Panic Proof Your Financial Plan.

3 Tips to Prepare for Uncertain Times

Election Day Mayhem

It had turned out to be a nice, sunny November day as I drove through unfamiliar territory across the great state of Wisconsin. I had met with 401(k) participants that morning and had further business to attend to in Minneapolis before heading back the next day to Texas. Nice, rolling pastures dotted with dairy barns passed by me.

Where were the cows I wondered? I had expected to see dairy cows but had not seen a single one. I supposed they were in the barns, locked in place with their heads in feed troughs and udders attached to tubes. More machine than animal, the modern dairy cow represents something entirely different than the nostalgic memories of my youth. My grandmother milked a cow for much of her life with her bare hands and a pail. The large grain elevators and other equipment hanging off the barns reminded me that things had changed. Things were changing in the Wisconsin political landscape too.

There it was again. A sign on the side of the road. The white block letters that reached out from a blue background read TRUMP in bold letters, with PENCE in a slightly smaller font just below. These signs seemed to be everywhere and far outnumbered the sparse showing of Hillary signs that I had expected.

It was Election Day, November 8th, 2016 and as had been the case for most of modern history, Wisconsin was expected to vote democrat. I thought back to my meetings that morning that had been held in a small distribution facility. As I was leaving, the informal conversation with some of the employees inevitably turned to the election, but not for long. The employees and management were guarded, and very tight lipped about their leanings as if they were holding onto secret information the rest of the world knew nothing about. At least not yet.

That evening, I checked into the Radisson Blu Hotel, a nice addition to the massive Mall of the America's on the outskirts of Minneapolis. There was a lot of activity as several local political watch parties convened in and among the convention halls. I wearily strode through the throngs of people and soon I was comfortably in my room, watching election results roll in.

I had some work to catch up on as I passively watched the big electronic CNN map of the country turn into a patchwork of blue and red states. It was late, really late, but the longer I stayed up the more interesting the patchwork became. I don't remember exactly what time it was, but it was well after midnight when Wisconsin, the state I had just driven through, lit up republican red. Holy cow. Trump was leading in an election he wasn't supposed to win with states he wasn't supposed to win. Wisconsin had previously voted for seven democrat presidential candidates in a row.
I was shocked, the pundits on CNN were shocked, and the world was shocked.

With a surge of adrenaline and intrigue, I immediately fired up my TD Ameritrade Market Monitor software. Just as I had expected the futures market was going nuts. Things settled a bit at the opening bell, but at one point in the early morning fray, S&P futures were down almost 5%.

Here we go, I thought. I know from many years of experience the stock market hates surprises. For months, the market had been pricing in the likelihood of a Hillary Clinton win so when these results came in, volatility ensued. It was anybody's guess what would happen next.

What did I do over the course of the next few days and weeks?

I went into what I call "hunker down" mode, minimizing any buying or selling for my clients while letting the dust settle.

Fear Creates Bad Decisions

What did the market do?

The stock market went almost straight up from that day on. Called the “Trump Bump”, it was a wild and wonderful ride for those who remained invested and therefore were able to participate. But many personal investors did NOT stay in the market, so they saw none of these gains. Fear and emotion are the personal investors greatest enemies. Many people tried unsuccessfully to predict what this surprise election meant, and they were rudely disciplined.

We should never, ever try to predict what the stock market is going to do, especially when it comes to politics. In 2012, when Obama was re-elected to his second term, I had a very conservative client who was absolutely convinced this was the end of democracy and America. He cashed out of all of his investments with me and bought gold. Then, over the next several months, he watched helplessly as the stock market went straight up and gold prices went straight down.

Over the years, I have reviewed a number of reports about stock market performance during election cycles, and whether democrat or republican presidents are better or worse for the stock market. There are no clear-cut indications, except that election years are generally good years, regardless which party wins. But, that’s not enough information for sound investment decisions.

So when it comes to preparing for this next election cycle, what is the prudent course of action?

I have three suggestions.

1. Don't Panic.

Our country has handed over the keys to the Oval Office forty-four times without turmoil or bloodshed. That's amazing if you really think about it. President of the the United States is arguably the most powerful office in the World, and each time the loser of the election has walked away without trying any funny business. In many other countries transition of power is punctuated by turmoil and bloodshed, yet we're able to do it in routine, clocklike fashion.

How? What makes us different?

Two things: precedence and balance of power. George Washington was truly a remarkable man on so many levels, but many would argue the most important thing President Washington ever did was hand over the keys to John Adams after only two presidential terms. Washington was hugely popular and probably didn't have to do that. Many men would not have relinquished power under similar circumstances. This set a precedence and legitimized our new republic's system of government.

That new system of government included the three branches and a balance of power between them. We all know this and accept it as the rule of law. However; many countries around the world are set up similarly without the same level of legitimacy.

With smooth transition and true balance of power, our country is governed for extraordinary financial market stability.

One consequence of three branches of government is very slow policy change. Even when a new president is elected, very little if anything different happens to any significant level. This is because the President cannot just do whatever he wants. Congress has to enact law and the Supreme Court has to agree that it is constitutional in order for the Office of the President to change much of anything.

Remember when I said that the stock market hates surprises? Since things change slowly in Washington, this results in lower volatility in the stock market. The slow, agonizing political process allows the stock market time to absorb information and adjust smoothly.

This means there is no reason to panic like my former client did in 2012 when he sold out of the market and bought gold. We can thank our founding fathers for a political system that is very conducive to a stable economy, albeit frustratingly ineffective at bringing about change.

2. Act Early.

The stock market adjusts to new information instantaneously. This means you and I have no chance of getting ahead of new information to gain profits or minimize losses, legally, that is.

Do you honestly think you know something that nobody else does about what's going to happen next?

Get real, it's highly unlikely. The volume of information the market trades on every second is more than the human brain could process in a lifetime. If you take a financial position based upon what you think is going to happen, you're just gambling, not investing. Consequentially, the longer you hold that position, the less relevant the information you acted on becomes...by the second!

In order to invest successfully through a volatile cycle you have to know that you don't know what's going to happen and be totally okay and content in this lack of knowledge. This means that early on, well before things get crazy, emotional and heated, you have to decide what level of risk you are willing to take with your money. Will you need some of it short term?

If so, you should take a conservative stance early on to protect yourself from losses. If you have long term money set aside for retirement or other needs in the distant future, maybe you can be more aggressive and invest thru any potential volatility.

The key here is to adjust your portfolio well in advance of any potential volatility. There is no reason to wait. I invest other people's money professionally and have been doing so for many years.

Friends and clients comment from time to time that "being responsible for other people's life savings must be very stressful".

It certainly can be stressful, but I have learned an important investing lesson that significantly alleviates most of the stress. Every day, at the end of the trading day, I want all of my clients' money to be prepared for the worst as if it's going to happen tomorrow. I have no idea what tomorrow will bring, nor do I worry about it. Rather, I just remain vigilant and prepared.

3. Protect Your Gains.

Being prepared doesn't mean we clear out all our positions at the end of the day or anything extreme, it just means we maintain a certain level of protection at all times. One longstanding, tried and true way to be safe is to diversify among several different stock positions, industries, types of stock, and countries. This way, no single surprise to one stock, region, or sector can hurt us too bad. That doesn't mean just tens or hundreds of stocks, rather for us it means thousands of stock positions held in every nook and cranny of every sector all over the world. From there, we want to add non-stock diversification like real estate, commodities or anything we can find that acts differently from stock in order to mitigate the stock markets potential for volatility.

Then there are bonds. Good old boring bonds are a crucial component to any investment portfolio. Because interest rates have remained historically low over the last many years, bonds have lost some of their appeal as a stock diversification tool. They still do a good job of reducing the risk and volatility of a portfolio, but their low yields make them less attractive as an asset than they used to be.

For this reason, we like to add another kind of protection that steps in and buoys the portfolio during a down market event, like a surprise election result or novel virus, yet also participates to some level in market gains. We call it a buffer, and it can be added to a portfolio fairly easily and inexpensively through new Exchange Traded Fund (ETF) based options strategies. The buffer essentially provides a narrowly defined outcome over a holding period, like one year.

This defined outcome has two components: a cap and a buffer.

The buffer provides downside protection by reducing losses by a specified percentage, generally 9 or 15%. To pay for the buffer, a cap is placed on how much market gain this part of your portfolio will be allowed to participate in. The cap varies based upon market conditions at the time of purchase. Because the strategy is wrapped in an ETF, we're able to maintain daily valuation and liquidity, along with good transparency of cost and fees.

Buffers are complicated but can be a very important component of a well-designed portfolio, especially in times of uncertainty.

Layer 1

S&P 500 Exposure

Synthetic 1:1 exposure to the S&P 500 (4 options)

Layer 2

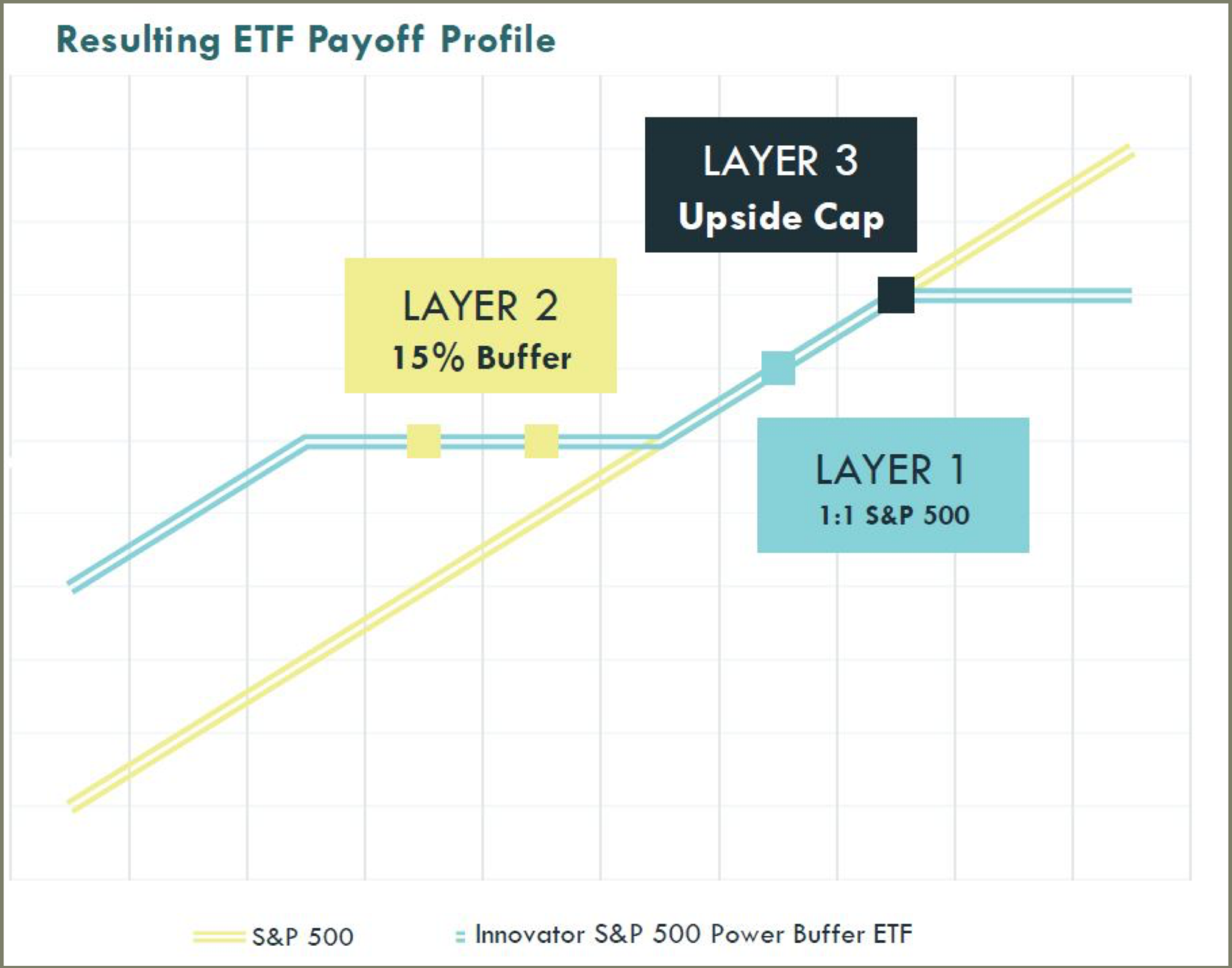
Create the Downside Buffer

Buy a Put Spread of S&P 500 options that provides either the **9%** or the **15%** downside protection (2 options)

Layer 3

Upside Cap

Sell and upside call option at a level that will finance the downside put



Are we in a time of uncertainty?

I don't think so, at least not any more than any other time. Uncertainty just means that we don't know what's going to happen next. Heck, isn't that just life? If you are feeling anxiety around the current market volatility, remember my first piece of advice: don't panic. We've seen elections, crisis, and uncertainty numerous times over the course of history. Everything should work out fine.

The best thing you can do is be prepared now and remain prepared. Get your portfolio in order and invested in a way that it can participate in good markets and survive the downturns, no matter which comes next.

That's where it gets tricky unless you design investment portfolios for a living. The stock market is complicated, and you have to keep up on things in order to do well. Because of this, you should seek professional guidance in designing a solid strategy.

Don't know where to start? We can help. Schulz Wealth is a fee-only fiduciary advisory firm. We don't sell investment products, rather, we provide advice. This means we can review your current situation, goals, and investments to provide specific recommendations on how you can succeed through good times and bad.

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I would love to connect with you, hear your thoughts, and know what you've learned from reading this. Please take a moment to sound off in the "Thoughts on Things Financial" group. Your feedback is important to me. It will also help me create more helpful content to help you take control of your finances.

Take care,

Rob Schulz, CFP®

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