

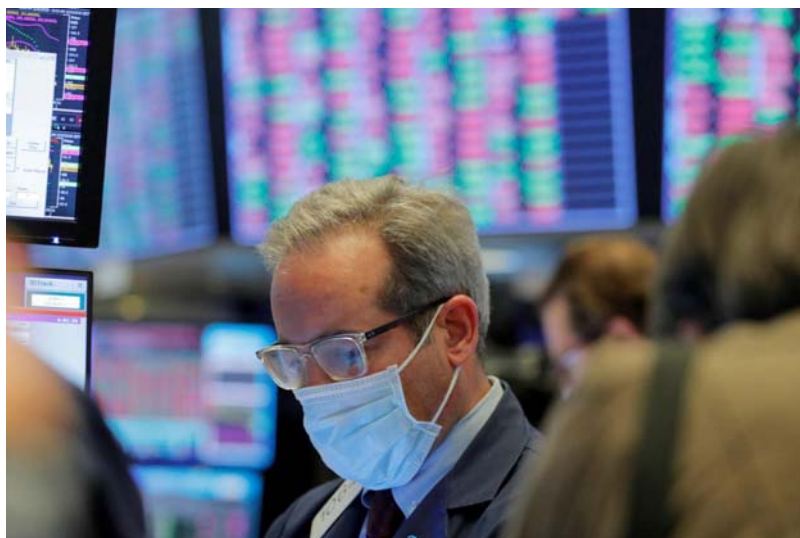
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JOURNAL REPORTS: FUNDS/ETFs

Five Assumptions Many Investors Are Making Now—but Perhaps Shouldn't

With the market in such a mess, it's important to examine the conventional wisdom



The stock market has shown resilience before, and could again. Shown, the New York Stock Exchange on March 20, before the trading floor was closed because of the coronavirus pandemic.

PHOTO: LUCAS JACKSON/REUTERS

By Michael A. Pollock

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Sometimes it pays to take a closer look at our assumptions. They might conform to the conventional wisdom, but that doesn't mean they are wise.

That's especially true these days for investing, as uncertainty grips the battered financial markets. What's really safe to assume now? Should people conclude that the era of strong stock gains won't return and just sell everything on the next decent move upward? Is it too late to reposition an equity-heavy portfolio? Are there certain signals that might foreshadow a big market rebound?

It's time to put certain assumptions under the microscope and examine them more closely. Here are five of them:

Assumption 1: We're in for a long bear market



PHOTO: PETER OUMANSKI

The unprecedented nature of the current health crisis may make it difficult to envision the stock market staging a strong rebound soon. But it could be a mistake to overestimate the duration of the market retrenchment.

Three months after the 2003 SARS epidemic hit the U.S., the S&P 500 index was up 22%, according to Sam Stovall, chief investment strategist at CFRA Research. It was up 6% three months past the first U.S. case of Ebola in 2014. On the geopolitical front, only one shock in the past two decades caused a market downdraft of more than six months, Mr. Stovall says. That was Iraq's 1990 invasion of Kuwait.

A key factor in the market's resilience has been the economy's strength at the point when an event took place, Mr. Stovall says. When the economy was fundamentally strong—as it was before this latest shock—the market recovery wasn't as lengthy. And recovery times have been shrinking, possibly because a digitally interconnected world enables a more rapid assessment of events, Mr. Stovall says.

Assumption 2: It's time to de-risk the portfolio



PHOTO: PETER OUMANSKI

Humans are instinctively risk-averse, and perceptions of risk sometimes are overly influenced by what just happened instead of longer-term patterns, says Andy Reed, a behavioral economist at Fidelity Investments. “If you just focus on the latest news, it’s hard to remember that in every previous recession, there’s always been a rebound,” Mr. Reed says.

Moreover, for many people, the stock market’s big decline already has resulted in portfolio rebalancing by reducing the equity allocation.

It’s also probably a bad move to try to cut risk by shifting now into defensive market areas such as consumer staples, says Michael Mullaney, director of global markets research at asset manager Boston Partners. Investors began flocking to such stocks some time ago, pushing up valuations. Some exchange-traded funds that focus on staples are trading at price-to-earnings ratios in the 20s, compared with a broad U.S. market P/E in the upper teens.

Assumption 3: My mutual fund is so damaged it may be time to reconsider holding on



PHOTO: PETER OUMANSKI

Financial advisers generally warn against bailing out of a fund after a steep decline, because you'll miss out on the rebound when it comes. Still, some investors may be tempted because of the depth of this drop and the uncertainty surrounding the progression of the coronavirus pandemic.

But keep in mind that many fund investors' portfolios perform more poorly than the funds they own at various times, largely because of poor decisions about when to go into a fund and when to exit. Plus, if a lot of fundholders rush to sell, funds may be forced to liquidate holdings at depressed prices to raise cash, and that could hurt performance even more.

Of course, that isn't to say that you shouldn't look closely at your funds. Pay particular attention to their consistency of returns over a long period, not just recent performance, says Campbell Harvey, finance professor at Duke University's Fuqua School of Business. Thoughtful analysis may lead you to sell a fund—but that's very different from exiting now just because the overall market has declined.

Assumption 4: Wait for signs that stocks have bottomed before going in



PHOTO: PETER OUMANSKI

Timing new investment in the market is as problematic as timing a market exit. For instance, it's widely assumed that once the rate of coronavirus infections in the U.S. begins to drop, markets will rally. That could happen, but it might be risky to bet on it.

Some older adages haven't proved their effectiveness as ways to time markets. In a recent analysis, John Rekenthaler, a Morningstar vice president, looked into the idea that when investors were holding a lot of cash in places other than equity, that signaled potential for a flood of money back into stocks. Mr. Rekenthaler concluded that there wasn't a clear pattern that would be useful in trying to predict when stocks would rally.

Many advisers say that, instead of trying to time the market, investors should put a consistent amount of money into the market at regular intervals, regardless of whether prices are up or down.

Assumption 5: Inflation is dead, so there is no need to worry about it

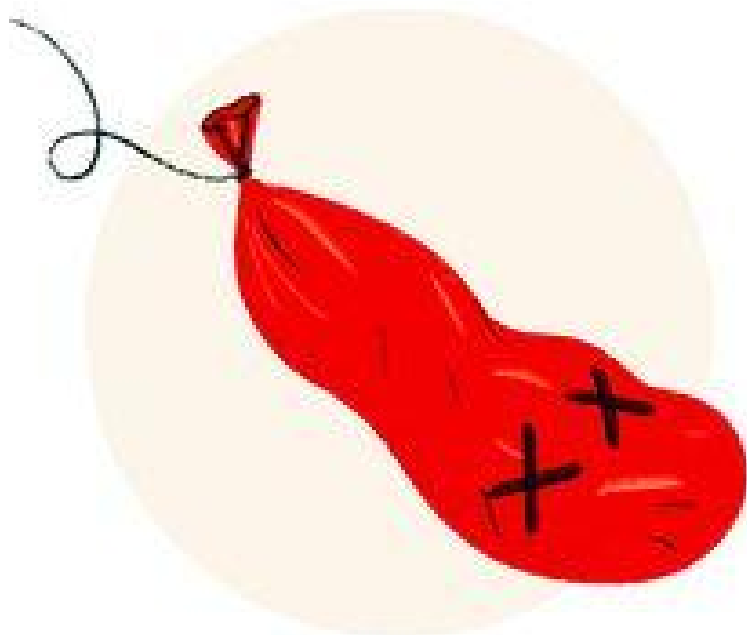


PHOTO: PETER OUMANSKI

U.S. inflation has been remarkably tame over the past decade, possibly because the rise of the internet and growing imports gave U.S. consumers and manufacturers better access to cheaper goods, says Ryan Detrick, senior market strategist for [LPL Financial](#), a retail investment advisory firm and broker-dealer. But he and others say that while disinflationary forces aren't going away soon, it could be a mistake to ignore the potential for a rekindling of inflation in the future. One concern is that a large Federal budget deficit might eventually help stoke inflation.

Any significant increase in the inflation rate could pose risk to holders of interest-rate-sensitive, long-maturity government bonds such as Treasuries, which are historically overvalued, says Richard Bernstein, a New York-based adviser.

His firm has been wagering that when inflation expectations eventually rise, that will boost certain inflation-sensitive assets such as gold and Treasury inflation-protected securities. When inflation expectations are low, all that has to happen for inflation-sensitive assets to do well is for inflation to exceed those expectations, Mr. Bernstein says.

Mr. Pollock is a writer in Pennsylvania. He can be reached at reports@wsj.com.

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