No strategy is always right

When the facts change, your strategy should change, as well. If you stay wedded to the same investment plan all the time, you lose sooner or later.

I was talking to an advisor earlier in the week about my firm's preference for tactical asset allocation, which rebalances the mix of your assets based on their performance trend, and weighing the portfolio by risk metrics. He told me a story about how he had allocated money to a tactical strategy that stopped working. This should not surprise a seasoned investor.

Every investment strategy stops working at some point, either temporarily or permanently. Buy-and-hold and asset allocation worked well in the bull market of the 1980s and 1990s, but those portfolios tanked in 2002 and 2008. The legendary value investor Bill Miller, whose fund at Legg Mason beat the Standard & Poor's 500 for 15 straight years yet lost a lot of investor money in the 2007–2009 downturn because he stayed the course with value investing – favoring undervalued stocks. Even a smart strategy fails sometimes, too.

Market dynamics are constantly changing, it is foolish to expect an investment methodology to work all the time in every type of market, or never just stop

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working. Here are four ways that you can protect against this.

1. **Use multiple, uncorrelated** methodologies. You need to be sure that your portfolio doesn't all move in lockstep. There is nothing wrong with hedging your bets. We use intermediate term momentum analysis to judge how strongly an investment is moving up or down and how likely it is to continue on that trajectory. We buy when it is going up and sell when it starts to weaken.

We also use short-term counter trend analysis. This model buys when something is weak and sells when it is going up. These methodologies do not move in the same direction at the same time and use completely different metrics. If one holding stops working, the others aren't affected.

So if you use a of buy-and-hold or asset allocation strategy, you need to combine it with a completely different return stream as a hedge in case your main strategy doesn't pan out.

2. Define what it means when your strategy stops working. If you follow a failing momentum strategy in a market that should be favorable for momentum, reconsider your strategy or the individual holdings in your portfolio. Decide ahead of time how much your plan can veer off before you must change tack. Every method fails at some point, so constantly monitor everything for signs that it is not working properly

3. If you identify a strategy that is not working as it should, determine why and whether it is temporary or permanent. Err on the side of caution here. Over the years my firm used models that stopped working as we expected. For example, fixed allocation to commodities and bonds is common. Bonds are presumably safe, but right now there is a major selloff in government debt. Momentum investing can be very risky when prices are volatile, so we don't use that exclusively. We decided that these changes in the market dynamics were most likely permanent and took the models out of our strategies.

Let's take a closer look

There are three types of financial patterns that may affect your investments and ways to help you protect your financial future:

A bull market is when stock market indices like the S&P 500 and Dow Jones Industrial Average steadily go up by at least 20%. When markets rise, investors may see the value of their retirement account increase over time as well.

A bear market occurs when those same types of indices drop 20% or more from their previous peak over a period of at least two months. When bear markets occur, some investors may see the value of their investments drop significantly.

Unfortunately, rebuilding a damaged portfolio just to where it was may take time investors don't have.

A recovery is represented as the number of months from the bottom of a market decline to when the market reaches the level of its previous peak again

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4. Most importantly, always work to improve.
It is tempting to find an investment strategy with a great long-term track record and assume it must continue. Nothing works forever. Sticking to the same method, no matter the track record, is a recipe for disaster. Look at all the companies through the years that went out of business because they assumed that what worked for them in the past is sure to continue.

Just as companies need to innovate to stay competitive, a wise investor is always in a constant state of improvement. There is always a better way to manage our clients' portfolios, and I spend hours every day trying to find it. When I do, I try to find something better than what I just found.

How often do bull and bear markets occur (and how long do they last)?

It's impossible to predict how the markets will perform. But looking back through time, certain patterns begin to emerge:

- From 1900 to 2013, bear markets have occurred, on average, every 3.5 years.[3]
- Bear markets are usually shorter than bull markets – 15 months is the average duration of a bear market[2] but bull markets typically last 97 months.[4]
- Some bull markets run longer than usual (like the one we're experiencing now).

While past performance is no guarantee of future results, if history is any lesson, we may be overdue for a another bear market.

[3] www.cnbc.com/2015/08/24/8-things-you-need-to-know-about-bear-markets.html
[4] www.forbes.com/sites/robertlenzner/2015/01/02/bull-markets-last-five-times-longer-than-bear-markets/#1b8b41342dd5

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