CREATIVE PLANNING

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The Coming Correction

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A stock market correction is coming. Guaranteed.

That is quite a statement from a firm that has spent the last several years arguing that market timing is impossible. So, how can we make such a prediction? We can make it because stock market corrections happen all the time. They are a given. Predicting one is like saying, "It is going to rain sometime this year."

Let us start with the definition of a "correction." It is simply a stock market drop of 10% or more. If the market drops a total of 20%, we change the name from correction to "bear market."

How frequently does a correction occur? Using the year 1900 as a starting point, corrections happen approximately every year (source – *American Funds*). This means if you are around age 55 and reading this letter, you can plan on experiencing about 30 or more corrections.

Why not get out of the market once it drops 10% to avoid a further drop into bear market territory? The reason is most corrections never officially become bear markets. Historically, the average correction is a drop of 13%. Most corrections last less than two months, with the average length of a correction sitting at just 54 days (source - *Fidelity*). Less than one in five corrections turns into an official bear market.

> "Stock market corrections happen all the time. Do not bother trying to predict them, and do not freak out when they happen."

Knowing this, it does not make sense to go to cash whenever a correction occurs. In fact, with odds like that, it is a rather illogical decision to convert to cash once the market drops 10%. You would basically be moving to cash right before the typical bottom. Imagine how badly you could screw up your portfolio if you reacted to even some of these corrections.

Predicting stock market corrections and bear markets is a sport of sorts. Many commentators predicted the start of a correction following the crisis in Ireland, then Iceland, then the unemployment numbers, then Egypt and so on. The stock market recovery proved them all wrong. To make matters more difficult, sometimes corrections happen for a reason, and sometimes they do not.

We know it is a fact that corrections happen all the time. We know that most corrections do not evolve into bear markets. We also know that every single correction in history has given way to a full recovery. It seems completely ridiculous to panic and go to cash. In fact, with what we know about corrections, it makes sense to do what Creative Planning has done in the past, which is rebalance when the market is weak. This puts you in a better position than you were before the correction. In other words, the correction is a great time to position your portfolio to profit further, rather than to panic.

At Creative, we take advantage of corrections and bear markets. Part of our strategy is to opportunistically rebalance, which means to rebalance when the market is volatile. For example, if the market drops a lot in just a few days or weeks, we will rebalance portfolios, essentially buying more stock while others are selling. Corrections have always fully recovered. Once the market recovers, our clients have not broken even, but rather have come out ahead. ***This is one of the main reasons why the overwhelming majority of Creative's clients hit all-time highs in their portfolios despite the fact that the Dow itself still needs to go up nearly 1800 points to reach its all-time high.***

Thank you for the introduction to your friends and colleagues, and for your continued confidence.

Despite this common-sense approach to corrections, many Americans panic with each new correction and run to cash. In retrospect, corrections seem obvious and completely avoidable. How many "I told you so's" would you hear on CNBC if the various recent European problems led to a correction? More recently, how many people predicted the unrest in Egypt would spread and lead to a correction? For the last 6 months now, you cannot go a day without the media running a headline predicting a correction simply because the "current market run up is overheated" or "we are overdue for one."

"...when the correction gives way to the bull, as it has historically done, the intelligent investor is richer for it."

It becomes much easier to succeed at investing if you understand 4 things:

1. No one can consistently predict when a correction or bear market will happen.
2. No one can predict how long a market decline will last.
3. Anyone that tells you differently on 1 or 2 above falls into one of two camps: incompetent or dishonest. Take Warren Buffet's advice and try to avoid these people.
4. Historically, the market has always recovered.

The takeaway? Stock market corrections happen all the time. Do not bother trying to predict them, and do not freak out when they happen. Instead, not only welcome them, but ***embrace*** them. **They afford patient and intelligent investors an opportunity, *a true gift*, to take advantage of the volatility.** And when the correction gives way to the bull, as it has historically done, the intelligent investor is richer for it.

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