



The Impact of Recent Market Volatility on Financial and Retirement Planning





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Introduction and Recent History

On February 20, 2020, the DJIA (29,220), NASDAQ (9,751), and S&P500 (3,373) were near their all-time highs, despite the looming global COVID-19 crisis. Barely one month later, on March 23, the DJIA closed at 18,592 (down 36.4%), NASDAQ closed at 6,861 (down 29.6%), and the S&P500 closed at 2,237 (down 33.7%). However, by June 8, these indices had recovered the majority of their earlier losses (DJIA up 48.3% to 27,572, NASDAQ up 44.7% to 9,925, and S&P500 up 44.5% to 3,232). By July 31, despite a second wave of the coronavirus spreading throughout the U.S., the markets had remained mostly level (relative to June 8), with the good news of a pending vaccine and improving employment figures counteracting both poor quarterly corporate earnings and negative virus-related trends.

The market volatility observed in 2020 was unprecedented in recent times, with the exception of the financial crisis of 2007-2009. For most clients, their 1Q20 investment reports were as poor as they had ever seen, whereas if they stayed the course, their corresponding 2Q20 reports (relative to 3 months earlier) were surprisingly stellar. Still, the prolonged atmosphere of fear and anxiety has created ripples throughout the financial services industry, and financial advising and retirement planning in particular. Here, we focus on how the role of financial planners has been impacted through these wild swings, with special attention given to clients who are approaching or are at retirement ages. In turn, we consider the impact of the pandemic environment on the role of financial advisers, the behavior of their clients, the factors that induce investors to make trades, and any allocation shifts within individual investment portfolios.

Financial Advising Impact

From late February through late March 2020, financial advisors were faced with an unusually high volume of customer inquiries. When an agitated client calls in a time of potential crisis, the advisor's first role is to listen and attempt to quell the feelings of uncertainty and angst. The client may initially intend to exit the market or at least a large segment of their portfolio, but the advisor will caution that selling off will lock in losses without the potential of recovery. If the client truly cannot handle the elevated risk levels, and is comfortable with realizing sizeable investment losses, the advisor will eventually acquiesce and satisfy the client's request.

However, other alternatives are available, such as shifting the asset allocation of a portfolio, hedging positions that are overly exposed, or adapting a wait-and-see attitude (if the client is not completely desperate for cash). A seasoned advisor can draw upon their experience with handling similar concerns amid the recession of 2007-2009, and remind their clients that the years that followed that episode of high volatility were some of the most favorable

in stock market history, with markets trending upward (with very low volatility) for the great majority of 2009 and the 2010s decade. Financial planners must also avoid becoming overconfident in their supposed ability to time the market or select individual stocks, as the majority of returns (positive or negative) in such times are governed by macro-level effects that may be beyond the control of many individual firms or agents.

Client Behavioral Impact

It is quite difficult for the average American to avoid feeling fear and the resulting financial insecurity that accompanies the current pandemic. News telecasts and printed media coverage remind viewers constantly of the adverse health, psychological, and transactional aspects of the new normal. Many investors have lost access to a source of their regular income, through reduced hours, going on furlough, or even having their jobs eliminated if they are unfortunate enough to work for failing companies or within industries that cannot operate at full capacity amid the economic slowdown/shutdown.

Some companies may be suspending retirement contributions into employee accounts indefinitely as a less painful alternative to cessation of employment. Meanwhile, clients must continue to make house/rent payments, car payments, bill/tax payments, and other potentially large periodic cash outflows. To satisfy these obligations, clients may be forced to withdraw funds from their investment accounts, even at suboptimal times when prices are deflated. Alternatively, they may also suspend periodic contributions into IRAs, Roth IRAs, and 401(k) plans. In short, financial planners are likely seeing more outflow in the accounts they manage than inflow in 2020, which can affect their compensation structure if based on volume of assets under management.

Investment Transaction Impact

Requests for financial transactions (among clients) are almost surely higher for most financial advisors this year than in a typical year. It is fascinating to follow the financial news headlines this year, as almost on a daily basis, there are wild swings in U.S. stocks and market indices that induce traders and/or clients to take action within their investment holdings. Such swings may be caused by various governmental actions (Presidential announcements about upcoming stimulus plans, interest rate changes by the Federal Reserve, or the degree to which the national economy may be restricted or opened up due to pandemic spread management). Many large corporations are frequently announcing forecasts or earnings that may be significantly different from previously expected. Any new information relating to the efficacy and timing of a potential vaccine can especially sway investor sentiment for both economic and health motivations, as can less optimistic comments from someone like Dr. Anthony Fauci.

For investors approaching, at, or just beyond retirement age, the ramifications of these changing conditions are particularly paramount. The notion is that one has built up their nest egg over 30 or 40 years and is not about to forfeit these gains due to something resembling a market crash. Those near retirement comprise a large share of the highest-maintenance clients (and highest-income ones) that are most likely to keep their financial advisors up at night. These concerns are elevated further if the client is forced to retire early (so that less income is available to accumulate an adequate retirement fund), if there are major health issues within the family (among which could include the virus itself), or if there is financial strain in the family (for which the retiree has agreed to assume the burden). If there is a short-term need for emergency funds, especially when one's liquid assets and banking accounts are depleted, this dilemma may supersede any traditional investment considerations that would otherwise exist.

Asset Allocation Impact

Many advisors, either with or without their clients' permission, have taken the recent opportunities provided to make asset allocation shifts to client portfolios. A common goal may be to minimize risk among the volatile pandemic-era conditions, while preserving previous capital accumulation as much as possible. High-risk, unpredictable sectors like International or Emerging Markets may be down-weighted until the economies represented in such investments can be better understood. Furthermore, many investors have requested a shift from stocks to bonds (especially Treasuries), or other assets (like certain commodities) that may be inversely or lowly correlated with stocks and mutual funds. In other words, the benefit of diversifying one's portfolio is greatest in times of high volatility (like most of 2020). Some may even desire a significant share of their retirement funds to 'sit on the sidelines' in cash or cash equivalents for a few months or quarters, until markets stabilize again.

One interesting phenomenon is that growth stocks/funds, especially high-tech ones, have outperformed value stocks/funds amid the crisis. This is counterintuitive, since historically, the value sector has suffered lower losses in down/volatile markets than has the growth sector, while the growth sector outperforms in bull markets. In fact, as of July 31, the NASDAQ is at/near its all-time high (10,745), more than double its value just before the dot-com crash of early 2000. Since June 8, 2020, the date when extreme market volatility began to drop, until July 31, the NASDAQ is up 8.2% further, while the S&P 500 is only up 1.2%, and the DJIA has retreated by 4.1%. Advisors may also be applying hedging techniques more often than usual to minimize portfolio losses, while simultaneously giving up the opportunity for large gains, at least in the short-term.

Conclusion / Future Direction

The most predictable aspect of the remaining months of 2020 is that they will be highly unpredictable. It would be foolhardy to speculate on the future direction of financial markets, or whether the coronavirus will soon either increase or abate in intensity. What is more certain is that these two phenomena are deeply intertwined, especially for the financial advisory profession and clients who are aging and at or considering retirement. If health and economic constraints allow one to have enough freedom to make unrestricted choices, perhaps a long-term view is most recommended. In other words, instead of making drastic financial decisions that potentially overreact to the temporary upheavals experienced recently, one might, cautiously but optimistically, make plans for the pending upcoming return to normalcy.

Personal Statement

I became increasingly interested in financial planning topics during the Spring 2020 semester, when I taught Personal Finance for the first time at Drake University. Almost exactly halfway through the term, the genesis of the COVID-19 pandemic hit North America, causing Drake to send its students home early so that all classes after Spring Break were online only. In fact, a circuit breaker shut down U.S. markets during the middle of one of our last in-person classes in early March, for which my students, after checking their cell phones, informed me live. I would like to thank Adam Schwallier who provided valuable perspective and insight on financial advice issues and influenced many of my personal thoughts for this essay.

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