85.66%	90.02%	95.01%
Percentage of Time Returns were Negative	19.52%	14.34%	9.98%	4.99%

Sources: Bloomberg and Wells Fargo Advisors. This information is hypothetical and for illustrative purposes only. Index returns reflect general market results, do not reflect actual portfolio returns or the experience of any investor, nor do they reflect the impact of any fees, expenses or taxes applicable to an actual investment. **Past performance is not a guarantee of future results.**

Meet the unluckiest investor

Over the past 50 years, the three worst calendar months for returns for the S&P 500 were: October 1987, when the S&P 500 declined 21.5%; August 1998, when the S&P 500 declined 14.5%; and October 2008, during which the index declined 16.8%. Hypothetically suppose our investor, as luck would have it, invested $1,000 at the end of the month prior to each of the aforementioned calendar months. So he invested $1,000 on three occasions, September 30, 1987, July 31, 1998, and September 30, 2008. His first investment of $1,000 would have declined to $785 in just one month and that first $1,000 investment wouldn't have been back above $1,000 until April 1989. Given that he also invests $1,000 just before each of the other two largest declining months, his performance had to be disastrous, right? Actually, with time on his side, his performance was pretty decent. In fact, the three different investments of $1,000 each (at the different times) would have accumulated to $37,525 by April 30, 2021 for a money-weighted average annual return of 10.01% as illustrated in Figure 4.

Figure 4



Sources: Bloomberg and Wells Fargo Advisors First investment September 30, 1987, second one July 31, 1998, and third one September 30, 2008.

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Suggested course of action

We believe history seems to suggest that staying the course in the stock market may be prudent, even with occasional market corrections (except for monies that need to be used in the near term). Again, past performance cannot guarantee future results.

Your financial advisor has a number of tools that he/she can utilize to help you meet your goals. In all cases, periodic reviews of your portfolio(s) should be performed, including a review of your asset allocation, sector allocation, etc. Large swings in the market (in either direction) may prompt additional reviews and possible realignments. Proper diversification should help to reduce risk (but not completely eliminate it, however).

Disclaimers

All investing involves some degree of risk, whether it is associated with market volatility, purchasing power or a specific security. There is no assurance any investment strategy will be successful. Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments.

S&P 500 Index is a market capitalization-weighted index, composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is not managed and is unavailable for direct investment.

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