Investing Today

Keeping Perspective in Volatile Markets

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Brighthouse FINANCIAL℠
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THE EMOTIONAL INVESTOR

Introduction

This brochure defines four important financial principles that will help guide you through the financial decisions you will be faced with.

Investing and making sound financial decisions are not easy tasks. Investors are bombarded by many stimuli, such as media reports, market forecasts and volatility – any of which can influence even the best investor to abandon their investment plan to appease short-term emotions.

Understanding and abiding by the following principles will help you view the markets in the correct perspective, and be in a better position to make thoughtful, deliberate decisions despite the urges to do the contrary.

Evaluate Volatility

As you evaluate how volatility (the ups and downs of security prices) can sometimes cause irrational mispricing of securities, you will identify ways you can take advantage of it for your benefit.

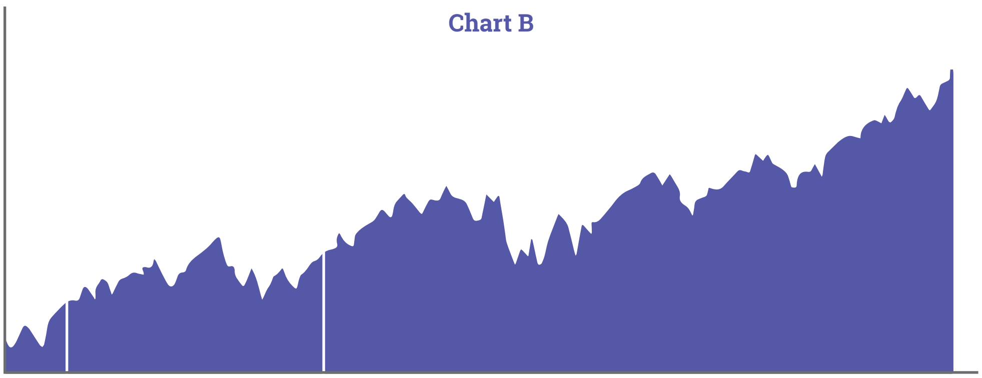
The emotions of fear and greed often influence investors to sell after experiencing losses and buy after witnessing gains. This emotional response (which is quite common) provides opportunities for thoughtful, rational investors to buy securities at very attractive prices and sell them when others are irrationally optimistic.

It may be wise to define an investment strategy or process that specifies how you will take advantage of future volatility. Consider the following facts about volatility and accompanying illustrations to provide basis to your investment plan.

Volatility Facts

- Significant volatility is an inherent part of investing. Expect it to occur from time to time.
- Volatility creates mispricing in securities, but that can be a great opportunity for investors who are prepared for it.
- Volatility often causes us to react emotionally — giddiness and greed upon experiencing significant gains; anxiety and fear with losses.
- Volatility is largely a function of time. The more often you look at the market or evaluate performance, the more volatility you will experience.
- Market movements are unpredictable and volatile over short periods of time.

Which chart would you prefer your portfolio to look like?



The charts teach us an important lesson about volatility.

Chart A is quite volatile and ultimately goes nowhere. Any well-intentioned investor may be influenced to sell and look for better opportunities elsewhere. Chart B is a great chart. Nice upward trend… a very profitable investment.

But here is the catch. Charts A & B are the same investment — the S&P 500® Index. Chart A is simply a nine-month period of time within Chart B.[1] The section within the vertical white lines in Chart B illustrates the time period interval that comprised Chart A.

Thus, we see that a great long-term investment, even a very profitable investment, can have periods of frustrating and poor performance. And those periods can last longer than we would like. If we allow short-term volatility and performance to influence our investment decisions, we may end up making very costly decisions.

Short-term performance is not indicative of the eventual profitability of an investment. It is much more constructive to focus on creating the right investment strategy to begin with… preferably one with a systematic process to help you take advantage of the occasional mispricing of securities to enhance your return.

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[1] Chart A is S&P 500 from 11/2009 – 07/2010. Chart B is S&P 500 from 05/2009 – 07/2013. The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. All indices are unmanaged and may not be invested into directly.

Consider the Noise

Most information reported by the financial media is “noise,” not news. Noise is information that is exaggerated, short-term in nature and/or not relevant to a long-term investment strategy. But it gets our attention!

The financial media’s primary goal is to make money. They need viewers. They need you to tune in today and come back tomorrow. The financial media’s job is not to help you reach your goals. It is simply to get you to tune in.

The media often presents news in a way that elicits emotions and creates a (false) sense of urgency. They work hard to grab your attention and keep it.

Take a look at the headline below from The Wall Street Journal dated January 24, 2014:

“U.S. Markets Tumble As Fear Spreads”

“Tumble” and “fear” get our attention. This headline was printed after the market experienced just four days of losses. Why would they choose to only highlight the last four days? Why not use four weeks or four months? They did it for effect! Had they used a longer time horizon, the tumble would have been just a blip, and they wouldn’t have had a story.

This headline was published when the S&P 500 was down just 3.1% from its all-time highs. Evoking a sense of fear and urgency may have caused many investors to sell, as the market went down an additional 3% the following week.

However, just four days later the market had recouped all of its losses and continued heading higher to make new highs, despite the “spreading fear.”

So what should you do when the media is promoting fear and uncertainty? What if analysts and “experts” are predicting more losses?

The key answer to this question is your time horizon. When will you need the money? How many years until you liquidate the entire account?

Write your answer: ________ years.

If you don’t plan to liquidate your assets for several years (10 or more), it would be best to view future market losses as opportunities to buy low, not instances to sell. But it is difficult to own (or buy) an asset that is losing value and appears likely to keep going down.

It isn’t any easier when experts are forecasting worse times ahead after we have already experienced significant losses. It happened for Black Monday (1987) and the recent financial crisis. But it is important to remember the following points:

- The media’s job is to get you to tune in. They report stories to get (and keep) your attention. They can promote euphoria in good times and fear in bad times.
- Research has shown that expert forecasts are right only about half of the time. While they may be very confident in their prediction, their accuracy is less than stellar.

The next time you become concerned about a forecast or current news headlines, you may want to consider the following points to maintain the correct perspective:

1. Do you anticipate that current events will be worse than Black Monday 1987 or the 2008 Financial Crisis?

2. How did an investor that was fully invested in stocks before Black Monday and the 2008 Financial Crisis fare seven years after each crisis?[2] Give your best guess below:

   Black Monday ______________%　　　　2008 Financial Crisis ______________%

3. Given your time horizon, what would be the most prudent strategy if market losses occurred in the near future? (A great discussion to have with your advisor)

[2] Uses the value of the S&P 500 Index on 09/29/1987 and 09/30/1994 to calculate returns for Black Monday Scenario and value on 06/01/2008 and 05/31/2015 to calculate returns for Financial Crisis scenario. Assumes reinvestment of dividends. Black Monday +73%. Financial Crisis +80%.

Understand Your Threshold

The stock market is volatile by nature. Upon experiencing poor investment performance, many investors have felt compelled to sell, just so they could stop the pain. However, good this may feel in the short term, it often results in having to adjust or delay their goals.

Most investors can tolerate moderate losses. But significant losses influence investors to abandon their strategy. Defining "moderate" and "significant" losses is different for everyone.

It is important to understand your threshold of pain. This threshold identifies when you may be compelled (emotionally) to "throw in the towel" and preserve what you have left.

As investors, we often focus on the return we want, without too much consideration for risk. Yet more people fail to achieve their financial goals because they took too much risk, rather than not making as much as they could have in a bull market.

The reality is that risk and return are highly correlated; the more return you want, the larger the risk of loss. There is no exception to this rule. There may be time periods where it appears a high return asset has little risk, but that is just a temporary illusion (1999 Tech Bubble, 2002 Real Estate, 2008 Junk Bonds).

Identifying your personal threshold can be difficult.

There is no scientific way to determine your exact threshold. Your threshold is not static; it can change as your individual circumstances change. But the following two statements will give you a good idea where your "danger area" resides, and may be helpful in putting together the right investment strategy for you.

- I would be **concerned** if my portfolio fell to

  $ ______________________

- I would be **devastated** if my portfolio fell to

  $ ______________________

Focus on What You Can Control

In the investment realm, there are many factors that contribute to your performance. Some of those factors are completely within your control and others you have no control over. Unfortunately, we tend to focus on things beyond our control and ignore those things within our control.

Things you can control:

- Investment allocation
- Risk exposure
- Tactical strategies (rebalancing, defining when to buy low)
- How you react/respond to the things you can't control

Things you can't control:

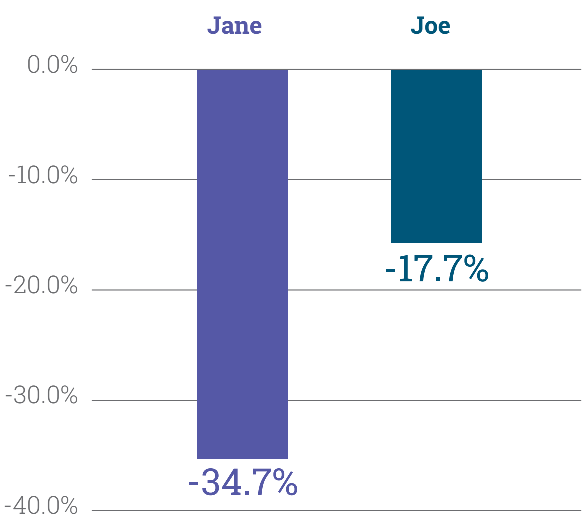
- Market performance
- Volatility
- Economic policies
- Headlines

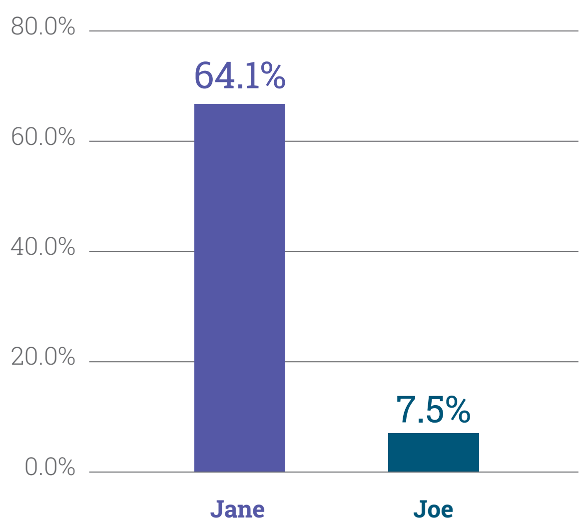
Consider the example on the following pages in which we compare the results of an investor who focused on those things she could control (utilizing an investment plan) to another that had the best of intentions, but no set strategy.

The charts below illustrate the performance of two identical investors beginning in June 2007 with a portfolio of 70% stocks and 30% bonds.

- Jane had a process that specified an annual rebalancing strategy, which she adhered to religiously, even after experiencing significant losses.[3]
- Joe had no such plan, but very good intentions. He always planned to buy low and sell high, but was influenced by losses and pessimistic forecasts to sell stocks at the end of October 2008.[4]

Let's see how they performed





Performance as of March 9, 2009

Over the short term it appears Joe was wise in selling stocks and buying bonds, as evidenced by the outperformance relative to Jane.

Performance as of June 1, 2016

But over the long term, the patience and diligence shown by Jane — sticking with her investment process — paid off handsomely.

Stock performance is represented by changes in the S&P 500 Index over periods defined. Bond performance is represented by changes in the Barclays Aggregate Bond Index over periods defined. Both indices assume reinvestment of dividends. The Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds. You cannot invest directly into index funds.

Investing involves risk, including the possible risk of principal. No investment strategy assures success or protects against loss. All performance referenced is historical and is no guarantee of future results. Report is for general information only; it is not to provide specific advice or recommendations.

3 Jane had a strategy of rebalancing every year if the allocation deviated 5% or more from the target. In this scenario, Jane rebalanced on the last business day of May in '08, '09, '11, and '14.

4 Joe is assumed to have sold all stocks on Oct 31, 2008 and invested all into the bond index.

Knowing is just the beginning

Keeping perspective is easy to understand. Discuss your communication preferences with your financial professional to ensure your concerns and needs are addressed.

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