How to manage your portfolio and emotions during volatile markets

Video Transcript

Recorded on March 6, 2015

Featuring:
Michael Santoli, *senior columnist, Yahoo! Finance*
Matthew Diczok, *managing director, head of portfolio solutions, Merrill Lynch Wealth Management*
Michael Liersch, *managing director, head of behavioral finance and goals-based development, Merrill Lynch*

Please see important information at the end of this video.

MICHAEL SANTOLI: Hello. I'm Michael Santoli, senior columnist at Yahoo! Finance. I'm here today with Matthew Diczok, managing director, head of portfolio solutions for Merrill Lynch Wealth Management, and Michael Liersch, managing director, head of behavioral finance and goals-based development for Merrill Lynch, to talk about what you can do to manage your investment portfolio, and your emotions, when financial markets get volatile and you're uncertain about what to do next.

Welcome, Matt and Michael.

Section 1: Change your view of volatility

So, Michael, just to get started, as somebody who studies investor behavior, what should an individual investor do when market fluctuations get them worried?

MICHAEL LIERSCH: The first thing some investors do is stick their heads in the sand—what's called the "ostrich effect" in behavioral finance terms, where they're trying to avoid the markets and the volatility. So they do nothing.

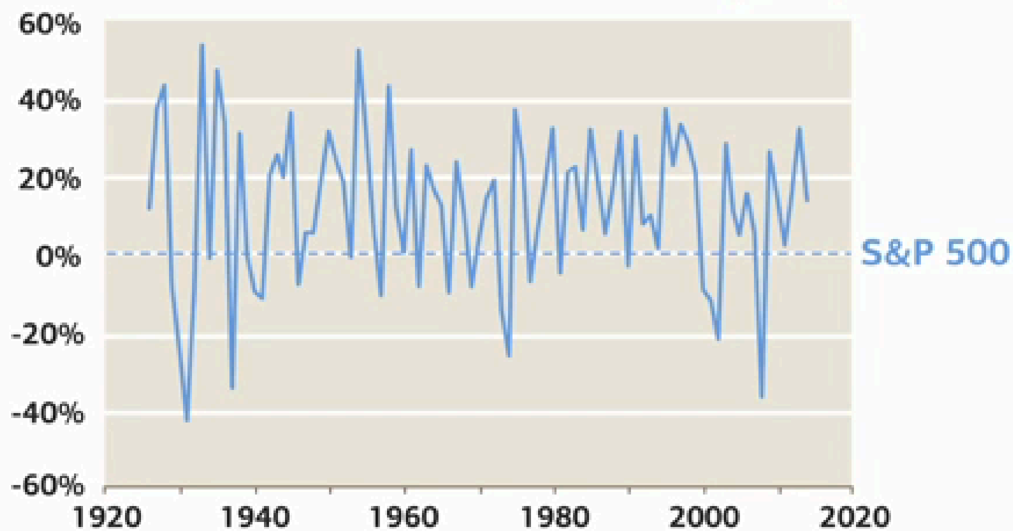
On the flip side, we see other investors. What they do is they do the opposite of the ostrich effect and they overreact to markets, so they over-engage [and] maybe make some hasty decisions. So what I suggest investors consider doing is taking a step back, articulating their goals in concrete terms, and then investing toward those goals by committing to those investments so they can stay the course, even in the face of volatility.

MR. SANTOLI: So, Matt, what does market history tell us about that need to remain focused on those goals and translate them into an investment portfolio?

MATTHEW DICZOK: I completely agree with Michael: Volatility is inevitable. It's not a question of if it's going to happen, but when. And, unfortunately, we can't answer when it's going to happen. All we can do is build diversified portfolios matched to

our goals, and manage them in a systematic way.

Remember that market downturns occur regularly



Sources: Bloomberg and Ibbotson Association, 2/2015.
Past performance does not guarantee future results. The chart shows total return of the S&P 500, including reinvestment of dividends and does not include transaction costs. The S&P 500, or the Standard & Poor's 500, is an unmanaged American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ.

There are numerous times over history when the market has fallen 10, 20, even 40 percent or more. It's important to know that going in ahead of time and be able to sort of deal with that when it occurs.

Now, as a very recent example, from the peak in 2000 until 2002, the market fell about 50 percent, and then it basically doubled by 2008, and again it fell by 50 percent.

Remember that market downturns occur regularly

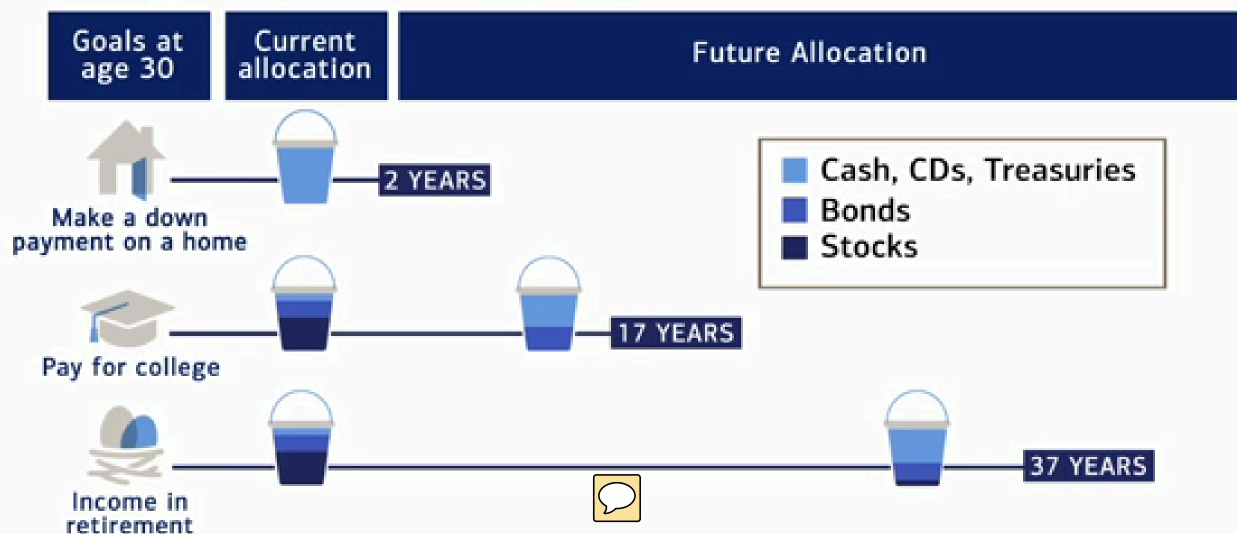
- In 2002, the market went down about 50% from its peak in 2000
- From 2003 to 2008, the market went up again—almost doubling
- Again in 2008, the market fell 50%

So there's a very recent tangible example: Two times in less than a decade that the market's fallen 50 percent. Realize that can happen to your equity portfolio, plan for it, be ready to deal with it, and have a diversified portfolio that you understand could withstand those market movements.

Section 2: Focus on what you can control

MR. SANTOLI: So, Matt, you advise investors not to get caught up in the day-to-day fluctuations of the market, but of course we're constantly treated to reminders of what the Dow or the S&P 500 or interest rates are doing every moment of every day. So, Michael, how can an investor tune out those real-time fluctuations?

MR. LIERSCH: One of the first steps is to not look at arbitrary benchmarks like the S&P 500, as you just described, and instead look toward goals—like a purchase of a home or an educational goal for your children or a retirement goal. What kind of asset allocation is appropriate for those goals?



When you have longer time horizons, you have a higher risk tolerance. Then maybe a heavier weight toward stocks is more appropriate relative to cash-like investments. For example, [for] a retirement goal with a long time horizon, while stocks may be appropriate, you also want to consider holding those cash-like investments so you can meet your cash flow needs in retirement.

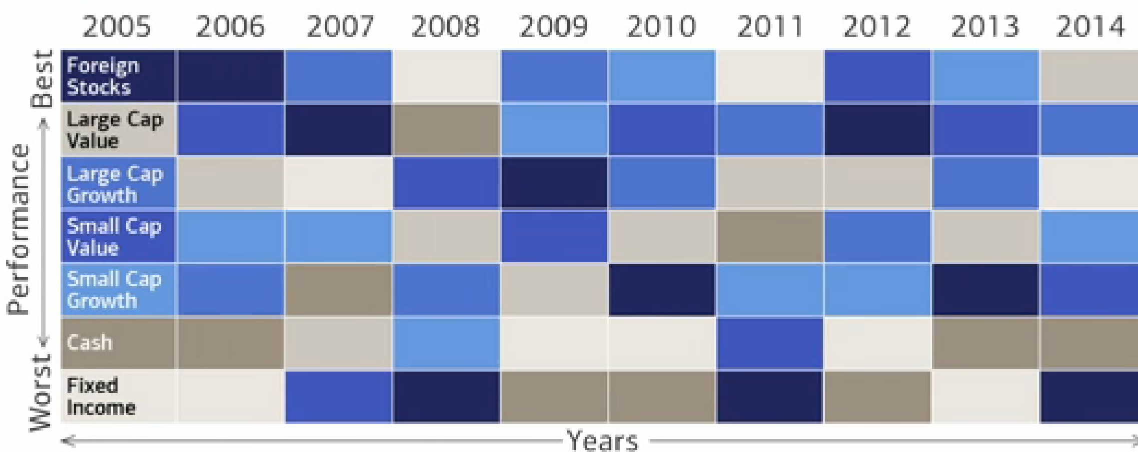
And when time horizons shrink, that's when you really need to focus on CDs, treasuries and cash, so that you have the liquidity you need in order to meet the outcome you're expecting with that goal.

And, Matt, since you do a lot of portfolio construction work and portfolio strategies work, and you're an expert in this area, can you comment?

Section 3: Stop chasing performance and diversify

MR. DICZOK: Yes, certainly. For instance, buying last year's winners as a way to pick this year's winners: Not going to be a winning investment strategy. Take a look at this chart:

Single asset class annual returns 2005-2014



Source: Bloomberg.
This information should not be construed as investment advice. It is presented for information purposes only and is not intended to be either a specific offer by any Merrill Lynch entity to sell or provide, or a specific invitation for a consumer to apply for, any particular retail financial product or service that may be available.

The illustration of the annual performance of various asset classes is in relation to one another and does not reflect the performance of any specific investment. Results shown are based on indexes and are illustrative; they assume reinvestment of income and no transaction costs or taxes. Past performance is no guarantee of future results. Diversification and asset allocation do not ensure a profit nor protect against a loss in a declining market.

It shows that there's really no correlation between what did well last year and what did well this year. Individual investors have a tremendous advantage. Assuming they're saving and investing for a long-term goal, they can actually use under-performance in one asset class to potentially add to that asset class.

When things are cheaper, it might be a good time to rebalance and add more of that asset class. Warren Buffett, one of the best investors of all time, has a great analogy.

He likes hamburgers, right? So if he goes to the grocery store and it happens that ground beef is 20 percent off, 30 percent off, he says he'd like to buy more of it. Think about that as an analogy for the equities in your portfolio. He thinks of stocks not as pieces of paper to trade, but individual pieces of businesses. When those prices are cheaper, that *may* be a better time to rebalance and add more to that asset class.

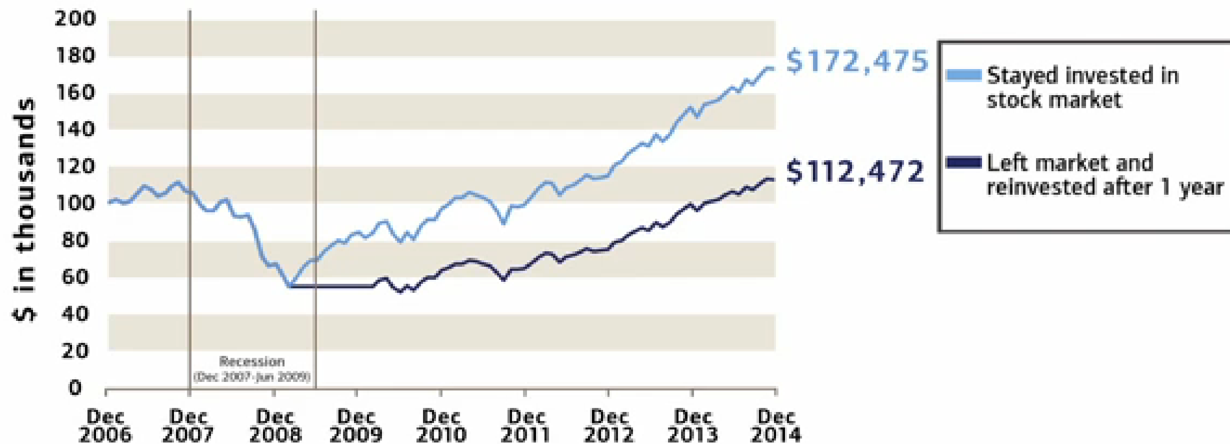
Section 4: For long-term goals, consider staying in stocks

So if you're investing for a long-term time horizon, it can be to your benefit to have a consistent asset allocation and potentially add to it.

If you had sold stocks at the worst part of 2009 when we were all feeling bad and

we were all looking at our investment portfolios and every day they were down—if you [had] said, “You know what? I’m selling equities at that point. I’m going to stay in cash for a year until the market’s better”—this [chart] highlights how costly that would’ve been to you, how much you [would’ve given] up by taking your money out of equities at the wrong time.

Sticking with stocks can make a big difference



Source: Merrill Lynch Investment Management & Guidance (IMG).

The image illustrates the value of a $100,000 investment in the stock market during the period of December 31, 2006 - December 31, 2014, which included the global financial crisis and recovery that followed. This chart is for hypothetical purposes only. Past performance is no indication of future results. The market is represented by the Standard & Poor’s 500®, an unmanaged group of securities considered to be representative of the U.S. stock market. Cash is represented by the 3 month U.S. Treasury bill.

An investment cannot be made directly in an index. The data assumes reinvestment of income and does not account for taxes or transaction costs. Returns and principal in stocks are not guaranteed. Stocks have been more volatile than bonds or cash. Holding a portfolio of securities for the long term does not ensure a profit and investing in securities always involves risk of loss.

Now, this is definitely no guarantee that you’ll always make money doing that. However if you routinely sell when the market is going down—advocating basically what sounds like a “sell low” strategy—over time that will generally have a drag on your performance.

MR. SANTOLI: Absolutely. Very important to remember. So just to summarize what we’ve discussed here:

Things to remember:

- Volatility is inevitable
- Focus on what you can control—invest based on your individual goals
- Don't chase returns—diversify instead
- Use market dips as a possible buying opportunity
- Consider staying invested

Remember that volatility is inevitable. Your objective is to create an investment portfolio that doesn't require that you react to changing markets.

Focus on what you can control; invest based on your individual goals, time frame, liquidity needs and risk tolerance.

Don't chase returns, but diversify instead to help smooth out the market's ups and downs.

Look at volatility as a possible buying opportunity.

Consider staying the course and remain invested according to your investment goals.

For more helpful information and tools to help you ride out volatile markets, I encourage you to go to merrilledge.com/changingmarkets.

GRAPHIC: merrilledge.com/changingmarkets

Thank you, Matt and Michael, for your perspectives.

This is Michael Santoli. Thanks for watching.

This video includes a third-party presenter who is not affiliated with Merrill Lynch or any of its affiliates and is for informational and educational purposes only. The opinions and views expressed do not necessarily reflect the opinions and views of Merrill Lynch or any of its affiliates. All opinions are subject to change due to market conditions and fluctuations.

The information presented is for discussion purposes only and is not intended to serve as a recommendation or solicitation for the purpose or sale of any type of security. Past performance is not a guarantee of future results.

The investments or strategies presented do not take into account the investment objectives or financial needs of particular investors. It is important that you consider this information in the context of your personal risk tolerance and investment goals. Due to the time-sensitive nature of the content and because investment opinions may have changed since the time any comments were made by research analysts, the latest Merrill Lynch investment opinion and investment risk rating for any particular security discussed should be reviewed, including important disclosures, before making an investment decision.

Asset allocation and rebalancing do not ensure a profit or protect against loss in declining markets.

Investing involves risk. There is always the potential of losing money when you invest in securities.

Investing in fixed-income securities may involve certain risks, including the credit quality of individual issuers, possible prepayments, market or economic developments and yields and share price fluctuations due to changes in interest rates. When interest rates go up, bond prices typically drop, and vice versa.

Equity securities are subject to stock market fluctuations that occur in response to economic and business developments.

Index sources: **Small Cap Growth**–Russell 2000® Growth Index; **Small Cap Value**–Russell 2000® Value Index; **Large Cap Growth**–Russell 1000® Growth Index; **Large Cap Value**–Russell 1000® Value Index; **Foreign Stocks**–MSCI Europe, Australasia and Far East (EAFE®) Index; **Fixed Income**–ML US Broad Bond Index; **Cash**–ML US Treasury 3-Month Index. Indexes are unmanaged. Direct investments cannot be made in an index. Source: Bloomberg.

Foreign Stocks—Morgan Stanley Capital International Europe, Australasia, Far East Index–MSCI EAFE® Index. This is a weighted, unmanaged index of performance that reflects stock price movements within Europe, Australasia, and the Far East.

Large Cap Value—Russell 1000® Value Index. Measures the performance of those Russell 1000® companies with lower price-to-book ratios and lower forecasted growth values.

Large Cap Growth—Russell 1000® Growth Index. Measures the performance of those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values.

Small Cap Value—Russell 2000® Index. Measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000® Index.

Small Cap Growth—Russell 2000® Growth Index. An index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000® Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000® Growth Index serves as a benchmark for small-cap stocks in the United States.

Cash—Cash returns comprise one-month Treasury bill returns.

Fixed Income—ML US Broad Bond Index. This index tracks the performance of U.S. dollar denominated investment grade Government and Corporate public debt issued in the U.S. Domestic bond market, including collateralized products such as Mortgage Pass-Through and Asset-Backed Securities.

Merrill Edge is available through Merrill Lynch, Pierce, Fenner & Smith Incorporated (MLPF&S), and consists of the Merrill Edge Advisory Center (investment guidance) and self-directed online investing.

MLPF&S is a registered broker-dealer, member SIPC and a wholly owned subsidiary of Bank of America Corporation.

Investment products:

Are Not FDIC Insured	Are Not Bank Guaranteed	May Lose Value

© 2015 Bank of America Corporation. All rights reserved.

ARQVLBLR