

## TEN YEARS AFTER: LESSONS LEARNED FROM THE FINANCIAL CRISIS

For the Woodstock generation, *Ten Years After* was a band ... but March 9, 2019 also marked the 10-year anniversary of the market bottom of the 2008 financial crisis. With the benefit of hindsight, we know that staying the course and maintaining one's equity exposure was the right thing to do. We thought that the 10-year anniversary was an excellent opportunity to revisit the pitfalls of market timing.

Much has been written in the financial press about trying to time allocations to and away from the equity markets at the appropriate times. While there are investors or asset managers out there that have pretty good track records market timing, we believe it is exceedingly difficult or even impossible to do on a consistent basis. The fact is that overvalued stocks can keep rising in price for a long period of time and stocks that "don't look like they can get any cheaper" invariably can, and do. Our philosophy at LMCG, pertaining to our Global MultiCap strategy, is to provide a client's core equity portfolio: fully invested at all times. We believe investors should work with their advisors to determine an appropriate allocation to equity, based on risk tolerance and time horizon, and then stay the course through the ebbs and flows of equity market returns. Investors who are inclined to de-risk in certain market environments do so at their peril. The long-term impact on one's financial security can be significant. Looking back to the financial crisis, it certainly tested investors' fortitude.

On March 9, 2009, the US stock markets touched a long-term bottom following the financial crisis that unraveled global markets in 2008. The equity market had turned into a fire sale as liquidity dried up and forced selling was creating repeated declines. Stock indexes were falling to new lows nearly three months after the price plunge in October 2008. While economists, regulators and politicians still argue over the successes and failures of the subsequent recovery in financial markets, ten years is a good time to look back at the investment decisions made during that difficult first quarter of 2009.

### The Misery and Uncertainty of February 2009

We knew we had an important message to deliver to our investors in those trying times. While we could empathize with their angst after a 40% market drawdown by February 2009, history tells us that permanent wealth destruction was likely if they abandoned equity investments after a severe bear market.

Nearly every client communication we were having in early 2009 involved the temptation to take money out of equities until some order and economic stability returned. A new presidential administration was taking control and the "known unknowns," even among the most sophisticated analysts, were vast and unsettling.

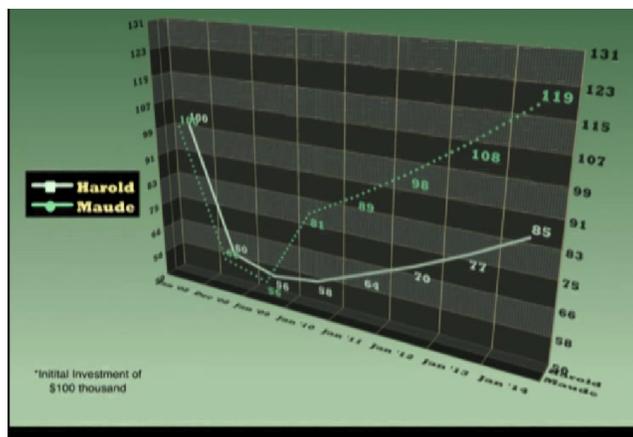
**So we tried something very simple:** Let the historical numbers of stock markets do the talking.

We put out a short video in February 2009 discussing this history. Of course, we didn't know until many months later that we were only a few weeks away from the market trough. To illustrate to our clients the potential for loss from being "out of the market," we made a 5-year forecast of the consequences of being out of the market. We based that forecast upon the average recovery of the S&P 500<sup>1</sup> Index over previous market lows. We compared the potential results of "sitting out the market" for one year (versus remaining invested) as economic and global financial conditions sorted themselves out.

We compared the projected results of two investors: Maude, who maintained her equity investment through the downturn; and Harold, who sold out in February and waited for a year to reinvest. To the right, we show the graphic from the video of that forecast, estimating that Maude would likely be \$34,000 wealthier on her \$100,000 initial investment than Harold by February 2014. We wanted to show the numbers in real dollars rather than in percentages, hoping to drive home the point – history shows real money can be lost by abandoning a long-term investment outlook after a significant market fall.

### Making the Example Real World

So let's update this example for Harold and Maude with real world results through the end of February 2019. Now, let's assume both investors started with \$500,000 (our minimum for separately-managed accounts) each on September 30, 2007<sup>2</sup> in LMCG's Global MultiCap (GMC)



We forecasted the potential loss of sitting out of equities with a year with a 5-year scenario of stock returns from a January 2009 starting point. The forecast was based upon historic trends following bear market bottoms.

strategy. Maude stays the course through the financial crisis, while Harold bails out – going to cash on December 31, 2008 – and staying out until December 31, 2009.

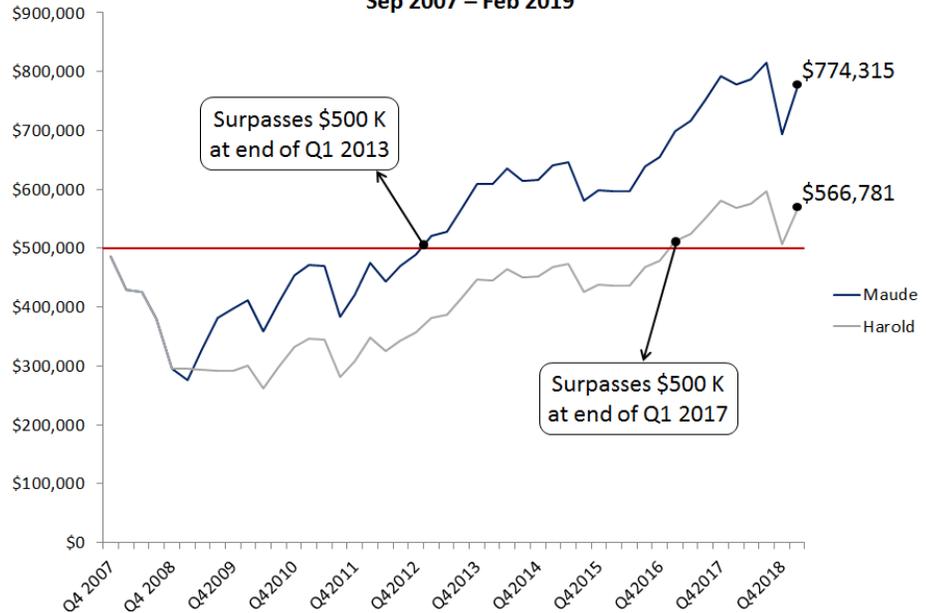
As you can see from the graph to the right, the decision to liquidate helped Harold initially – when the S&P 500 was down another 9% in February 2009 – Harold looks pretty smart. But as time goes on, the benefits from de-risking were overwhelmed by the compounding effect that Maude benefits from on the value she recovered in 2009. *It takes Harold four additional years to get back to \$500,000 starting level.*

The ending values of Harold’s and Maude portfolios differ by \$207,534. This is the type of wealth that can impact a retiree’s standard of living.

### Client Behavior – Q4 2018

In the tumultuous fourth quarter of 2018, we received only a few calls from our individual clients considering de-risking: “Should I re-allocate to fixed income? Should I just put it in cash?” While each client has a different financial situation, our responses generally fell into three themes. First, work with your financial planner to *evaluate your asset portfolio holistically* – including real estate owned, assets held elsewhere, etc., as LMCG typically “sees” only a slice of a client’s overall portfolio. It’s critical to view one’s equity exposure through this lens, especially when the equity market is volatile. The second area we addressed was *risk tolerance*. We can reassure clients all day long that long-term equity returns should compensate for the risk taken, but that’s not helpful if a client is having trouble sleeping due to the S&P 500 being down 2% on a single day. Finally, *time horizon* is a key determinant for how much equity exposure one should have. If a client is going to need to use a major portion of their portfolio in the next year or two, equities are probably not the best choice. However, if a client can look at this “bucket” as a long-term commitment (say, ten years) then history would suggest equities will typically provide the best return. We looked at all rolling 10-year periods from February 1970 onwards to generate the histogram below. The average return was 10.9% and only 5% of the time was

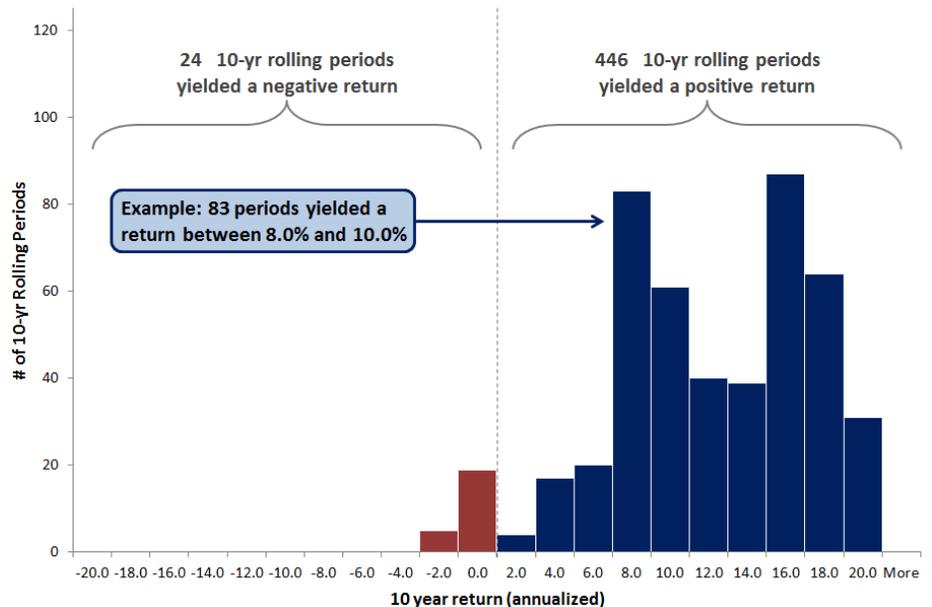
### Market Timing Can be Hazardous to Your Wealth Growth of \$500,000 Invested in LMCG Global MultiCap Strategy Sep 2007 – Feb 2019



Source: LMCG Investments, Global MultiCap Composite, Net of Fees

Past performance is not indicative of future results. Investment advisory fees are described in Part 2A of LMCG’s Form ADV. Net returns are calculated by applying the investment management fee schedule noted in the composite disclosure to the gross returns of accounts included in the composite. For information regarding the impact of investment management fees on performance, please refer to the composite disclosure shown below. This chart is shown as supplemental information only and complements the Global MultiCap composite disclosure attached.

### S&P 500 - Rolling 10 year Returns (annualized) Feb 1970 – Feb 2019



Source: FactSet

the return negative. There were only five out of 470 10-year periods where the return was less than 2%. The *S&P 500 – Rolling 10-year Returns* graph on the previous page demonstrates that if investors have a long enough time horizon, they should be able to withstand the market’s volatility.

*Of course the future may be unlike the past and these relationships may not hold.* We believe for long-term investors with an appropriate risk tolerance, the risk is well worth it.

Of course market timing CAN work. In our Harold and Maude example, if Harold had liquidated on 12/31/2007 and missed the 2008 38% drawdown, he would have been ahead of Maude’s fully invested portfolio. But the challenge is getting the timing right – at the end of 2007, things did not look nearly as bleak as they did early in 2009. It’s that major drawdown – 45% – which can strike fear in investors’ hearts ... and things can get emotional ... e.g., “I can’t afford to lose any more.” But history tells us that staying the course is more often than not the better path.

## Summary

We believe that trying to time the equity market is fraught with much more downside than upside. For investors that seek the long-term return premium that equities offer, we believe working with a financial advisor to “right-size” that equity allocation makes the most sense. Sticking with the plan through turbulent markets should be easier with both an appropriate allocation and a long enough time horizon.

<sup>1</sup> The S&P 500 was used as a broad-based barometer of market behavior. The benchmark for LMCG’s Global MultiCap strategy was initially the MSCI World Index, but was changed to MSCI ACWI IMI July 1, 2011 because its profile better represents the GMC profile.

<sup>2</sup> The fourth quarter of 2007 was the first full quarter of performance for the GMC strategy.



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## Global MultiCap Composite

Schedule of Annual Returns

January 1, 2008 through December 31, 2017

	Gross Returns (%)	Net Returns (%)	Benchmark <sup>1</sup> (%)	Dispersion <sup>2</sup> (bps)	Composite 3yr Ex Post Standard Deviation <sup>3</sup> (%)	Benchmark 3yr Ex Post Standard Deviation <sup>3</sup> (%)	Number of Accounts	Composite Assets at End of Period (\$ millions)	Total Firm Assets (\$ millions)
2017	22.9	21.1	24.0	29	10.8	10.3	298	289.0	7,551.3
2016	11.0	9.4	8.4	38	11.5	11.1	310	254.3	7,367.5
2015	-1.6	-3.0	-2.2	24	10.7	10.7	327	242.0	6,786.9
2014	2.6	1.2	3.8	28	10.7	10.6	314	237.1	6,370.5
2013	26.6	24.8	23.6	55	14.3	14.1	255	199.8	5,831.5
2012	18.2	16.4	16.4	78	17.8	17.3	188	125.2	4,402.6
2011	-6.1	-7.4	-7.9	54	20.2	20.9	150	87.0	4,200.7
2010	15.6	14.0	14.4	82	23.1	24.9	95	61.8	4,412.7
2009	36.5	34.6	36.4	128	-	-	32	21.5	4,365.1
2008	-38.2	-39.1	-42.3	NA	-	-	11	6.0	2,527.4

<sup>1</sup> Benchmark returns have been obtained from an independent source and have not been examined by independent accountants

<sup>2</sup> Not statistically significant because insufficient number of portfolios in the composite for the year.

<sup>3</sup> The three-year annualized standard deviation is not presented from December 31, 2008 through December 31, 2009 because the composite did not have 36 monthly returns in that time period.

**Global MultiCap Composite** Portfolios included in this composite are invested to achieve consistent returns above the benchmark over a full market cycle. Primary emphasis is placed on investing in financially strong small, mid-sized and large capitalization companies both domestic and international with above average earnings growth potential, strong balance sheets, improving profitability and attractive valuations. On July 1, 2011, the benchmark was changed from the MSCI-World Index to the MSCI All Country World Investable Market Index (“MSCI ACWI IMI”). The broader country and market cap universe of the MSCI ACWI IMI more closely aligns with the strategy than the previous index. Returns for the MSCI ACWI IMI are net of all foreign withholding taxes from a U.S. tax perspective. The inception date of the composite is September 1, 2007. The composite was created in January 2008.

Royal Bank of Canada (“RBC”) became LMCG’s indirect majority owner in November 2015 when RBC acquired City National Corporation (“CNC”). Effective January 1, 2015, Lee Munder Capital Group, LLC is known as LMCG Investments, LLC (“LMCG”), an investment adviser registered with the Securities and Exchange Commission. In July 2009, the firm was reorganized as an affiliate of CNC and took the name of Lee Munder Capital Group, LLC., prior to which it was known as Lee Munder Investments Ltd. (“LMIL”), which itself was an investment adviser registered with the Securities and Exchange Commission. The firm maintains a complete list and description of composites, which is available upon request.

The investment management fee schedule is as follows: 1.50% on the first \$1 million, 1.47% on the next \$1 million, 1.32% on the next \$3 million, and 1.07% on assets above \$5 million. This is the maximum fee schedule applicable to the strategy. Actual investment advisory fees incurred by clients may vary.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The U.S. Dollar is the currency used to express performance. Performance results are presented gross and net of management fees, include the reinvestment of income and are net of foreign withholding taxes. Net returns are calculated by applying the fee schedule disclosed above to the monthly gross returns of the accounts included in the composite. The annual composite dispersion presented is an asset weighted standard deviation calculated for the accounts in the composite the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.