The era of low volatility may be over, but the need to pursue long-term financial goals is not. Investors should consider both the financial and emotional impact of market volatility. Positive returns are achievable in a volatile environment with the appropriate investment strategy.

In the wake of the great financial crisis, an improving economy and unprecedented monetary policy bolstered asset prices and suppressed market volatility. Many who benefitted from this trend assumed that it would continue indefinitely. However, that assumption was shattered by the recent turbulence across global financial markets. We believe the era of low volatility may be over as the markets digest several key issues:

- Divergence in central bank policy as the U.S. Federal Reserve has embarked upon a tightening cycle while other global central banks remain accommodative
- A recognition that we are in a slower global growth environment based on demographic trends and China’s transitioning from an investment-led to a consumption-led economy
- A dramatic oil price shock and the potential geopolitical risks that it brings

As we prepare for an environment of potentially higher volatility, it’s important to consider both the financial and emotional impact to investors. Let’s look at an example of each.

Exhibit 1 presents three hypothetical portfolios, each with the same $100,000 starting amount and the same simple average annual return of 5%. However, you will notice that the ending value of each portfolio is very different. Why? Because the volatility of the returns matters. If their portfolios were able to deliver more consistent returns with less variability, then investors would be better positioned to reach their desired outcomes.
Beyond the potential financial impact, volatility can also be an emotional hurdle. History has shown that investors often make emotional investment decisions during periods of significant market volatility — buying as markets rise and selling as markets decline (Exhibit 2). For investors with long-term wealth accumulation goals, simply participating in the upside of markets isn’t enough. The potential impact of the downside is a critical consideration. Investment strategies that seek to generate more consistent returns and less severe drawdowns may offer investors a higher likelihood of maintaining their investment plan.

Exhibit 2: Growth of $10,000 global equity portfolio and corresponding net equity mutual fund flows

Past performance does not guarantee future results. It is not possible to invest directly in an index.
Sources: Morningstar Direct and Columbia Management Investment Advisers, LLC. Equity net mutual fund flows represented by 12-month trailing equity net mutual fund flows (international and U.S. equity). Global equity index represented by MSCI ACWI Index. As of December 31, 2015.

This year has clearly gotten off to a difficult start. Our base case for 2016, which we outlined in the latest Investment Strategy Outlook, is a continuation of the environment of 2015 — lower returns and higher volatility. We strongly believe, though, that positive returns are achievable, even in this new environment, with the appropriate investment strategy.

To help ease the impact of volatile markets, we encourage investors to consider risk allocation and alternative investment strategies, both of which may offer enhanced diversification benefits. In addition, embracing flexibility through tactical and dynamic reallocation may provide return opportunities while helping to mitigate loss if market conditions were to worsen.

Louisa May Alcott once wrote, “I’m not afraid of storms, for I am learning how to sail my ship.” Volatility is a natural part of investing. Investors who are able to navigate both the financial and emotional hurdles that come with market volatility may stand a better chance of reaching their long-term financial goals.
We believe diversified portfolios will fare better in 2016 than in 2015

Investment strategy is all about decisions and outcomes
Even for investors who are skeptical of the efficient market hypothesis, there is no denying that investing is difficult. We make decisions under tremendous uncertainty, not only about what real world events will transpire but indeed about how market prices will react to these events. We investors must make decisions in the presence of this uncertainty, knowing that not all decisions will pay off. Sometimes good decisions are met with bad outcomes, and sometimes bad decisions are met with good outcomes. We can only control our decisions and expect that good decisions will pay off, on average, over the long run.

Diversification is a good decision
Diversification offers one of the best opportunities in all of investing. By combining dissimilar investments in our portfolios, we earn the weighted average of the returns of these investments. However, we do not retain the weighted average volatility (risk) of these investments. Because we can usually expect some of our investments to pay off even while others struggle, we generally see that diversification reduces some of the ups and downs of investing at the overall portfolio level. For this reason, diversified portfolios, over time, offer more return per unit of risk than concentrated ones.

Diversified portfolios struggled in 2015, but 2016 should be better

Source: Columbia Threadneedle Investments, 12/15
Equal weighted average of 10 major markets, 1970–2015: U.S. stocks represented by S&P 500 Index, international stocks represented by MSCI EAFE Index, U.S. government bonds represented by Barclays U.S. Treasury Index, international government bonds represented by Citigroup World Non-U.S. Government Bond Index, high yield represented by Barclays High Yield Index, investment grade represented by Barclays U.S. Corporate Bond Index, securitized represented by Barclays U.S. Mortgage-Backed Securities Index, TIPS represented by Barclays Global Inflation-Linked Index, commodities represented by Dow Jones-UBS Commodity Index and REITs represented by FTSE/NAREIT Index. If a particular index did not have a sufficient track record back to 1970, a representative index of similar risk/return characteristics was used.

Spreading investment portfolios across numerous asset classes has a great track record
A simple, diversified portfolio strategy produces a positive return in the vast majority of years (see chart). Notice that since 1970, a diversified approach produces a positive return in most years, and
that these returns can be quite meaningful much of the time. In fact, the example portfolio would have produced an average return of 9.8% through 2014, with only three down years over that span.

**Yet 2015 delivered very bad outcomes for diversified investors**

Glancing at the chart, we can easily see that, in context, 2015 was a horrible year for diversified investors. In fact, with the exception of the great financial crisis of 2008, 2015 delivered the worst outcome to diversified investors since 1974. This simple observation was nearly absent from most market commentary in 2015. But let’s be clear, 2015 was a historically awful year for diversified portfolios.

**2016 should be better. It seems a fairly safe presumption that diversified portfolios will fare better in 2016 than in 2015**

Historically, after each of the prior three negative years, the following year delivered firmly positive returns. More to the point, however, we note that many of the asset classes reflected in this chart experienced a meaningful reset of their forward-looking risk premia (in other words, their expected returns). High-yield bonds, for example, offered yields 277 basis points higher than in the middle of 2014.* Commodities too must have a somewhat more limited downside with oil at $40 per barrel than with oil at $100 per barrel.

Diversification almost always works. For investors frustrated by performance in 2015, we confidently recommend that you stay diversified with a keen eye to how your risks are allocated.

* The high-yield option-adjusted spread (OAS), a measurement of the spread of a fixed-income security rate and the risk-free rate of return, had a low of 3.23 on June 23, 2014 vs. 6.00 on December 7, 2015.

**Disclosures**

The Barclays Global Inflation-Linked Index includes securities that offer the potential for protection against inflation as their cash flows are linked to an underlying inflation index. Securities have to be issued by an investment-grade rated sovereign in its local currency. The list of eligible currencies is the same set of currencies eligible for inclusion in the Global Aggregate Index. The index represents a standalone multi-currency index exposed to the real yield curve for each relevant currency.

The Barclays High Yield Index covers the universe of fixed rate, non-investment grade debt. Pay-in-kind (PIK) bonds, Eurobonds and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures and 144-As are also included.

The Barclays U.S. Corporate Bond Index measures the investment-grade, fixed-rate, taxable corporate bond market.


The Barclays U.S. Treasury Index is an unmanaged index of public obligations of the U.S. Treasury with a remaining maturity of one year or more.

The Citigroup World Non-U.S. Government Bond Index is composed of bonds from several major world government bond markets outside the United States with maturities of at least one year. The bonds represented by this index involve investment risks, including default and loss of principal.

The Dow Jones UBS Commodity Index is based on 12 commodities derived from pricing on contracts that trade on exchanges that call for a cash commodity to be delivered or received at a specific future date, place and price. Due to market fluctuation, the commodities represented by this index may experience loss of invested principal, as they are subject to investment risk.
The **FTSE National Association of Real Estate Investment Trusts (NAREIT) Index** is an index that reflects the performance of all publicly traded equity real estate investment trusts (REITs).

The **MSCI EAFE Index**, an unmanaged index, is compiled from a composite of securities markets of Europe, Australasia and the Far East.

The **S&P 500 Index** tracks the performance of 500 widely held, large-capitalization U.S. stocks. Index returns assume the reinvestment of all distributions unless otherwise indicated.

It is not possible to invest directly in an index.

**Asset allocation and/or diversification** does not assure a profit or protect against loss.

Investing involves risk including the risk of loss of principal.
### Weekly Market Summary as of 5/2/16

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<tr>
<th>Bonds</th>
<th>Last Year</th>
<th>Last Week</th>
<th>Last Month</th>
<th>YTD</th>
<th>Year Ago</th>
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<tr>
<td>U.S. 2-year</td>
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<td>U.S. 10-year</td>
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<td>U.S. 10-year Breakeven (TPS)</td>
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<td>Barclays U.S. Aggregate</td>
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<td>Barclays U.S. Agg Corporate</td>
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<td>Barclays High Yield</td>
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<td>AA/A Multi 10-year</td>
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<table>
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<tr>
<th>Commodities</th>
<th>Price</th>
<th>% Chg</th>
<th>Price</th>
<th>% Chg</th>
<th>Price</th>
<th>% Chg</th>
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<tr>
<td>Gold</td>
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<td>5.00</td>
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<td>8.59</td>
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<td>Crude Oil</td>
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<td>-6.1%</td>
<td>36.0</td>
<td>-14.4%</td>
<td>37.0</td>
<td>-16.6%</td>
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<tr>
<td>U.S. Dollar Index</td>
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<td>0.8</td>
<td>-2.6%</td>
<td>0.98</td>
<td>-2.4%</td>
<td>0.98</td>
<td>-1.6%</td>
<td>0.93</td>
</tr>
</tbody>
</table>

Source: Columbia Management Investment Advisers, LLC

**Past performance does not guarantee future results.** It is not possible to invest directly in an index.

**DESCRIPTION OF INDICES**

The **Barclays U.S. Aggregate Bond Index** is a market value-weighted index that tracks the daily price, coupon, pay-downs, and total return performance of fixed-rate, publicly placed, dollar-denominated, and non-convertible investment grade debt issues with at least $250 million par amount outstanding and with at least one year to final maturity.

The **Barclays U.S. Corporate Investment Grade Index** is an unmanaged index consisting of publicly issued U.S. Corporate and specified foreign debentures and secured notes that are rated investment grade (Baa3/BBB- or higher) by at least two ratings agencies, have at least one year to final maturity and have at least $250 million par amount outstanding. To qualify, bonds must be SEC-registered.

The **BoFA Merrill Lynch High-Yield Bond Master II Index** is an unmanaged index that tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

The **Standard & Poor’s (S&P) 500 Index** tracks the performance of 500 widely held, large-capitalization U.S. stocks.

The **Russell 1000 Growth Index** measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The **Russell 1000 Value Index** measures the performance of those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The **Russell 2000 Growth Index** measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The **Russell 2000 Value Index** tracks the performance of those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The **MSCI EAFE Index** is a capitalization-weighted index that tracks the total return of common stocks in 21 developed-market countries within Europe, Australia and the Far East.

The **MSCI EM Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

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