

STOP AVERAGING OUT MARKET REGIMES—NAVIGATE THEM!

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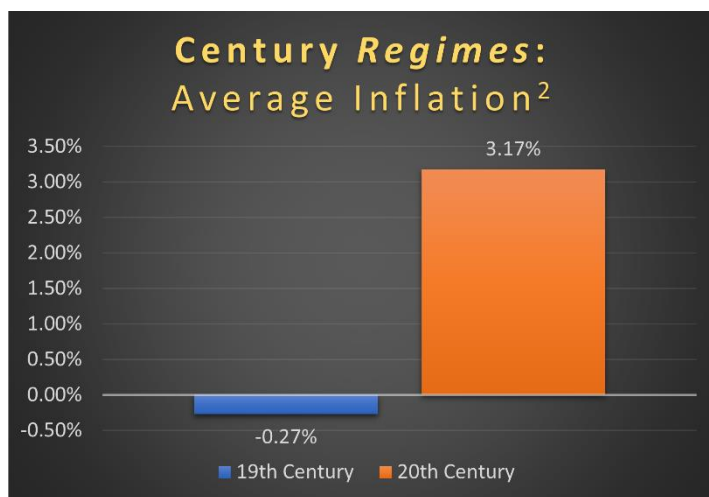
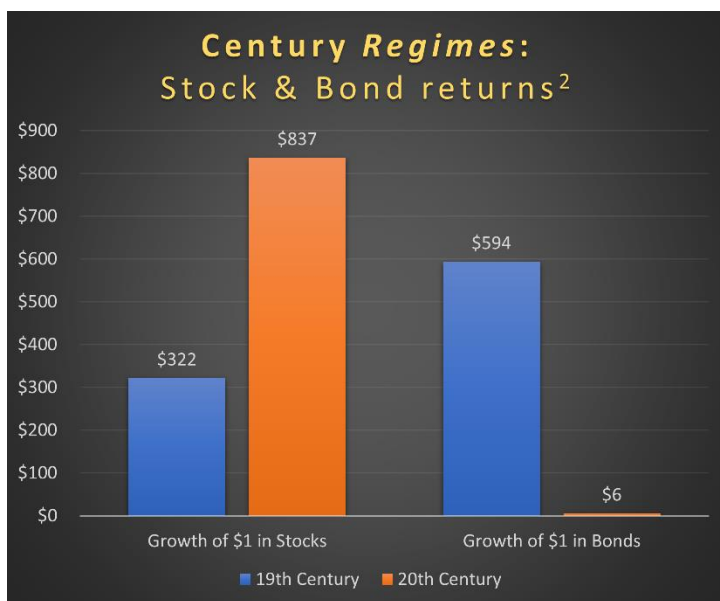
Understanding market regimes is crucial in investing.

Regimes are large-scope waves characterized by a dominant directional orientation.

While regimes tend to persist for long periods, they eventually change. However, if investors align their portfolios with longer time frames—often recommended as ‘wise’ practice—they risk fusing different regimes with opposite orientations. Such amalgamation can easily offset (average out) the distinct characteristics of each regime, neutralize them, and leave investors unable to recognize and navigate the unfolding realities of the markets effectively.

Case in point:

If investors take this advice and max their historical aperture to include both the 19th and 20th centuries, diligently tuning their portfolio to all available data, they can paradoxically overlook a major regime shift: the change from the bond-favoring deflationary 19th century to the stock-championing inflationary 20th century.



This oversight could lead them to incorrectly conclude that a modern-day 50/50 stock/bond portfolio is well-positioned for current market dynamics. After all, between 1800 and 2000, \$1 initially invested in stocks and bonds grew to nearly equivalent terminal wealth—\$916 for stocks versus \$843 for bonds, a mere difference of 4% over 200 years.

Could such a mistake occur?

It already has—data [1] shows us that the global portfolio of all assets held by every investor worldwide is close to a traditional 50/50!

Ouch! Beware—regimes matter; don’t average them out!

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[1] Doeswijk, R. Q., Lam, T. W., & Swinkels, L. A. P. (2020). Historical Returns of the Market Portfolio. *Review of Financial Studies*, 33(9), 3716-3754. <https://doi.org/10.1093/rfs/hhz133>

[2] McQuarrie, E. F. (2024, May 30). Stocks for the long run? Setting the record straight. CFA Institute. <https://blogs.cfainstitute.org/investor/2024/05/30/stocks-for-the-long-run-setting-the-record-straight/>

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