"It's never paid to bet against America. We come through things, but it's not always a smooth ride."

– Warren Buffett

The third quarter wasn't pretty: Stocks of all stripes fell sharply in the United States and abroad, and bond yields fell about a quarter of a percentage point.

But the quarter did serve to remind us of the value of a diversified portfolio. As the chart below illustrates, some types of assets declined less than others. For instance, small-cap stocks, represented by the Russell 2000 index, fell 12.2%. The large-cap, blue-chip stocks in the S&P 500, on the other hand, dropped just 6.9%.

Market/ Index	End of 3Q	End of 2Q	Change	1 Year Ago	Yearly Change
DJIA	*16284.70*	*17,619.51*	*-7.6%*	*17042.90*	*-4.4%*
NASDAQ	*4620.16*	*4986.87*	*-7.4%*	*4493.39*	*2.8%*
S&P 500	*1920.03*	*2063.11*	*-6.9%*	*1972.29*	*-2.6%*
Russell 2000	*1100.69*	*1253.95*	*-12.2%*	*1101.68*	*-.1%*
Global Dow	*2245.80*	*2513.38*	*-10.6%*	*2534.53*	*-11.4%*
10-yr Treas.	*2.06%*	*2.34%*	*-28 bps*	*2.51%*	*-45 bps*

Large-cap companies might not have the potential to grow exponentially like smaller ones do. But those smaller stocks are much more risky. By blending small- and large-cap stocks, we can manage risk while remaining positioned to reap gains when the markets regain their upward trajectory.

That's just one, simplified, example of how diversification works. A fully diversified portfolio includes several asset classes, all carefully counterbalanced to minimize risk and maximize return. It's long been established that diversification, while it does not guarantee against loss, is the most important component of reaching your long-term financial goals.

Let's look at some of the highlights of the July-through-September quarter.

The U.S. Economy

The United States job market remained sluggish during the third quarter: Just 142,000 jobs were added in September, while August employment growth was revised downward. The unemployment rate remained at 5.1%, but only because labor participation continued to decline. Meanwhile, we learned that housing prices continued to grow—about 5% for the 12 months ended in July. But market-watchers noted a decrease in the rate of price growth.

A continuing concern was the ongoing slump in oil prices, which may help consumers stretch their dollars, but has hurt earnings in the country's energy sector.

Second-quarter gross domestic product was revised upward from 2.6% to 3.7%, with growth in consumer spending and business investment.

Meanwhile, uncertainty about when the Federal Reserve would start to raise interest rates helped to fuel volatility in the markets. The body ultimately passed on taking action at its September meeting due to concerns over inflation, and some believe it will wait until 2016.

At Steel Peak, we believe it's important to look past periods of short-term volatility and stay focused on the long term. The market has over-reacted, in our opinion, to the prospect of rate increases. And historically, the market has done well in periods of rising rates. Why? Because the Fed generally waits to raise rates until the economy is strong. And a strong economy tends to underpin a strong stock market.

Investor Education: Market Volatility

The third quarter featured plenty of volatility, with market indexes performing a virtual roller-coaster act. Many panicked investors headed for the exits, but long-term investors who remained true to their investment plans are likely to be rewarded.

To put the recent market dips into perspective, consider that from 1980 to 2014, intra-year drops of more than 4% were common. More importantly, in 29 out of the 35 years where these declines occurred, the market overcame the setback to deliver a positive return for the year. Past performance is no guarantee of future results, of course.

It's tempting to flee the market when a scary drop occurs. But history shows that it usually pays to stay put. If you invested $1,000 in the S&P 500 index on the last day of 1994, it would be worth $5,355 two decades later. Now suppose that, by pulling your money out of the market and putting it back in, you missed the 10 best days during that 20-year period. At the end of 20 years, your investments would only be worth $3,622.

The bottom line: To overcome short-term volatility, it's essential to maintain a long-term vision.

Troubles Overseas

Global markets, including the United States, faced a headwind from China, where the economy continued to show signs of slowing growth and the government had to step in to try to limit market upheaval. China's leaders devalued the country's currency by 2%, which created fears of a currency war and putting added pressure on emerging-market currencies from Vietnam to Kazakhstan. Meanwhile, continuing conflicts in the Middle East created additional pressure on the world's economies and markets.

On a brighter note, the so-called Greek drama came to a resolution, if not a conclusion. The beleaguered country agreed to concessions in return for more than $90 billion in loans over three years from the European Union.

What's more, Iran and a coalition of nations led by the United States reached agreement to limit the country's development of nuclear weapons.

Looking Ahead

In the fourth quarter, market watchers will have their eyes peeled for the initial estimate of third-quarter gross domestic product. If it is strong, it may show the U.S. economy's ability to withstand headwinds from overseas, the effect of the stronger dollar on exports and other challenges.

Whatever events unfold in the economy and markets, the key to long-term investment success remains the same: To create and follow a well-thought-out plan based on your goals, time horizon and risk tolerance—and stick to it through the inevitable periods of market volatility.