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Market Ethos

The latest market insights from Richardson Wealth

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Be prepared: Have your portfolio playbook ready

Summary: In this Ethos, we share a bit of our process for being prepared for potential outlier events and how we may trade them. It's like an NFL playbook for various scenarios. We think about potential events in a calmer environment with the goal of making better decisions in the heat of the moment.

What will you do if the market tumbles 8% in October, a month known for having above-average volatility? You are probably thinking you will put some cash to work and buy that dip! Okay, well the market dropped 9% from mid-July till early August. Did you do some buying then? Making a portfolio change is always challenging. During upward market swings, greed becomes a more prominent emotion, just as fear does during downward swings. Very, very seldom do these emotions help results or decision-making.

Worse yet is the narrative. When the market is down, financial news is certainly tilted towards doom and gloom. When it's up, there is more euphoric messaging about how AI or something else is going to change the world. The takeaway: financial news, X, or whatever your source is, likely exacerbates that fear/greed emotion. Tweets and comments on August 5 included many saying the bear market had started or the world was ending. Whoops.

And then there is the time. If you are inclined to make a change during a big market move, it takes time to become comfortable with the portfolio change, research and analyze it, rationalize the decision, and then implement it. If it's a model change for many clients, that takes even more time. All this contributes to a more buy-and-hold approach: position a portfolio for what you believe will happen in the coming months, quarters, or years.

We can all agree, markets will go from point A to B but not along a smooth line

Source: Bloomberg, Purpose Investments

But markets never move in a straight line, and there will be big oscillations, up and down, along the journey. These moves can create opportunities to add value to a portfolio by being a bit tactical, even if just around the edges. So, how can we overcome decision paralysis due to emotions, somehow navigate the noise from financial media, and implement a change in a timely, thoughtful manner?

Portfolio playbook: Think about it now to be more prepared for later

Today, the S&P 500 is at 5,500. What would you do if it reaches 6,000 before year-end? That would be up over 25% this year. What would you do if it tumbles down to 5,000 in the fall months? That is a drop of about 9% from here. Pre-conceiving a few broad scenarios can really help the decision-making when/if that moment happens. We are not saying it should be automatic or easy, but working through some scenarios in advance will help lighten the load if it happens, which may improve the implementation speed or decision-making process.

Portfolio managers will use this approach in equity portfolios with revisit levels. They are not triggers but rather levels the team will re-assess, which could lead to selling, trimming, adding, or buying. But today we are talking multi-asset portfolios. So, the potential scenarios are more market or economic events that might change our thinking in one direction or another, and result in a change in our multi-asset portfolios tilts or exposures. It is not a wholesale change, as the portfolio's core is predicated on a longer-term view and objective. Rather it is smaller changes around the edges as markets create what could be opportunities.

Considering these events ahead of time and how we may trade improves our process during what could be a stressful time. Please note, it almost never works out as envisioned, but can often have some similarities. These are not forecasts; more things could happen and impact how we consider reacting.

Note: These are sample scenarios and potential portfolio ideas for illustrative purposes only. Any actual portfolio changes are subject to many additional considerations in real-time.

Event	Additional Context	Market Reaction	Potential Changes
Contested U.S. election leads to market drop (-10%)	If economic data remains decent	Equity market down, bonds may also be down, U.S. dollar may be down with gold higher	Take some profits on gold, deploy cash into unhedged U.S. equities
	If economic data is softening	Equity market down, bonds up, with gold higher	Given softer economic data, would not be buying dip
Bond yields move higher: U.S. 10-year 4.75%, Canada 10-year 4%	Inflation resurgence	Bonds down, equities down more so for growth factor	Believing inflation will be volatile this decade – add to bonds to lock in yields
	Market concerned over deficits	Bonds, equities, US dollar down.	This could be a tail risk event, continue to hold gold. Don't buy dip.
Bond yields move lower: U.S. 10-year 3.5%, Canada 10-year 2.75%	Recession risk has risen, inflation risk faded, equities are stable	Bonds up, stocks stable	Trim bonds and/or reduce duration. Likely raise cash
	Recession risk has risen, inflation risk faded, equities are down too	Bonds up, stocks down, credit spread likely higher	Trim bonds/duration. If still believe shallow recession, add to credit
S&P 6,000!!!!	Lifted by drop in rates, Mag 7, AI excitement	Equities up, bonds likely up a bit too with lower rates	Trim U.S. exposure, raise some cash
	Broad based market advance and earnings growth	Equities up, bonds likely down a bit on improving growth	Let the good times roll, perhaps add in some trailing stops to take a bit of profit
Seasonal sell-off, it is September after all	Broad based global sell-off, everything down	Stocks down, bonds & U.S. dollar up. Vanilla risk-off	Buy that dip
	Narrow sell-off in Mag 7, broader market down less, defensives up	Headline indices down a lot, but damage below surface limited	Do nothing, at some point this concentration will begin reversing and could take years

Final thoughts

We find considering different outcomes ahead of time lightens the load when we are considering a portfolio change in the moment. The number of scenarios can really expand, as can the additional context characteristics. We believe the more thinking you can do ahead of time in a calmer environment, the better your decision-making will be when things go crazy or reach extended levels. Of course, many scenarios may never trigger, but it is still better to be prepared in case the market doesn't simply move up in a steady, smooth line.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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