



PRATO CAPITAL

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## **Volatile Markets With A Financial Life Plan**

by Christopher Conway

Rather than chasing market returns and the next hot stock, a Financial Life Plan with a diversified and balanced portfolio puts the focus toward both long and short-term financial goals and not just the portfolio returns.



**The Financial Life Plan**

Have I saved enough for a house or second home? Can I afford to pay for my children's college expenses? Can I afford to travel during retirement? Is my family financially protected should I need nursing home care in the future? Many have these same questions and a Financial Life Plan (FLP) can provide answers.

At Prato Capital, we view a client's Financial Life Plan much like a road map for their successful financial future. The FLP is tailored to each client's needs and goals. This plan is reviewed regularly and can be changed anytime financial goals, current or in the future, may change.

Previous [newsletters](#) and [blogs](#) have discussed the planning process we use for each client and how it can help provide a guide for their financial future. An FLP at Prato Capital can include insurance considerations (disability, life, and long-term care), tax considerations (the tax implications of where you live, where you will retire, and how to distribute required minimum distributions efficiently), legal considerations (trusts, wills, and estate planning), and of course investments. With investments, we can plan additions of recurring savings, future contributions, and future lump sum payments like bonuses and inheritance if they can be expected.

Over time, the portfolio is the source of growth in the FLP that helps clients reach their financial goals. The FLP takes into account the impact of costs from inflation, market ups and downs, income and real estate taxes, and the types of investments in the portfolio. Using almost 100 years of historical stock market returns, an FLP can provide a very accurate forecast of each client's portfolio through market ups and downs. A Financial Life Plan accounts for volatile markets like we have seen this year and in past market disruptions.

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## **A Balanced and Diversified Portfolio Complements the FLP**

At Prato Capital, every client's portfolio is based on their current situation, future goals, and risk tolerance and all of this makes a better and more concise FLP.

During volatile times in the stock market, it is easy to chase returns through market timing and lose sight of why a balanced and diversified portfolio is the best choice for investors with future financial goals. Research has shown that a diversified portfolio can outperform market timing and trying to always pick the 'hot stock'.

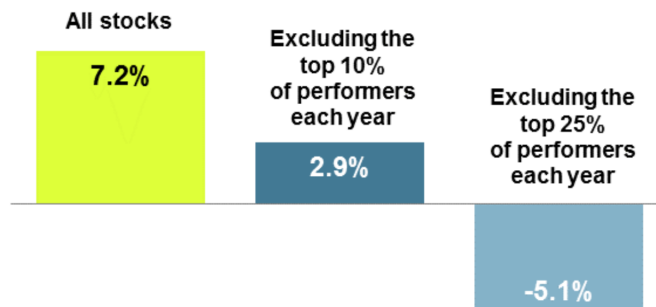
**Exhibit 1** below illustrates how a diversified equity portfolio can perform over the long term compared to trying to time or pick stocks. For reference, the US stocks with the highest return for 2018 and 2019 were Twilio Inc. (+278%) and Axxome Therapeutics (+3,578%) respectively. These are generally not the stocks most investors are thinking about or have in their portfolios showing just how easy it would be to miss the top performers.

## EXHIBIT 1

### Benefits of Diversification

Compound average annual returns: 1994–2018

Research shows there is no reliable way to predict top performers. Broad diversification helps reduce unnecessary risk and can boost returns.



"All stocks" includes all eligible stocks in all eligible Developed and Emerging Markets at their market cap weights. Eligible stocks are required to meet a minimum market capitalization requirement. REITs and investment companies are excluded. Compound average annual returns are computed as the compound returns of the value-weighted averages of the annual returns of the included securities. "Excluding the top 10%" and "Excluding the top 25%" are constructed similarly, but exclude the respective percentages of stocks with the highest annual returns by security count each year. Individual security data are obtained from Bloomberg, London Share Price Database, and Centre for Research in Finance. The eligible countries are: Australia, Austria, Belgium, Brazil, Canada, Chile, China, Colombia, Czech Republic, Denmark, Egypt, Finland, France, Germany, Greece, Hong Kong, Hungary, India, Indonesia, Ireland, Israel, Italy, Japan, Republic of Korea, Malaysia, Mexico, Netherlands, New Zealand, Norway, Peru, Philippines, Poland, Portugal, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, United Kingdom, and the United States. Diversification does not eliminate the risk of market loss. Past performance is no guarantee of future results.

A diversified portfolio of equity and fixed income based on a client's risk tolerance is ideal for an FLP for several reasons.

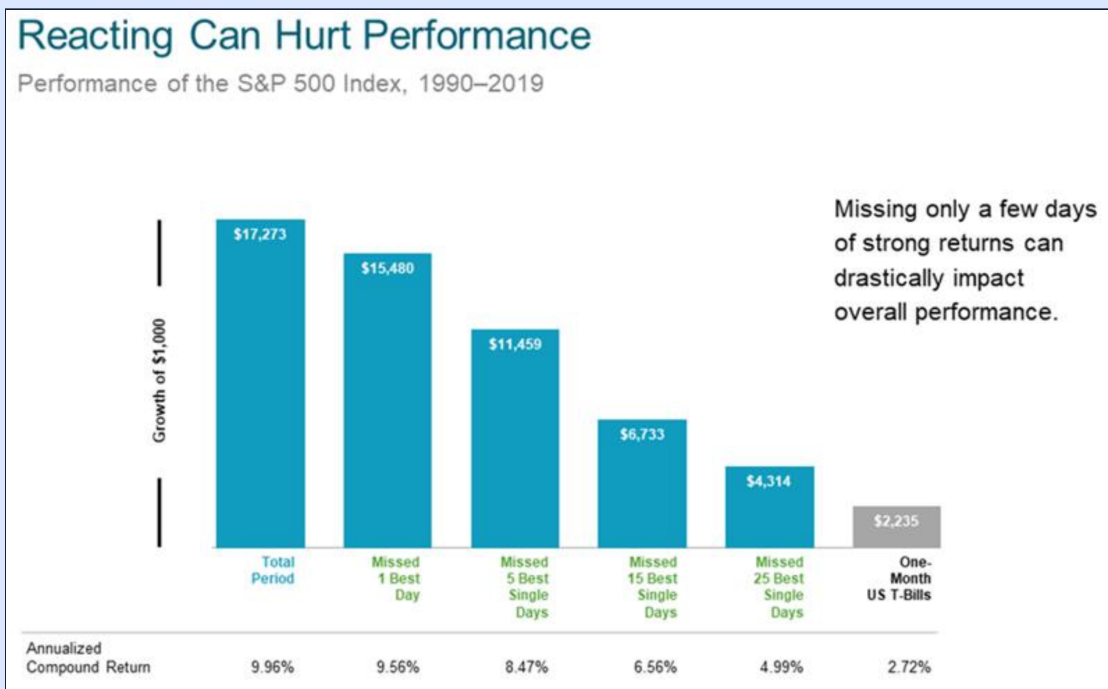
- A globally diversified portfolio of equities can deliver more consistent outcomes over time with less volatility. This helps our clients stay on track through all kinds of market conditions.
- A balance of fixed income in a portfolio can provide income and balance any volatility of the stock market.
- It is our view that a balanced, diversified portfolio of equities and fixed income provides more reliable long-term returns which increases the probability of success in our clients Financial Life Plan.

## The Benefit of a Disciplined Approach to Investing

A disciplined approach to investing starts with a balanced and diversified portfolio appropriate for each client's risk tolerance. This approach continues with rebalancing the percentage of equities and fixed income through market volatility to keep an appropriate balance of risk and future possible gains. At Prato Capital, using almost 100 years of stock market returns as a guide, we remove emotion and media noise from investment decisions. This can eliminate some of the anxiety associated with market volatility for clients and minimize the risk of chasing returns to the detriment of their portfolio.

**Exhibit 2** below shows how reacting to volatility, whether letting emotions cloud investment decisions or trying to time the ups and downs of the stock markets, can have significant impacts on portfolio performance.

### EXHIBIT 2



Market timing does not work. It adds risk to a portfolio, and it adds significant risk to any FLP. A disciplined approach to investing avoids this risk and maintains a more accurate FLP.

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## Conclusion

A Financial Life Plan is much more than just an investing plan. It is a client's individual guide for their financial life and allows them to make educated and informed decisions about their financial future.

Although volatile markets can cause anxiety and stress for investors, reacting emotionally, and altering long-term investment strategies in response to market volatility is not the correct response. By adhering to a well thought-out and disciplined investment strategy based on one's personal risk tolerance and their specific FLP (which takes into account periods of market volatility), clients may feel better assured during periods of short-term market volatility.

At Prato Capital, we remain undeterred in our approach when it comes to the financial planning process as well as our long-term investment philosophy.

This allows our clients to stop worrying about the future and start looking forward to it.

Times have changed since the days of Confucius but this statement is still relevant today:

*"A man who does not think and plan long ahead will find trouble right at his door."*

– **Confucius**

Thinking of you always,  
Gregory, Gabriella, Brian, Chris, and Samer

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