SIGNATURE RESOURCES CAPITAL MANAGEMENT

Commentary: March 2021

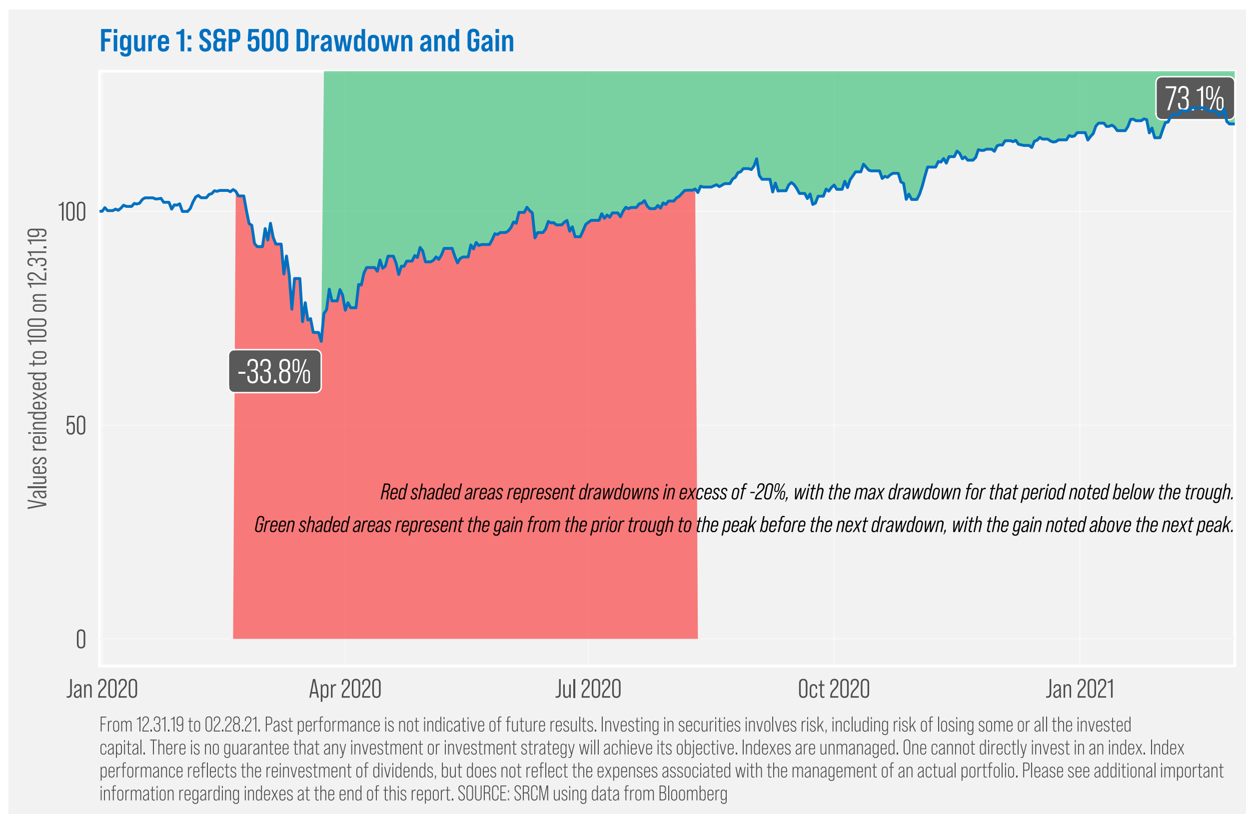
BRIEF HISTORY OF RETURN AND RISK

Even without the pandemic or the U.S. election, market returns alone would have made 2020 an abnormal year. Adding to their peculiarity, though, was the fact that global equity markets at one point in 2020 had lost a third of their value from a prior peak. The historic drawdown and the ensuring gargantuan rally, all within a mere 12 months, offer a fresh reminder of the give and take of return and risk in investing. Negative calendar years are relatively rare. But, negative 1-year periods are not. Neither, frankly, are negative 5-year periods. With markets near all-time peaks, it's a fine time to reassess tolerance for exposure to market risk.

In a Nutshell

The year started like most any other. But news of a virus run rampant in China had investors on edge. Once it was clear the COVID-19 outbreak would encompass the globe, with hospitals beginning to overflow with patients and governments implementing strict lockdown measures, investors took leave of risk. That flight saw the domestic stock market, as represented by the S&P 500, drop almost 34% from February 19 through March 23. But, in that decline, we imagine, no small portion of those same investors saw an opportunity, with flows rushing back into stocks seeing that index recover the entirety of those losses by mid-August. The index would tack on another 11-ish percentage points by year end to bring the 2020 tally to 18.4%.

Figure 1: S&P 500 Drawdown and Gain



From 12.31.19 to 02.28.21. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

Well Above the Norm

That high-teen gain ranks 41st of 95 years from 1926 onward for the S&P 500, so not too special. Still, the gain is well above the simple average of returns across those years. Of course, that simple average is rather less meaningful when placed in the context of the grand volatility in annual returns the market has experienced over that long time frame. That is to suggest that the average isn't the return one normally gets; from one year to the next, we can expect returns to differ—sometimes wildly—from that long-term average.

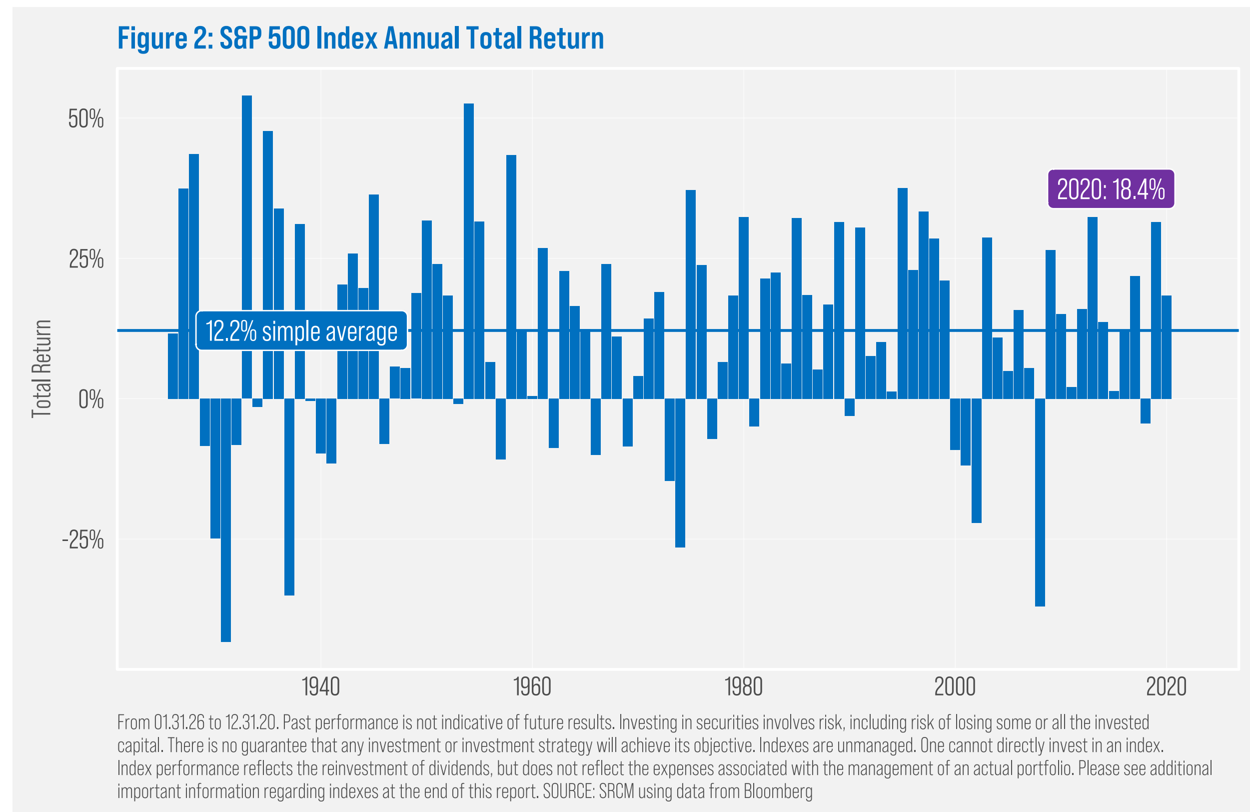


Figure 2: S&P 500 Index Annual Total Return

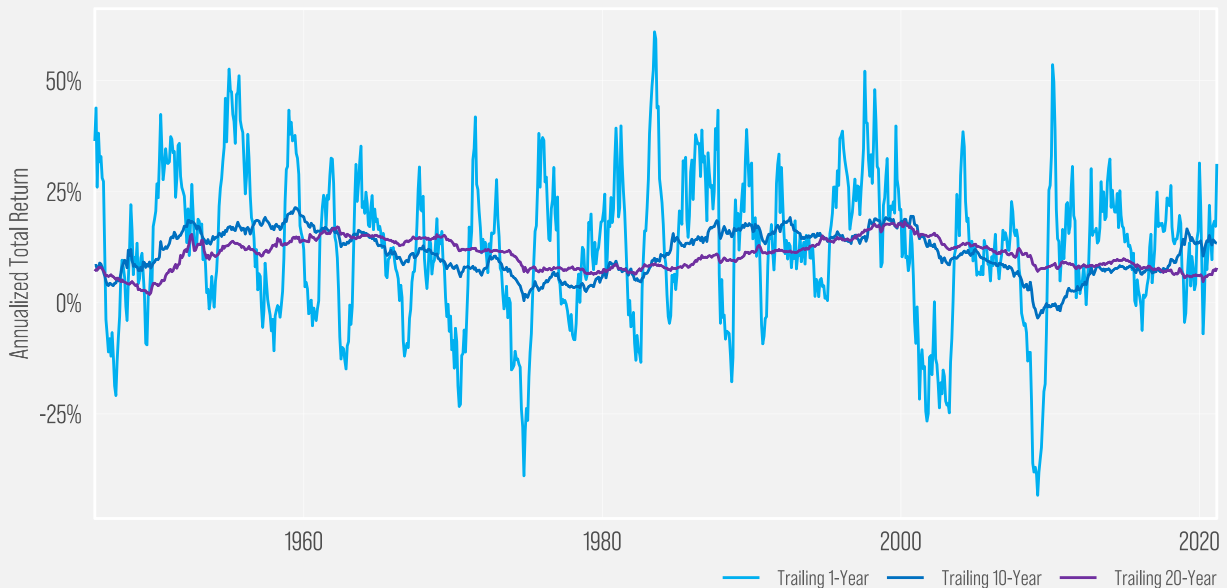
From 01.31.26 to 12.31.20. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

Know Your Exposures

And that tendency to see wild differences from year to year in annual returns is a feature of investing well worth revisiting with an advisor on a regular basis. As important, too, is the idea that a series of annual return such as that which we show in Figure 2 masks the even wilder swings one can see when looking at stock returns over a range of periods. To do this, we prefer to look at market returns on a periodic basis using monthly data. We might, for example, take each month in the history of market returns and look back one year to gauge the returns we might have experienced no matter our starting point. So, instead of having only 95 years-worth of returns since 1925, we actually have a bit more than 12 times that many (one trailing 1-year period for each month in the series at the end of the first year). We can generate similar lookbacks over longer periods (e.g., 3-year, 5-year and 10-year periods) to determine the range of outcomes that equity investing has seen. We've provided that historical view in Figure 3. Note the tendency for variability in outcomes (in terms of annualized total return) to narrow as the time period increases. The outcomes also tend to be more positive with increases in the time horizon. We show this feature of equity market returns—that the likelihood of a negative outcome decreases as the time horizon increases—more plainly in Figure 4.

Figure 3: Rolling Periodic Performance of the S&P 500 Index

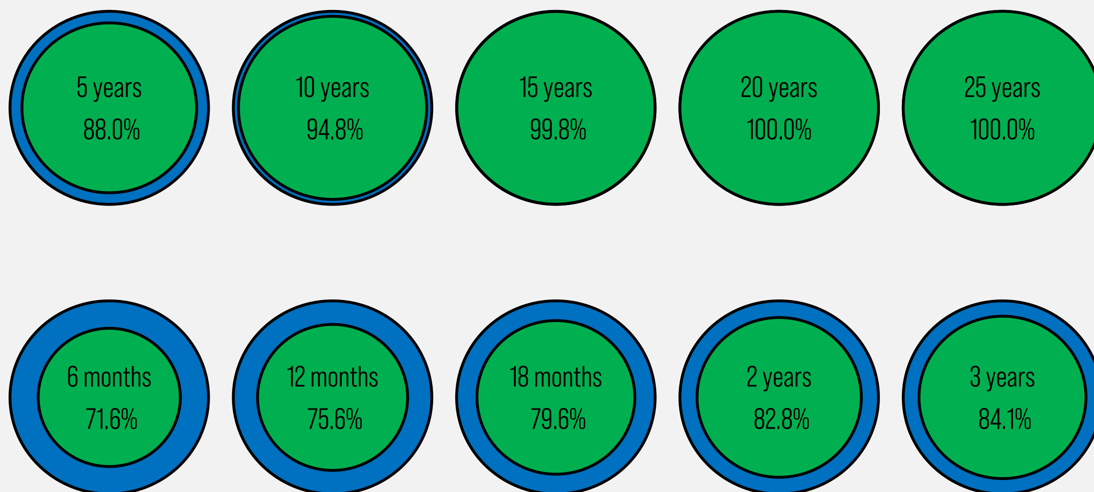
Variability of rolling returns tends to decrease as the time horizon increases



Monthly data from 01.31.26 to 02.28.21. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from via Bloomberg and Dimensional Fund Advisors

Figure 4: Length of Holding Period and Risk of Loss

Returns tend to become more positively biased with time



Percent of Rolling Periods with a Positive Total Return

From 01.31.26 to 02.28.21. Underlying data are monthly total returns for the S&P 500 Index. Rolling calculations based on given trailing periods for each month end. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg and Dimensional Fund Advisors

Past as Guide

We believe data such as those presented in this commentary help to center our expectations, while also providing a sense of the breadth of potential scenarios we might encounter on a going-forward basis. Knowing that time can be seen as a salve against nearer-term market drawdowns can help allay fears that arise in the midst of it. On the flip side, understanding that markets can be far from kind over short- and even medium-term periods may help us to modulate our exposures to that risk accordingly.

Of course, past is not prologue, and the future may hold outcomes that never before have been experienced. Still, we think the use of past data to set expectations remains the foundation of the more principled approaches to optimizing investment outcomes.

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