Observations and Perspectives:

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Terri Spath joined Sierra Mutual Funds in 2015 and has more than 27 years of investment management experience. She is responsible for market and economic analysis, portfolio allocation and investment strategy for the firm.

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Passive ETF Investing & Sleepy Markets. Stay Alert!

"The reports of my death have been greatly exaggerated", quipped Mark Twain after being told a newspaper had published his obituary when he had fallen ill. The death of active management has also been prematurely announced and is rooted in the herds of investors pouring money into passive ETF funds mimicking indexes.

It's easy to feed money into low-fee benchmark-centric ETFs (and to feel smart doing it) when volatility is at record lows and markets are melting up. By most measures, the U.S. stock market has rarely been more expensive and calmer than it is today. Consider:

- It's been 261 days and counting since even a 5% correction in the S&P 500.
- The first half of 2017 registered the second smallest drawdown (a decline of 2.8%) for the S&P 500 since 1950 (the smallest was in 1995).
- The VIX (a measure of expected volatility in the S&P 500 for the next 30 days) has closed under 10 a total of 11 times since May 8, something it had done just 20 times in the prior 27 years!

Clearly, many have forgotten that even a normal year for the stock market includes a 14% drawdown. Losses like that, and much bigger ones, may be healed by a 10 or 20-year time horizon, but that's not an acceptable solution for most, especially as retirement approaches.

We are not sounding a siren that it's time to hit the sell button this instant; we are simply pointing out that as markets yawn to higher highs while registering lower lows in volatility, it's too easy to forget that, in fact, stocks do sometimes go down. Passive investing cannot protect against that. Tactical strategies can.

Specifically, do you or your advisor have a sell discipline in place that seeks to protect against drawdowns? What are the quantitative criteria that define the sell strategy? Can it be repeated successfully?

Losses that require years to recover may ruin even the best laid retirement plans. Our time-tested stop-loss rules seek to limit weakness when it arrives, a crucial element for long-term investment success.

Volatility is a statistical measure of the dispersion of returns for a given security or market index.

Drawdown is the peak-to-trough decline during a specific period of an investment, fund or commodity.

The **S&P 500 Index**, a registered trademark of McGraw-Hill Co., Inc., is a market-capitalization-weighted index of 500 widely-held common stocks. Investors cannot directly invest in an index and unmanaged index returns to not reflect any fees, expenses or sales charges.

VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. it is constructed using the implied volatilities of a wide range of S&P 500 index options.

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