Clark Capital MANAGEMENT GROUP

NavigatorInsights

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As Clark Capital's Chief Investment Officer, Sean oversees all of the Firm's investment activities and heads the Firm's portfolio team. Sean joined the Firm in 1993 and is responsible for asset allocation and investment selection for Navigator Investment Solutions as well as directing ongoing market research and contributing to the development of proprietary products. Sean is a member of the Clark Capital Management Committee and the Board of Directors. He graduated from the University of Delaware, earning a B.S. and an M.A. in Economics. Sean is a Chartered Financial Analyst and a member of the CFA Institute (formerly AIMR) and the Financial Analysts of Philadelphia, Inc. Sean is considered an industry expert and is often asked to appear on CNBC and Bloomberg television to share his views on the market. In addition, Sean has been quoted in a number of articles in nationally distributed business journals and newspapers.

Is Now the Time to Take Some Risk Off the Table?

Source: Morningstar Direct

Investors who were blind-sided by the Great Recession generally fit into two camps. There were those who stayed in the market (or didn't get out for too long) and have fully recovered and those who sold out of the market and missed some or all of the rewarding run-up that followed the recession. In this article, we'll focus on the first group.

For investors who remained committed to their financial plans, 2008 and 2009 might feel more like a distant nightmare than a reality. The last five years, although fraught with geopolitical concerns, government shutdowns, and doom-and-gloom headlines, have rewarded investors with double-digit returns in the S&P 500 four out of the last five years.

Historically, investors allocated to fixed income to de-risk and to provide income and stability. However, fixed income may not offer the same risk-return benefits that it did during its most recent 30-year bull market. But there are other tools out there, tools that can be used to help investors diversify and de-risk without relying too heavily on fixed income or market timing.

Target Weightings with a Twist

What the markets will bring in the future is anyone's guess, although one could argue that now is a good time to take some risk off the table and rebalance back to target weightings. However, a traditional equity and fixed income portfolio in a rising rate environment may not offer the same benefits as in a declining rate environment. Now as we hover around all-time market highs, the answer may not be as simple as allocating 40 or 50% of a portfolio to fixed income to provide protection.

For investors who are on track to reach retirement, we as financial professionals must seek to ensure they are not taking more risk than is necessary. We saw this in 2006 and 2007 when assets had piled into the equity markets and managers hungrily chased bloated benchmarks.

I can't tell you how many stories I heard about investors who had taken on too much risk in their portfolios prior to the bear market. For instance, a couple who were two years from retirement, their portfolios loaded with stocks, or a widow who had all of her assets in a few so-called high quality stocks. In a cruel and ironic twist, the quality areas of the markets experienced some of the sharpest declines as institutions and investors looked for liquidity during the worst parts of the recession. This created what appeared to be a worst case scenario for conservative equity investors, and it made investors feel as though there was nowhere to hide.

I am not suggesting that we are headed for another great recession or even a bear market. What I am suggesting is that advisors take a look at current client allocations and determine whether they are appropriate in the current market environment.

Looking back, the market's run-up has been tricky. At every turn, a timid investor might have been tempted to back off from equities. Yet the Fed did not reward investors for being conservative. All-time lows in bond yields sent a message loud and clear: load up on equities or lose out. We have not had a correction of over 10% since 2011, although we came very close (-9.93%) in the spring of 2012. With rates potentially poised to rise, it may make sense to look beyond traditional asset classes and incorporate alternatives into a portfolio.

Won't Get Fooled Again

One example of an alternative strategy is a managed volatility hedging strategy. By incorporating tools that track volatility into a portfolio, the manager seeks to offset losses. Typically right before or during a market meltdown, volatility spikes. In this way, it is negatively correlated to the equity markets. By incorporating and actively managing volatility, it can help to diversify a portfolio and to protect investors when they need it most.

Arguably the best time to incorporate a hedging tool into one's portfolio is before a market setback in an effort to lock in gains and protect against losses. When I look around at the excitement of the markets and their rise from the ashes, I believe now might be the best time to take the advice of The Who in their 1971 song "Won't Get Fooled Again" and think about de-risking and incorporating hedging vehicles. It could help prevent investors' hard-earned savings and income plan from being derailed.

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