Wealth Management
Dominion Securities

Ravinsky Wealth Management Group

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Recent Posts

What is the equity selloff saying about the investment outlook?

We regard the pullback as something that should be endured on the way to further market gains instead of portending "something worse."

New year, new U.S. recession scorecard indicator

We're adding a seventh recession indicator to our scorecard. What's new and why is it being added?

The new year has gotten off to a poor start. The main culprit has been government bond yields which have moved to highs not seen since before the pandemic. A good portion of the equity market weakness so far has been focused in the technology sector and other so-called growth pockets, where stock prices can be particularly vulnerable to swings in bond yields and interest rates. The other important factor of late has been the fourth quarter earnings season which is now underway. Below, we discuss why earnings may play a more important role going forward in driving equity returns.

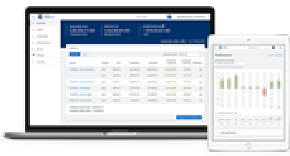
There are two forces that typically drive stock prices: valuations and earnings. The former can be described as the value that investors are willing to ascribe to the earnings, cash flows, and dividends that are expected to be generated by a business in the future. As expectations change, and factors such as interest rates rise and fall, so too can the valuations that investors are willing to pay. Not surprisingly, valuations have moved higher for global stocks over the past decade as interest rates have declined.

Today, global equities are not cheap. Some markets around the world are trading above historical averages when looking at various commonly used metrics such as the "Price to Earnings" ratio. But, that was the same case a year ago and returns proved to be quite strong last year. So, elevated valuations do not imply an imminent risk, nor do they suggest that returns can't be reasonably attractive in the short-term.

Nevertheless, higher valuations do have important implications for investors. Historically, equity returns have been less robust over the intermediate to longer-term when the starting point for valuations has been higher, as is the case today. This is somewhat intuitive as it is simply hard to imagine valuations increasing significantly after having meaningfully done so over the past decade. As a result, investors may have to lean on earnings growth to drive positive equity returns going forward, rather than an increase in the valuation investors are willing to pay for stocks. Moreover, any significant move higher in bond yields could reduce the multiple that investors are willing to pay, putting even more pressure on earnings growth. As a result, investors should moderate their return expectations going forward, and pay increasing attention to potential earnings growth.

Fortunately, this coming year should be reasonably good on the earnings front, barring any unforeseen headwinds to global growth. Consensus expectations are for close to 7% earnings growth for the world stock market this year. That is a meaningful decline from the nearly 50% growth in 2021. But, last year was skewed by the sharp recovery from the earnings decline witnessed in 2020. Earnings growth should moderate from the incredibly strong levels seen last year, but should still be close to or above historical trend. And, there is upside potential should inflation moderate more than expected later this year, supply chain pressures ease, inventories get restocked, and restrictions be lifted more quickly.

The tailwinds of very low interest rates and bond yields are shifting. This presents a headwind to asset valuations and will create bouts of volatility as the markets reposition for a changing monetary policy backdrop. Yet, we have confidence in the economic outlook and the prospects for earnings over the months to come.



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David Ravinsky

Alex Tsapekis

Jo-Anne Mackenzie

We're here to help!

We're committed to keeping you informed about the progress you are making towards your financial goals. Our team is always available to answer your questions, provide advice or review your portfolio.

We appreciate the opportunity to serve you and look forward to continuing to help you accomplish your long-term financial goals.

Should you have any questions, please feel free to reach out.

Sincerely,

The Ravinsky Wealth Management Group

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