Time & the Concept of Risk

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April 12, 2023

In the beginning paragraph of last month's commentary, I discussed and provided examples of how simple mathematical relationships can drive the daily prices of certain types of securities. I will begin with a short discussion of risk to flush out the meaning of the commentary title.

In order to make my point, I refer to an article Fortune published on December 31, 2022, titled: The U.S. Treasury market just suffered its worst-ever annual loss in 2022, written by Elizabeth Stanton. The article, regarding 2022's losses in Treasury securities stated:

"The Bloomberg US Treasury Index returned -12.5%, its second straight full-year loss and the biggest in its four-decade history."

Thus, if an investor bought a basket of U.S. Treasury securities or an ETF that tracks the Bloomberg US Treasury Index at the beginning of 2022 and sold that investment one year later on December 31, 2022, that investor would have incurred a loss in excess of 12% in spite of holding supposed RISK-FREE U.S. Treasury bonds. How can an investor lose money owning a security that is risk-free?

Time! (Risk-free only applies to investors who hold treasury securities to maturity.)

U.S. Treasury bonds are universally considered risk-free from a credit risk perspective, but being traded securities, subject to highly efficient quantitative market pricing, they can indeed be very risky if not held to maturity. If held to maturity (3, 5, 10, 20 or 30 years) these bonds are universally considered risk free.

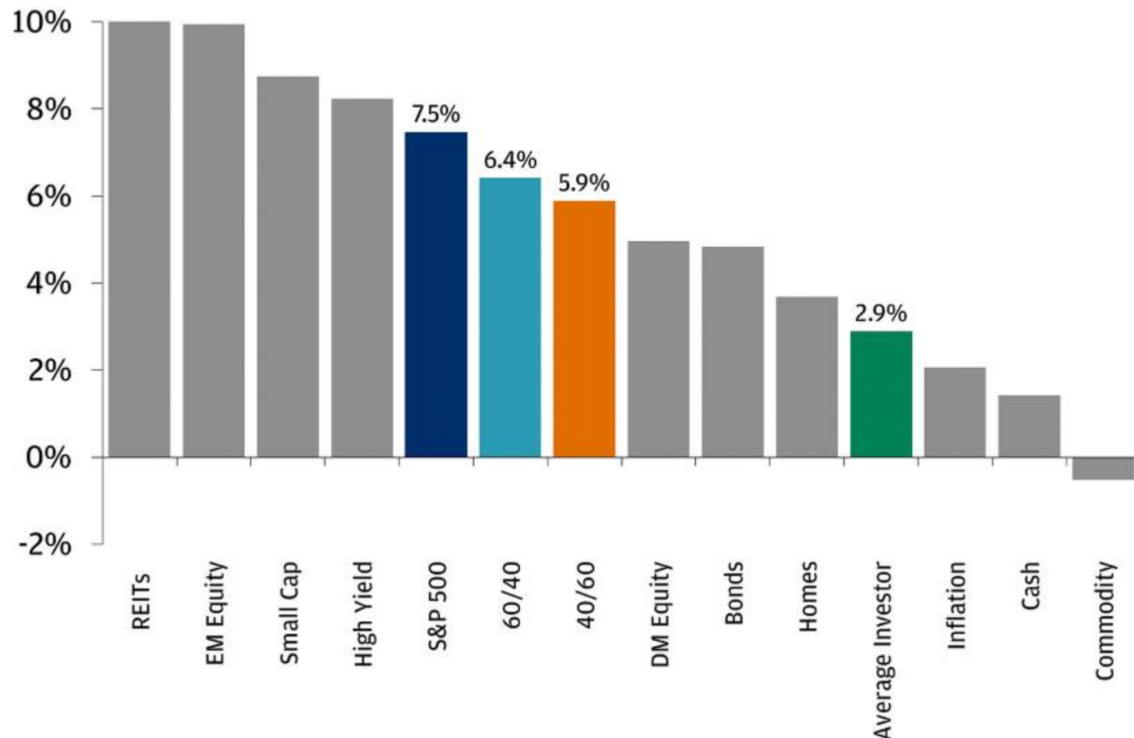
Treasury bonds are the purest example that the concept of risk is determent upon the time an investment is held. The same concept of risk can also be applied to other investments, such as stocks. I could fill this commentary up with quotes from the likes of Warren Buffett, Mario Gabelli, and Bill Miller regarding the necessity to hold stocks for the long term. I will instead summarize a March 7, 2023, Forbes Advisor article titled 7 Tips for Long-Term Investing written by Stacy Rapacon:

The article's seven tips were*: Get Your Finances in Order, Know Your Time Horizon, Pick a Strategy and Stick with it, Understand Investing Risks, Diversify Well for Successful Long-Term Investing, Mind the Cost of Investing, Review Your Strategy Regularly.*

Below are some select quotes from the article that I believe are good reminders of how important time is to a successful investment plan:

- *Withdrawing funds early from long-term investments undercuts your goals, may force you to sell at a loss and can have potentially expensive tax implications.*
- *Typically, long-term investing means five years or more, but there is not a firm definition.*
- The article quotes the CEO of Francis Financial in New York City*: "When there is a market downturn, there's a lot of fear and anxiety as you see your portfolio tank," But selling at that time and locking in losses is the worst thing you can do."*
- *Stocks may be classified as a combination of the above, blending size and investing style. You might, for example, have large-value stocks or small-growth stocks. The greater mix of different types of investments you have, generally speaking, the greater your odds for positive long-term returns.*
- *Overall, investing is all about focusing on your financial goals and ignoring the busybody nature of the markets and the media that covers them. That means buying and holding for the long haul, regardless of any news that might move you to try and time the market.*

The lesson to take from this month's commentary is that any time one sells a long-term investment, that decision introduces additional risk that can transform a no-risk investment or a moderate-risk portfolio strategy into a highly risky transaction. I came across the following graphical illustration of how the "average investor" misses out on strong "average returns" across various common asset classes by creating additional risks that result in compounded errors over time. This illustration was produced by JP Morgan Wealth Management and was included in an article written by JP Morgan Global Investment Strategist, Elyse Ausenbaugh:



We are currently enduring a very challenging time in the market. We are also living in the age of 24/7 news and social media. The average person is bombarded by predominately negative stories about everything from crime, war, and corruption to conspiracies and over-amplified fears. During times prior to social media, it was talk radio that people searching for conspiracies and sensationalism turned to. But today we have social media algorithms that amplify this type of information every time you log on to the most used social media platforms and 24/7 "news" channels on television whether you are looking for that type of information or not. What used to be reserved for the more extreme corners of AM talk radio has now been normalized and delivered to audiences under the guise of "the truth" or "news."

We simply need to constantly tell ourselves that much of what we hear and how we feel about the issues that cause us the most anxiety are not unique to this time in history. What today we view as unprecedented, dangerous, and corrupt has always been out there in one form or another, it just was not amplified and delivered to your eyes and ears daily. In the late 1880's children were forced to work under intolerable conditions, freed slaves were only free on paper in many parts of the country, women could not own land, could not vote, and rarely were allowed to be educated. In the early 1900's we had women's suffrage battles, World War I, and a global pandemic. During the mid-1900s had the Great Depression, WWII, the holocaust, two nuclear bombs dropped, and Joe McCarthy's communist conspiracy in Washington DC. In the 1960s,

70’s, and 80’s we had a President, Attorney General, and Civil Rights Leader assassinated, we had a military draft, and we were embroiled in a war that the country largely opposed. Later we had a President resign in disgrace, we had economic stagnation and high inflation for ten years, and globally there were wars being fought in the Middle East and Afghanistan. Also, for much of the latter half of the 20th century, Greatest Generation and Baby Boomers spent much of their lives under the continual threat of nuclear annihilation by Russia.

Every generation has faced its own unique “unprecedented” crises, political dysfunction/corruption, and frightening threats from afar. No matter the generation, that generation always believes that previous generations had it easier and better. This is rarely true, and it is usually the opposite, especially in the United States.

At Seven Summits Capital, we manage investments using our knowledge of history and our insights into the future as they relate to our chosen investments. We process information using perspective and a keen awareness that the way information is delivered today is designed to trigger negative emotions.

So far in 2023, the dire economic predictions that pushed markets down in 2022 have not materialized, corporate earnings have come down from the high levels seen in the post pandemic period of 2021, but have generally held up far better than feared, and concerns that inflation would be persistent at highly elevated levels for much longer have largely receded. In the short-term markets gyrate according to the narratives being peddled, with negative narratives usually crowding out more reasonable and measured voices. When this happens, gamblers/traders jump on the negative bandwagon and exacerbate a market's decline. But, over the long-term markets behave far more rationally as overly negative narratives fade into the past and a more reasonable and measured reality is validated and that is the reality in which we choose to invest.

Disclosure:

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