Witch's Brew:

Stirring up a Cauldron of Diversification

Cetera® Investment Management LLC

As fall settles in, the days grow shorter and the nights stretch longer. Our cave-dwelling instincts awaken, wary of what lurks in the dark. Creaking floors, howling winds, and the occasional witch's cackle send shivers down the spine. After all, it's what we cannot see that unsettles us most.

For investors, an unexpected market drop can feel just as chilling, casting shadows over once-bright investment returns. But fear not—we've conjured a guide to warding off white-knuckle market volatility, drawn from the centuries-old wisdom of witches. With the right ingredients, you can brew a portfolio that remains balanced, resilient across market environments, and prepared for whatever the witching hour may bring.

As the market's path grows more unpredictable, even seasoned investors can feel the chill of uncertainty. There is no hocus pocus here—only five essential ingredients to help safeguard your portfolio when darkness descends. And like every good brew, it begins with knowing what kind of witch—err, investor—you are. So, gather 'round the cauldron…it's time to begin.

I Put a Spell on You

All Roads Lead to Salem. Once the site of the infamous witch trials, Salem, MA, has transformed into a tourist haven for those drawn to its dark history. Each October, more than a million people flock to Salem,[1] enchanted by haunted tours and the allure of witches.

Black Cats. Long associated with witches, black cats have carried the weight of superstition and bad luck myths for centuries. Truth be told, black cats cast the ultimate spell of loyalty and affection on anyone who gives them a chance. And they'll keep the rodents away, too.

Green Skinned. Margaret Hamilton's portrayal of the Wicked Witch of the West in The Wizard of Oz earned her a spot among the top five movie villains of all time, according to the American Film Institute.[2] Her iconic green makeup was made with a toxic, copper-based dye that burned her skin, required a grueling removal process, and forced her onto a liquid diet to avoid ingestion. The wickedness was real.

Wicked Good. Wicked, the musical adaptation about the witches of Oz, is one of Broadway's top earners, with over $1 billion in ticket sales. Its 2024 film adaptation is the highest-grossing musical film based on a Broadway production,[3] generating $750 million at the box office. The classic tale of "wicked vs. good" is considered wicked good by critics—and audiences, clearly under the spell of witches, agree.

Triple Witching. Even Wall Street isn't immune to witchcraft. Four times a year, the stock market experiences a "triple witching," when stock options, index futures, and index options contracts all expire at once. This convergence casts a spell of heightened volatility, often stirring a surge in the day's final hour as traders seek arbitrage opportunities where price discrepancies emerge.

Witch's Brew Recipe Card

- ✓ Know Your Fear Factor
- ✓ Don't Let Your Broomstick Fly Off Target
- ✓ Peer into the Crystal Ball to Reveal Your Stock Exposure
- ✓ Strengthen Your Defense with Bonds
- ✓ Add an Alternative Potion

Are You a Scaredy Cat? Know Your Fear Factor

Every investor has a different fear factor. Some can stomach a wild broomstick ride through the twists and turns of volatile markets, while others prefer a gentle glide. Younger investors with longer time horizons may lean toward more aggressive strategies, while those nearing retirement may seek stability.

Understanding your risk tolerance is key to building a portfolio that matches your comfort level. A risk-aligned investment strategy can help you stay calm when your broomstick hits turbulence, as in March 2020, when markets plunged during the COVID-19 selloff. Even investment oracles like Warren Buffett remind us that fear can be an opportunity. His advice to “be fearful when others are greedy, and greedy when others are fearful” is easier said than done but having a plan for when markets go dark can help you stay the course until the skies clear.

There are plenty of spooky tales from the market crypt, but fear doesn’t have to haunt your decisions. Whether you’re ready to soar or prefer to keep both feet on the ground, the key is choosing a path that matches your comfort level. Once you’ve found your path, make sure your portfolio doesn’t drift into the unknown. A well-matched plan can help you fly steady—even when the winds of uncertainty howl.

Don’t Let Your Broomstick Fly Off Target

Even the most seasoned witches can lose their way—especially when their broomsticks aren’t properly calibrated. That’s why it’s essential to check your flight path to ensure your broomstick doesn’t fly too far from its target. Without regular rebalancing, your portfolio may quietly veer into riskier skies.

Over time, asset classes move at different speeds, shifting a portfolio’s allocation and risk profile. A moderate risk portfolio that begins with a 60% stock allocation (tracking the S&P 500) and 40% bond allocation (tracking the Bloomberg U.S. Aggregate Bond Index) can look dramatically different without rebalancing. For example, here’s how the allocation would have shifted (as of August 2025) without rebalancing if invested:

5 years ago: 76% stocks / 24% bonds

10 years ago: 83% stocks / 17% bonds

5 years ago: 90% stocks / 10% bonds

Strong stock performance and subdued bond returns pushed this hypothetical portfolio into a much higher-risk category. The reverse occurs in bear markets, when falling stocks shift a portfolio to a more conservative allocation.

If your broomstick has drifted off course, it may be the time to realign your portfolio with your risk tolerance. Next, we’ll peer into the crystal ball to uncover what lies beneath the surface.

Peer into the Crystal Ball to Reveal Your Stock Exposure

Witches don't just cast spells, they peer into their crystal ball for guidance. Investors would be wise to do the same when reviewing their portfolios. Looking beneath the surface can reveal hidden risks in your portfolio's underlying exposure.

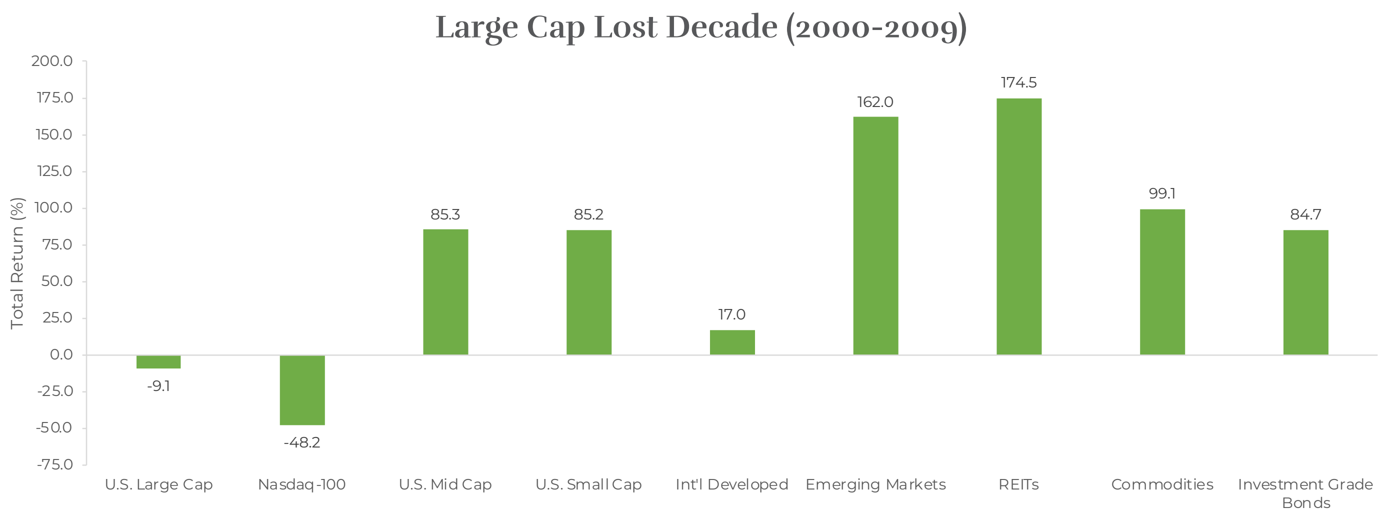
Stocks are often the largest source of risk in a diversified portfolio. They offer many benefits, including strong return potential, but concentrated exposure in a single sector, region, style, or just a handful of stocks can leave you vulnerable when storm clouds gather over markets.

That's why diversification remains one of the golden rules of investing—its protective powers are unmatched. By spreading equity exposure across sectors, geographic regions, and market caps, you reduce the chance of your plan being derailed by one sinister spell. A diversified equity allocation helps balance risk with opportunity and capture a broader base of return potential. Peer into your portfolio's crystal ball to uncover:

- Concentration in a single sector or stock.
- Overexposure to a single country or region.
- Imbalance towards large cap stocks.

History has shown what happens when diversification is ignored. After the late 1990s tech bubble, the S&P 500 suffered a lost decade (Figure 1), and the Nasdaq took nearly 15 years to climb back to its dot-com peak.

Figure 1: Large Cap Lost Decade



Source: Cetera Investment Management, FactSet, Standard & Poor's, MSCI, Bloomberg, FTSE. Indexes used: S&P 500 (U.S. Large Cap), Nasdaq-100, S&P Mid Cap 400 (U.S. Mid Cap), S&P Small Cap 600 (U.S. Small Cap), MSCI EAFE (Int'l Developed), MSCI EM (Emerging Markets), FTSE Nareit All Equity REITs (REITs), Bloomberg Commodity (Commodities), Bloomberg U.S. Aggregate Bond (Investment Grade Bonds). Returns are cumulative and include dividends and interest.

The market graveyard is filled with investors who took too much risk and failed to diversify. It's a tale as old as time. Maintaining a clear view of your equity exposure can help spot potential pitfalls before market turbulence creeps in from the shadows. Investors must also look beyond today's winners. Technology stocks have dominated returns for over a decade, but market leadership tends to rotate when the cycle turns.

Strengthen Your Defense with Bonds

Witches cast spells and go on the offensive, but they also need a strong defense against dark forces. Bonds help keep the cauldron sealed tight when stock market volatility begins to bubble over.

Bonds not only reinforce your portfolio's defenses against market sorcery, but they also offer stability, income, and low correlation with stocks. Government bonds, corporate debt, municipal securities, and other fixed-income categories each bring unique characteristics. While holding cash and cash equivalents like T-bills may feel like dead weight, they're essential for covering short-term expenses and adding another layer of protection.

Like equities, bond exposure deserves a closer look. An imbalanced bond allocation with excessive duration risk, poor credit quality, or high-interest rate sensitivity can be wicked for your portfolio. High-yield bonds, for instance, often lead fixed-income performance during economic expansions, but too much exposure can be ominous during a credit crisis, as they tend to correlate more closely with stocks. For example, in 2008, the Bloomberg U.S. Corporate High Yield Index plunged 26% while credit markets were deep asleep during the financial crisis.

A well-blended bond allocation adds a vital layer of protection to your portfolio. Just be sure to brew the right mix.

Add an Alternative Potion

While stocks and bonds are the core ingredients of most portfolios, adding a pinch of lesser-known potions may add a little extra magic to your cauldron. Introducing alternative asset classes, which often exhibit a lower correlation to stocks and bonds, can help smooth out returns over time and reduce volatility when stormy skies loom. These mystical ingredients include real estate, precious metals, commodities, managed futures, long/short strategies, and other multi-alternative categories. Stirring in the right mix of alternative investments may enhance diversification and offer a steadier flight across market cycles.

Gold and commodities, for instance, may provide a hedge against inflation. Alternatives can be a powerful potion for some investors, but they aren't for everyone. Before blending these elements into your investment cauldron, consult your financial professional to ensure they belong in your spellbook.

Prepare for the Witching Hour

Investors must always be ready for the witching hour, when unexpected market volatility bubbles over. It's been a yellow brick road for stock market returns in recent years, with high-flying stocks pushing valuations to nosebleed levels in some corners of the market.

But that doesn't mean it's time to panic. The golden path markets have followed doesn't guarantee a showdown with the Wicked Witch, but it's wise to keep your broomstick ready. Now is the perfect time to evaluate your portfolio's brew. A balanced mix of stocks, bonds, alternatives, and cash can help protect against "broom and gloom" and sweep away downside risk.

Diversification may not always shine in the short term, but its magic compounds over time.

Every investor's blend is a unique concoction, shaped by personal circumstances, risk tolerance, and financial goals. Please consult your Cetera financial professional for guidance in brewing the right mix to keep your investment plan flying toward your goals.

When the witching hour strikes, a well-crafted strategy will help you sleep soundly through the night. No spells required.

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Glossary

The S&P 500 is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Dow Jones Industrial Average is a price-weighted average of 30 U.S. blue-chip stocks traded on the New York Stock Exchange and NASDAQ. The index covers all industries except transportation, real estate and utilities.

The NASDAQ Composite Index includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index includes over 2,500 companies, spanning all 11 sector groups.

The Russell 2000 index is comprised of 2000 small-capitalization companies. It is made up of the bottom two-thirds in company size of the Russell 3000 index.

Sources:

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3: https://en.wikipedia.org/wiki/Wicked_(2024_film)

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