ACTIVE MANAGEMENT
A POTENTIAL CURE FOR THE VOLATILITY BLUES?

Even when markets seem to be steadily climbing higher, investors can find it difficult to maintain the discipline required to stick with a long-term investment plan. When markets become volatile, however, that discipline is often quickly stretched to its breaking point. And the underlying impetus is completely understandable.

Any sort of volatility – whether in our personal, professional or financial lives – tends to make us apprehensive. We may say we enjoy excitement and change, but deep down most of us place a tremendous value on predictability and stability. This bias (referred to as "loss aversion" by those who study behavioral finance) shows that people place far more value on avoiding losses than they do on acquiring gains. In fact, some studies suggest that the negative psychological impact of a financial loss may be twice as powerful as the positive impact of an equivalent financial gain.

Bombarded by market warnings on social media and exacerbated by so-called financial experts speculating about potential financial disasters seemingly around every corner, it's no wonder that so many people act compulsively when it comes to their portfolios; making knee-jerk decisions rather than taking a longer-term view.

MANAGING VOLATILITY

It's important to first understand that volatility and market corrections are by no means bad things or harbingers of doom. In fact, we believe they are essential elements necessary to sustain a healthy stock market – acting like pressure release valves that allow a bull market to pause and let off some steam before continuing upward. It's when volatility and corrections DON'T occur (think back to the dot-com bubble) that investors need to be most concerned.

In our view, there is, however, a way to better preserve your assets during these times of heightened market volatility by employing more active portfolio management techniques. While passive index-tracking investing may suffice as markets rise, this approach offers little in the way of downside protection when indexes begin to fall.

At CTS, we believe that active management strategies afford you the flexibility to make tactical adjustments to either capture incremental returns or reduce downside exposure by either overweighting or underweighting certain sectors and/or asset classes. In addition, we believe that active managers can

more readily and quickly reduce your portfolio risk by cutting back allocations to highly volatile stocks or increasing exposure to more defensive assets. This can be exceedingly important during the latter stages of a bull market as volatility spikes.

Active managers can leverage a wide array of investment strategies in an effort to provide you with an added measure of downside portfolio protection. These may include some combination of:

- **Time frame diversification** – the proper coordination of timing in trading strategies to help smooth the curve and improve the odds of success. By trading off some potential timing-based appreciation, risks can be mitigated and capital preservation strengthened.

- **Stock and bond allocation weightings** – the reallocation of stock and bond exposure helps take advantage of strengthening sectors and helps to reduce exposure to areas of market weakness.

- **Cash as a safe haven** – although markets generally rise over the long-term, no one can predict shorter-term price movements – meaning that a buy-and-hold or passive management strategy can leave a portfolio "in the red" for an indeterminate period of time. The utilization of active management allows for dynamic position sizing, increasing exposure to money markets if we have concern about the performance of a particular asset class or position. This helps to reduce the maximum drawdown and make funds available for other potential investment opportunities as they arise.

Increased volatility doesn't necessarily signal that it's time to bail out of the market, but can serve as a useful reminder to ensure that your portfolio isn't just well diversified, but also structured to reduce the impact of a major market correction (should one occur). For most investors, capital preservation is paramount, and active management strategies can help to significantly mitigate your investment risk.

While no amount of financial information will ever allow you to predict the future movement of the stock market with certainty, at CTS Financial Group we can help you take measures to better protect yourself from giving in to short-term emotions and potentially derailing your long-term plans.

Too many investors fail to realize that passive management strategies can actually carry significantly more market risk than active management strategies. These strategies have nobody at the helm with discretionary ability to shift allocations in an effort to provide downside protection when markets start to whipsaw. Having an active manager with his or her hand on the wheel, however, can make a world of difference to the long-term health of your portfolio.

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