

WEALTH MANAGEMENT NEWSLETTER

FALL 2024



‘UNCERTAINTY IS UNDERRATED’: HERE’S THE REAL REASON MARKETS REWARD THOSE WHO STICK AROUND

Given all that is going on in the world, investors have questions. Will the Federal Reserve cut interest rates, and if so, by how much? Who will win the US presidential election, and will it impact markets? How will global events affect my family and finances? A lot remains uncertain, which can naturally make investors uneasy.

For many people, uncertainty is something to avoid or at least mitigate. People often talk more about the downside to uncertainty than its upside. There’s even a term, loss aversion, that reflects how a loss can feel more painful than a gain of an equal amount can feel rewarding.

However, I have a different view: Uncertainty is underrated.

Without it, there would be no surprises, no joy in watching sports, and no 10% average annualized return on the stock market over the past century.¹

All investments involve risk—there is no guarantee of success. Investors can be rewarded for taking on the risk of not knowing exactly how things will play out.

If there was no uncertainty, returns would be predictable and there would be no difference between putting your money in a savings account and investing it in the stock market.

Think back to the beginning of the pandemic. At the end of March 2020, the S&P 500 Index was down nearly 20% for the year.² Yet investors who stayed in the market were rewarded. At the end of 2020, the S&P 500 Index was up 18.4% for the year, a 38% turnaround from its March lows.³ March 2020 was a scary time for almost everyone. No one knew what was going to happen. Yet even in those dark moments, I had faith in human ingenuity. When people are met with challenges, they are resilient and work to solve them. Companies are no different. Investing in the stock market means investing in the power of human ingenuity to adapt and innovate.

Because of uncertainty, life is one cost-benefit analysis after another, and we have no choice but to manage risk. At the extremes, some people may try to completely ignore risk, while others might try to eliminate it. Most of us fall somewhere in the middle.

We manage risk with our health, work, family, and just about every other aspect of our lives—including investing—because while few things are certain, we still have to make decisions big and small. For example, we can’t control the weather, but we can carry an umbrella if it looks like it might rain. And while we can’t predict stock market returns, we can manage the risk in our investment portfolios.

WHAT TO AVOID

One way of managing risk is to eliminate some of the things you shouldn’t do. When you want to improve your health, you might eliminate fried foods, soda, and sweets from your diet, which can increase your chance of a healthier outcome. It’s the same with investing. Eliminate bad habits, like attempting to predict the unpredictable by trying to time the market or pick winning stocks.

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Think of everything that has happened in the past 25 years, including:

- The dot-com bubble
- 9/11
- The Global Financial Crisis and Great Recession
- The COVID-19 pandemic

It would be natural to want to time when to exit and re-enter the market. To put the implications of doing so into perspective, consider a hypothetical \$1,000 investment in the Russell 3000 Index made at the beginning of 1999. This turns into \$6,449 for the 25-year period ending December 31, 2023. Over that same period, if you missed the Russell 3000's best week, which ended November 28, 2008, the value shrinks to \$5,382. Miss the three best months, which ended June 22, 2020, and the total return dwindles to \$4,546. See what I mean?

WHAT TO DO

Positive ways of dealing with risk can help you potentially capture the benefits of what scientific research has shown us. With health, that means exercising more, getting regular checkups, and eating more fruits and vegetables. With investing, that means ensuring our portfolios are diversified across regions and asset classes. While it doesn't guarantee making a profit or averting a loss, diversification allows us to reduce our risk while potentially capturing the returns of the market.

Since we know risk is unavoidable—and it's the source of investment returns—you want to find the amount of risk that is right for you. For example, Treasury bills are considered a relatively safe investing asset whose prices don't fluctuate as much as stock prices. However, Treasuries have provided, on average, a lower return than the stock market. Those tradeoffs can be weighed against your specific needs and preferences, and it's always good to be prepared for a range of outcomes. The more committed you are to a philosophy and a plan you can count on when you are experiencing the ups and downs of uncertainty, the more likely you are to succeed as a long-term investor.

YOU ARE ALREADY BETTER AT THIS THAN YOU THINK

You know more about investing than you think you do, because investing is all about risk and reward, just like every other part of your life. In investing and in life, some years are better than others, but the important thing is to be able to persevere so you're ready for what comes next. That's why I see uncertainty as a positive force and have faith in the ability of people to find better ways to manage risk. I've worked with thousands of investors during my five decades in finance and seen how, when they manage risk better, they live a better life. Instead of trying to predict your future, plan, adapt, and figure out the most sensible solutions for you. You might not only be underestimating uncertainty—you may be underestimating the positive impact of embracing it.

please see page 4 for disclosures

COMPOUND RETURNS QUICK TAKE

If you're like most people, you need your investments to grow to achieve the life you want. Fortunately, there's a deceptively simple but exceptionally powerful tool that can help you produce that growth. It's called **compounding**, and it's the process of earning investment returns on your past investment returns. Compound returns are such a big deal that they have been called the eighth wonder of the world (an expression likely misattributed to Albert Einstein).

THE WONDERS OF COMPOUNDING

What puts compounding on par with the Great Pyramid at Giza? It can help your portfolio grow exponentially over time. Take this simplified (very) hypothetical example:

- You invest \$10,000 and earn a 10% return the first year. In this example, your returns compound annually, so by the end of the year you have an additional \$1,000.
- Now you have a total of \$11,000. You keep it invested and earn another 10% return the next year.
- Since you started with more money, your 10% return produces a larger gain in dollar terms than it did the first year: \$1,100 rather than \$1,000.

The more your investments grow, the more you can reinvest in pursuit of more growth. You can pull a couple key levers to make the most of compounding. Using them wisely could give your savings a considerable boost. Let's take a look:

GIVE IT TIME

In investing, time makes it possible for wealth to snowball. The longer you can allow your investment returns to compound, the greater the snowballing effect can be. Thanks to compounding, money you invest early can become much more valuable than money you invest later in life. Many investors already get this on an intuitive level. But it can help to understand a numerical curiosity that explains why compounding works so well: Consider the following simplified example:

Investor 1, age 30, invests \$10,000 dollars a year for 10 years and earns a 7% annual return. At the end of the decade, they have contributed \$100,000. At that point they stop making contributions and leave their money to keep earning 7% annually.

Total portfolio value at age 65: \$802,370

Investor 2, age 40, is trying to catch up. They invest \$10,000 a year for 25 years, and they also earn a 7% annual return. Their total contributions add up to \$250,000. Their portfolio's value at age 65 is about \$125,000 less than Investor 1's, even though they contributed \$150,000 more.

Total portfolio value at age 65: \$676,765

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The Benefits of an Early Start

\$802,370



Age 30, saves \$10,000 a year for 10 years

\$676,765



Age 40, saves \$10,000 a year for 25 years

*NOTE: Totals are given as of the beginning of the 65th year/end of the 64th year by using an Excel spreadsheet to do computations.

CONTROL WHAT YOU CAN

Like most things in life, investing includes many elements you can't control, so it's essential to focus on what you can—especially those moves that help you make the most of compounding. That's why starting early, staying invested for the long term and capitalizing on tax-advantaged accounts are critical for investing toward your long-term goals.

HERE'S WHY YOU SHOULD INVEST IN ALL THE SECTORS, NOT JUST ONE

ANNUAL RANKINGS OF EQUITY SECTOR RETURNS 2014-2023

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Best Return	REITs	Health Care	Energy	Information Technology	Health Care	Information Technology	Consumer Discretionary	Energy	Energy	Information Technology
	Utilities	Consumer Discretionary	Communication Services	Materials	Utilities	Communication Services	Information Technology	REITs	Utilities	Communication Services
	Health Care	Information Technology	Financials	Health Care	Information Technology	Financials	Communication Services	Financials	Consumer Staples	Consumer Discretionary
	Information Technology	Consumer Staples	Materials	Consumer Discretionary	Consumer Discretionary	Industrials	Materials	Information Technology	Health Care	Industrials
	Consumer Staples	Communication Services	Industrials	Industrials	REITs	REITs	Health Care	Materials	Industrials	Financials
	Financials	REITs	Utilities	Financials	Consumer Staples	Consumer Discretionary	Industrials	Consumer Discretionary	Financials	Materials
	Consumer Discretionary	Financials	Information Technology	Consumer Staples	Financials	Consumer Staples	Consumer Staples	Industrials	Materials	REITs
	Industrials	Industrials	REITs	Utilities	Communication Services	Utilities	Utilities	Health Care	REITs	Health Care
	Materials	Utilities	Consumer Discretionary	REITs	Industrials	Materials	Financials	Communication Services	Information Technology	Consumer Staples
	Communication Services	Materials	Consumer Staples	Communication Services	Materials	Health Care	REITs	Consumer Staples	Consumer Discretionary	Energy
Worst Return	Energy	Energy	Health Care	Energy	Energy	Energy	Energy	Utilities	Communication Services	Utilities

Sectors represent groups of companies that make similar products or offer comparable services. Recent history shows the challenge of trying to pick "hot" sectors in advance.

- From 2014 to 2023, no sector was a consistent outperformer.
- Energy, the best performer in 2016, 2021, and 2022, delivered the worst annual returns six times. Tech, the leader in 2023, finished ninth out of 11 in 2022. Health care finished first in 2015, last in 2016, and first again in 2018.
- The absence of a reliable pattern in sector performance supports an "own them all" approach.

Holding stocks across all sectors puts investors in a position to capture higher returns where and when they appear.

Past performance is not a guarantee of future results. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. The annual returns are Russell 3000 Index Global Industry Classification Standard (GICS) sector returns. Real estate investment trusts (REITs) are shown as a separate category to illustrate their exclusion from certain funds. REITs are classified according to the GICS. Real Estate is excluded from the chart because it did not exist as a GICS sector category prior to September 2016. S&P/MSCI changed the GICS methodology after market close September of 2018 to rename "Telecommunication Services" to "Communication Services" and to reclassify a number of companies to that sector. Dimensional reports these changes in company membership to Communication Services starting October 2018, but changes the name historically to Communication Services to maintain consistency. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. The GICS was developed by and is the exclusive property of MSCI and S&P Dow Jones Indices LLC, a division of S&P Global.

Sector Definitions:

- Communication Services: Companies that provide telecommunication services, such as wire line, wireless, and internet access.
- Consumer Discretionary: Companies that produce nonessential goods and services, such as automobiles, apparel, and leisure activities.
- Consumer Staples: Companies that produce basic necessities like food, beverages, and household goods.
- Energy: Companies involved in the exploration, production, refining, transportation, and marketing of oil, natural gas, and other energy sources.
- Financials: Companies that provide financial services, including banks, insurance companies, and investment firms.
- Health Care: Companies that provide health-care products and services, including pharmaceuticals, biotechnology, medical devices, hospitals, and health insurance.
- Industrials: Companies that manufacture industrial goods, such as machinery, aerospace, construction materials, and chemicals.
- Information Technology: Companies that design, develop, and sell computer hardware, software, and services.
- Materials: Companies that produce basic materials, such as metals, chemicals, and forest products.
- REITs: Companies known as real estate investment trusts, which own, operate, or finance income-producing properties.
- Utilities: Companies that provide essential utilities, such as electricity, water, and natural gas.

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A BAD DAY IN THE MARKET: WHAT NOW?

Since the beginning of August, you've likely been bombarded with news of the latest market downturn. By Monday, August 5, the S&P 500 had fallen more than 8% from its all-time high in mid-July—putting it a little bit shy of correction territory. By Tuesday, August 6, the market had already staged an uptick. And by the time you're reading this, it may have reversed course again. Since we haven't seen as much market volatility recently, this one may have left you feeling a bit shaken. Why here? Why now?

To be blunt, we don't know for sure. Some investors might be worried the U.S. economy has weakened based on news of rising unemployment. Maybe it's because the Federal Reserve didn't reduce interest rates, as many investors had hoped—a move that can sometimes boost corporate profits. Or maybe it's fears of a U.S. recession or an uncertain election year.

If we look for them, we can always find reasons the markets might have taken a turn for better or worse. Unfortunately, there's no way to know in advance. But the good news is we don't need to know. Instead, we know this: Markets have always climbed upward eventually. This is a far more important message to bear in mind—and a comforting one for evidence-based investors like us.

So, what's the best course of action? Sit tight, and let your long-term financial plan continue to work for you. Instead of worrying about interest rates, the job market and strength of the U.S. dollar, consider focusing on enjoying your Fall. Take advantage of the last few warm weeks of the year. Read the daily financial news if you'd like—and let us know if we can answer any questions you may have. But remember, the long-term planning we've done in the past means you're not required to keep up with it all, if you'd rather spend your time elsewhere.

Disclosures for 'Uncertainty is Underrated': Here's the Real Reason Markets Reward Those Who Stick Around. Article Written By: David Booth, July 15, 2024

1. In US dollars. Based on S&P 500 index annual returns, 1926–2023. S&P data © 2024 S&P Dow Jones Indices LLC, a division of S&P Global. Past performance is no guarantee of future results. Indices are not available for direct investment; therefore their performance does not reflect the expenses associated with the management of an actual portfolio.

2. Decrease of 19.6% was from Jan. 1, 2020–March 31, 2020. Increase of 38% was from March 31, 2020–December 31, 2020.

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