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FORUM

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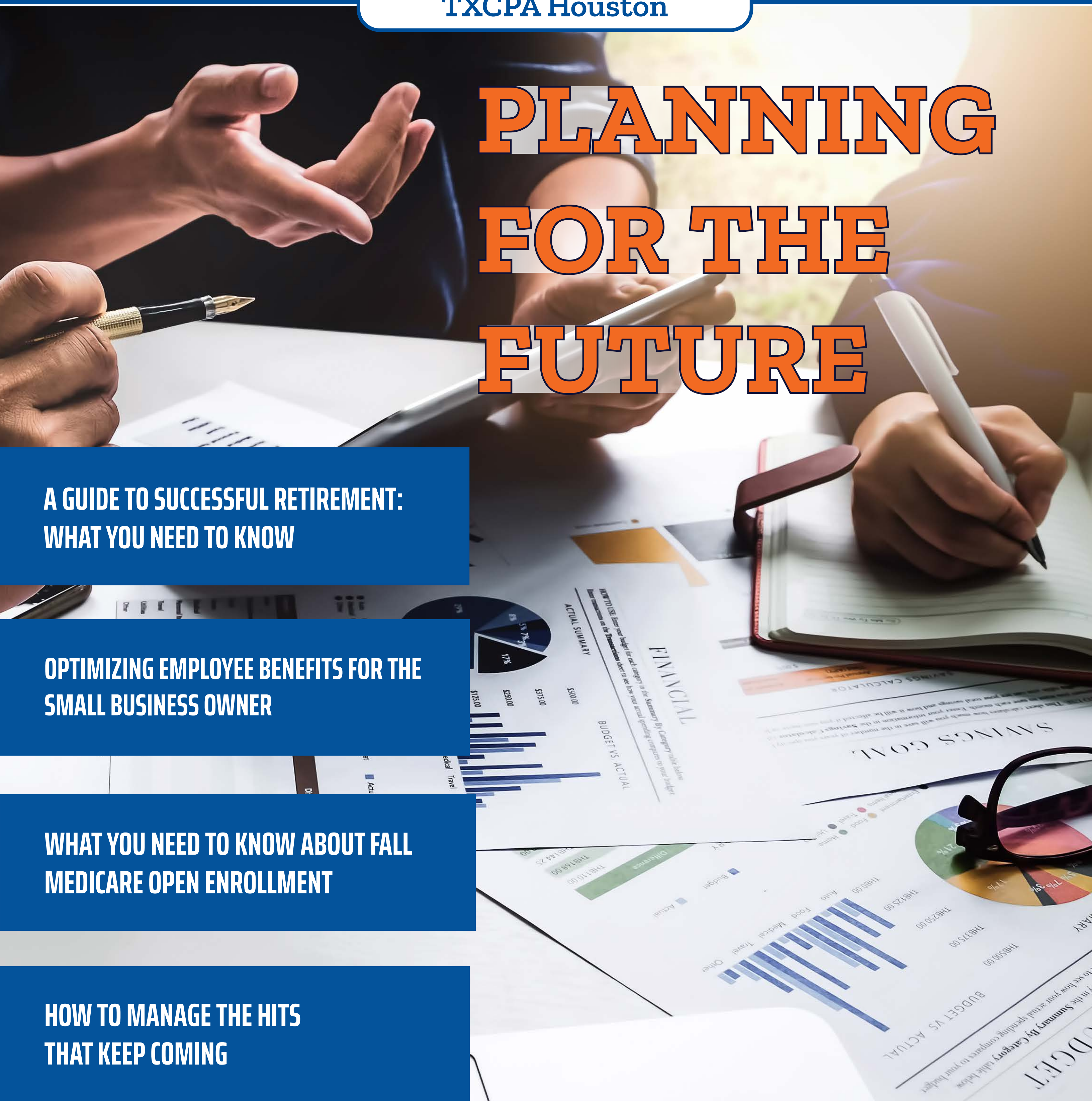

PLANNING FOR THE FUTURE

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Contents

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How to Manage the Hits That Keep Coming:
Exxon Mobil Issues and Stress Testing Your Portfolio

By Kevin Lenox, CFA®, CFP® and Scott Bishop, MBA, CPA/PFS and CFP®

Through August 2020 the stock market has continued to rally. However, many sectors have yet to rebound. That is very true in the oil and gas industry. Many of our Texas clients are reliant on the oil and gas sector for both their work and retirement benefits. With that in mind, we will take a look at oil and gas stocks in terms of the impact to your portfolio and the ancillary impacts to your planning – especially for those working in this sector. Please continue reading below and to hear more, please check out a special edition of the STA Money Hour where Kevin and Scott take a deeper dive into both the article and planning issues. In this article, we will also review investor behavior and discuss how and when to stress test your portfolio.

Energy Sector Stocks – Focus on ExxonMobil:

Although STA Wealth has worked with clients working for oil and gas companies from Anadarko to Zapata, for the investment portion, Kevin will be focusing on ExxonMobil Stock for this discussion.

On Monday, August 24, S&P Dow Jones announced that ExxonMobil will be removed from the Dow Jones Industrial Average on August 31 to make way for Salesforce. Exxon was first added to the Dow in 1928 and signifies a stunning fall from grace for a company that was the world's largest as recently as 2011. When a company is removed from an index like the Dow or S&P 500, it is a strong headwind to that stock as many index funds are forced to sell that stock – we saw it similarly happen to Shell Oil stock back in 2002 when it was taken off the S&P 500 index where the stock lost 10% in a single day.

The Dow is a price-weighted index, so the actions were prompted by the 4-for-1 stock split announcement by Apple, which will reduce its current 12% weighting in the index. As a result, S&P made the change to increase the weighting of technology companies.

The removal of Exxon represents years of underperformance versus Chevron, which has a stronger balance sheet and better operating/earnings metrics. Chevron will now be the only energy company in the energy sector and brings the Dow sector weightings closer to the broader S&P 500.

Comparison of ExxonMobil vs. Chevron vs. the S&P 500 Index:

When an investor sees market news such as explained above, there are certain behaviors and biases that may impact their investment decision making. As markets go through cycles, investors react to these cycles. At STA Wealth Management, we are aware of these behaviors and assist our clients in managing their portfolio. By understanding the market, historical perspective and how investor behavior bias impacts your decision-making skills, you can better manage your portfolio. Investors are told the market corrects and not to over-react, but when one sees their portfolio take a hit, it is hard NOT to react. By having an investment plan, you can better act with discipline versus just reacting based on your "gut."

STA Wealth Portfolio Analysis

When reviewing portfolios, our team at STA Wealth uses analytical tools available from sources such as Bloomberg, Morningstar and S&P Capital IQ, to name a few. In addition, we provide specific insights from our Investment and Financial Planning teams by reviewing your current portfolio's strengths and weaknesses given the market cycle, portfolio design, tax issues and account types/structure. This review and discipline allows us to determine whether your portfolio is aligned and optimized to meet your personal financial planning goals and objectives (goals such as knowing your Hurdle Rate).

STA Wealth – Portfolio Stress Test

After sharing our analysis as outlined above, we perform a Portfolio Stress Test that is specific and unique to your portfolio given your current holdings. Using this information, we are able to use Bloomberg's multi-factor based risk model to analyze and determine how your portfolio might be impacted if we see a repeat of several historical scenarios that caused market losses.

The table below illustrates the output of a recent scenario analysis we conducted for a client's portfolio (it was a large portfolio of over $10 million, but the percentage of profits & losses hold regardless of size). While this portfolio has done well in recent years, the analysis indicates that the portfolio might be subject to significant percentage and dollar losses if past market environments were to repeat.

Scenario	P&L ($)	P&L (%)
Russian Financial Crisis - 2008	-3,776,550	-41.96
Lehman Default - 2008	-1,914,580	-21.27
SPX down 20%	-1,513,128	-16.81
Debt Ceiling Crisis & Downgrade in 2011	-1,432,365	-15.92
Equities down 10%	-920,586	-10.23
Oil prices Drop - May 2010	-841,564	-9.35
Greece Financial Crisis - 2015	-351,215	-3.90
Japan Earthquake in Mar 2011	-183,000	-2.03
Libya Oil Shock - Feb 2011	-160,134	-1.78
EUR up 10% vs. USD	-50,522	-0.56

Source: Bloomberg Analytics

Please Note: The scenario analysis P&L is gross of fees and only accounts for the performance of liquid public securities held in the portfolio. The P&L impact is based on portfolio exposures to factor volatility and assumes that the covariance matrix fully determines the relationship between independent and dependent variables. Additionally, a small amount of shrinkage is made to the correlation matrix to improve the robustness of the inversion operation required to propagate stress across asset classes.

As you can see, quite a bit of positive portfolio performance can be wiped away in the event of a market event like those we have lived through in just the most recent nine years. This volatility can cause significant "money worries". Although losses can be made back over time, it requires you to stick to your investment discipline and a portfolio allocation aligned with your financial plan (assuming the market recovers). Without a strong discipline, our experience has shown us that many investors flee the market and "go to cash" during times of crisis – selling on "fear". These emotional decisions trigger many bad behaviors related to all of our behavioral biases.

Investor Behaviors and Biases

As we mentioned above, during times of stress, many investors (and even many investment advisors) make the mistake of NOT sticking to their investment discipline.

At STA Wealth, we believe that the two greatest attributes any investor or advisor can have are a written and defined discipline and a plan of action. Without either of those you may find yourself subject to a vicious journey like this:

Source: Stock Twits Blog

Historical Stock Market Corrections

Until this COVID-19 Crisis, we have not had a major market correction for many years. As shown in the stress test above, portfolios can be subject to large losses if not allocated, hedged and/or diversified properly. Risk does happen, has happened and will continue to happen in the markets. However, the real risk is reacting to market movements and buying or selling not based on your plan, but rather on emotion or based on your personal biases.

As it has been a while since the last correction, it is important to remember the impact of corrections in recent history (many of which you may have personally experienced) and to consider how you acted or reacted during those times. Pictured below is a quick recap of the major double-digit Dow Jones Industrial Average drawdowns in price since 1986, measured from intraday high to intraday low. Nearly every drop has been blamed on either rising interest rates (changing discount rates on business earnings), fears/reality of slowing economic activity, or both.

Market Corrections since 1986

April 1987 **-10% over 2 weeks**	May-Sept 2001 **-27% over 17 weeks**
Aug-Oct 1987 **-40% over 6 weeks**	March-Oct 2002 **-32% over 29 weeks**
October 1989 **-10% over 3 weeks**	Dec 2002-March 2003 **-17% over 12 weeks**
Jan-Feb 1990 **-10% over 5 weeks**	Sept 2007-Jan 2008 **-18% over 14 weeks**
July-Oct 1990 **-20% over 12 weeks**	April 2008-Mar 2009 **-50% over 44 weeks**
Jan-May 1994 **-10% over 14 weeks**	April-July 2010 **-14% over 10 weeks**
July-Oct 1997 **-12% over 15 weeks**	May-Oct 2011 **-19% over 17 weeks**
July- Sept 1998 **-21% over 8 weeks**	April-June 2012 **-10% over 6 weeks**
Aug-Oct 1999 **-13% over 6 weeks**	Sept-Oct 2014 **-10% over 4 weeks**
Jan-Mar 2000 **-17% over 7 weeks**	May-Aug 2015 **-16% over 13 weeks**
Sept-Oct 2000 **-14% over 6 weeks**	Nov 2015-Jan 2016 **-13% over 11 weeks**

Source: Various Third Party reporting of Dow Jones Industrial Average, Sorted by Paul Franke

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