PRATO CAPITAL

INVESTOR TAKEAWAYS FROM 2020

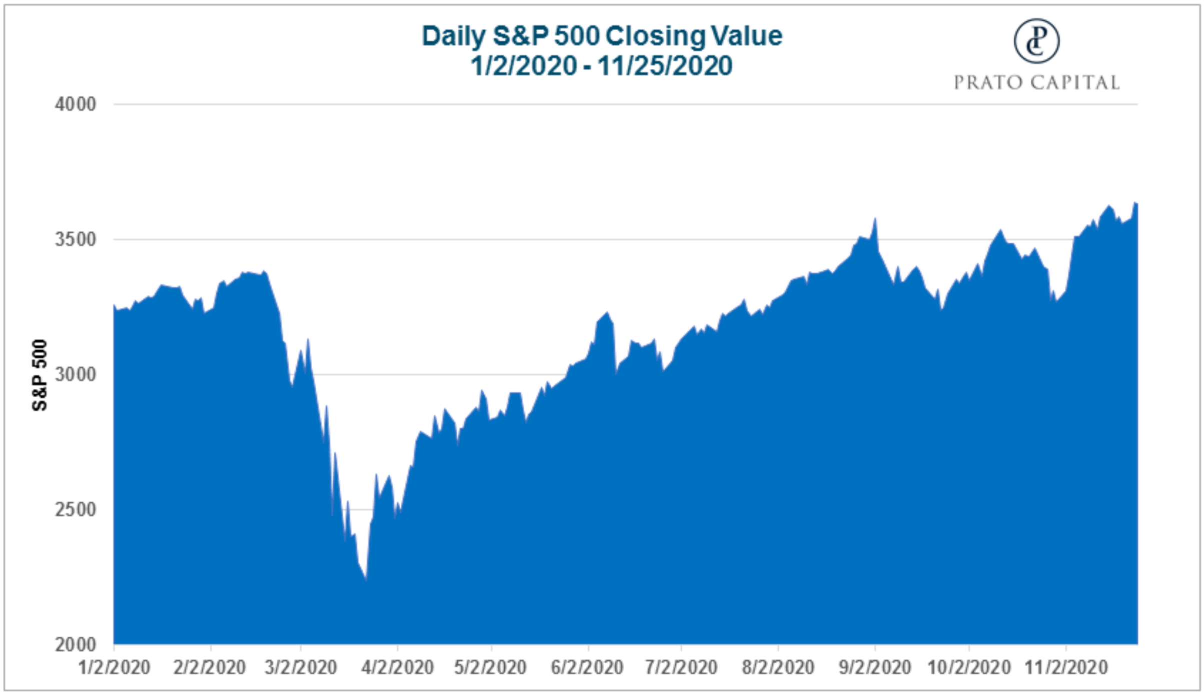
2020 has been an unforgettable year in many ways but for the S&P 500, this has been close to an average year.

Average?

By almost every measure, 2020 has been anything but average. Starting with the spread of the COVID-19 virus, lockdowns of economies across the globe, a divisive U.S. election, and stock market ups, downs and all- time highs set again in November, it has been a very volatile year in many ways.

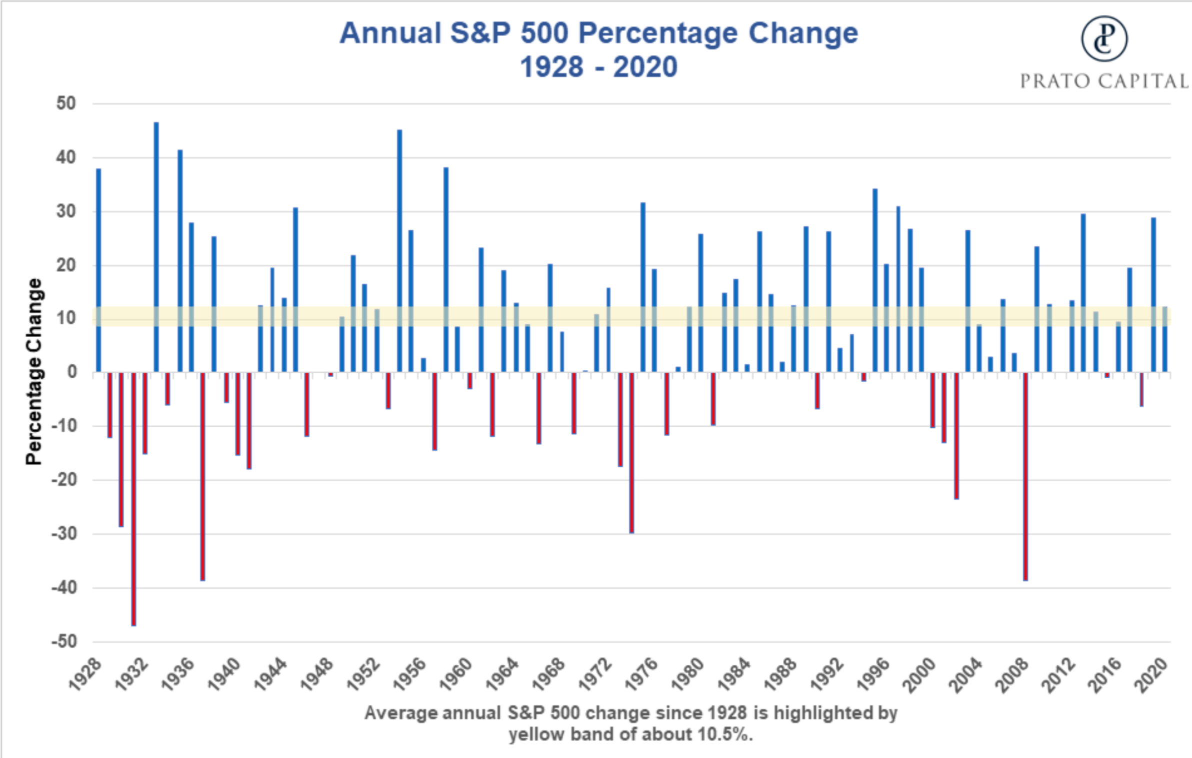
When looking at Exhibit 1 below showing the daily closing values of the S&P 500, it is hard to believe that this can be called an average year. There has been volatility most of the year through the ups and downs that are quite pronounced.

Exhibit 1



Since 1928, the S&P 500 has averaged a gain of about 10.5% per year. Exhibit 2 below shows how much of a variation most years have making up this average. The yellow band represents a ±2% range around the 92- year average and only 9 times in the past has the S&P gain fallen that close to the average. Even this year, with all the volatility we have witnessed between Covid-19 and the Presidential election, the S&P gains fall within this ±2% band making this close to an average year so far.

Exhibit 2



Lessons Learned in 2020

At Prato Capital, we like to use history as a guide when looking at how markets react to significant events like we have seen this year. Some investment ideas from the past are still relevant today and they proved very prescient this year. We have discussed these in greater depth in past newsletters and blog posts:

- **Stock market volatility is not a new concept.** Using history as a guide, we have seen short-term stock market volatility provide opportunities for long-term investors. Stability or the lack of volatility comes at a cost. As an example, US Treasury bonds provide a stable expected rate of return. But this stability comes at the expense of low interest rates. The expectation when investing in stocks is that returns will be higher than bonds and the cost of those higher returns is increased volatility.
- **It wasn't different this time.** Using history as a guide, we see the stock market volatility this spring was not much different from past declines. The overall stock market reacted (overreacted?) to changes and unknowns in economic conditions and future corporate profits. The markets functioned like they should based on the short-term uncertainty and again functioned properly when some clarity was provided about future economic and corporate profit growth.
- **Market predictions and market timing do not work over the long-term.** It is easy to see the market tops and bottoms with hindsight. Using history as a guide has shown that market declines can end very suddenly

and dramatically. Just missing a few days of gains can be very costly to a portfolio. Two of the largest daily percentage gains ever recorded in the S&P occurred this March.

- **Maintain a proper risk tolerance for each client through markets ups and downs.** It is easy to find risk acceptable when markets are rising. It is much more difficult after sharp declines like we saw in February and March. History has shown having a trusted advisor, like us at Prato Capital will provide the proper guidance and increase the chances of maintaining the proper risk tolerance for an investor through market volatility.
- **Rebalance a diversified portfolio when markets change.** Rebalancing will maintain a proper mix of stocks and bonds and also maintain a proper balance of different assets within the stocks and bonds. History has shown that it is impossible to predict which sectors will outperform and when the outperformance comes. Maintaining the proper balance within stocks this year allowed an investor to capture gains in large-cap stocks through the summer and then the gains from the small-cap stocks this fall, which have recorded a record month in November.

Benefit of a Financial Life Plan

A portfolio without an FLP is just a pile of money without a purpose. The FLP brings purpose and direction to an investor's portfolio, toward meeting both long and short-term financial goals and not just rates of return. Keeping the focus towards financial goals allows clients to 'tune out the noise' of short-term market changes.

The FLP modeling program used at Prato Capital accounts for stock market fluctuations not only like we have seen this year but have seen in years past. Again, this allows our clients to focus on reaching their overall financial goals and not the ups and downs of the stock market.

2020 has served as a reminder of how quickly everyone's life can change and shows the importance of otheraspects of the FLP, like proper life and disability insurance and the need for estate planning.

Conclusion

With the pandemic and election this year, 2020 has been a disruptive year in many ways. If we continue to use history as a guide, investors may find their portfolio less disrupted and better positioned for their future financial goals. The best tool to keep that long-term focus for any investor is having that Financial Life Plan. An FLP brings purpose to investments and provides a guide to what can be achievable with those investments. It also brings everything in a client's financial life together in one place and all working toward one goal.

> *"Those who fail to learn from history are condemned to repeat it."*
> – **Winston Churchill** (1948).
