WORST MIGHT BE BEHIND US ….HOPEFULLY

The last three months have been very interesting for both the equity and the fixed income markets. The markets actually did extremely well from mid-June to mid-August. For instance, the U.S. stock market (as represented by the S&P 500 index) increased by 17 percent from June 16th to August 16th. As of this writing, the US stock market is down about 7.5 percent since August 16th. On the plus side though, the markets are still sitting above the June lows. June 16th is still holding as being the low point for the U.S. stock market in calendar year 2022 - and we will hopefully not go below that low.

Needless to say, there is an ongoing debate amongst market experts as to whether we are still currently part of a downward 'bear' market trend or whether the market has now moved into an upward 'bull' market trend that began this summer. From a strict definition point of view, since the stock market has not increased by 20% since its June low, we are still regrettably in a bear market. But that is not the same thing as saying we will revisit the market lows. It might simply mean that we need to wait a while before the market is up 20% from its low, which when it does happen would then be defined as a 'bull' market.

What actually caused the decline in the markets over the past four weeks?

The simplest answer is to point to a speech by the Federal Reserve Chairman Jerome Powell's in Jackson Hole on August 26th in which he stated: *"Reducing inflation is likely to require a sustained period of below-trend growth….While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses."* (Source: Fortune.com, 'Jerome Powell says the Fed is ready to 'bring some pain', August 26, 2022)

The word 'pain' did not sit well with the markets, and made many market experts less optimistic that the Federal Reserve might be inclined to stop or even pivot from its hawkish policy of meaningful central bank rate increases. Increasing central bank rates now seem to be a worldwide phenomenon, as we just saw with the increase of Canada's central bank policy rate by 0.75 percentage points on September 7th. The U.S. Federal Reserve will most probably do a similar increase on September 21st.

If we were to dig deeper into the causes of the recent market declines, I would add the following observations:

- The markets had declined so much in the first half of the year - for various reasons – that we were due for a sharp break from that downtrend. We witnessed a strong upward reversal during the summer. And now the markets seem to be taking a breather from that steep uptrend. The market has not decided yet whether the summer rally we have recently experienced was simply a 'rally within a bear market' or 'the beginning of a new bull market'.
- Even prior to Jerome Powell's speech, market interest rates had been increasing. For instance, the U.S. government 10 year bond yield had decreased from 3.48% on June 14th to 2.61% on August 1st. That rate has since been increasing since August 1st. As of this writing, the U.S. government 10 year bond yield is back up to 3.36%. Higher market rates are a direct negative for the fixed income market. Furthermore, and other things being equal, increasing market interest rates are a negative for the equity market - especially for richly valued high growth stocks.
- During the summer time, there are fewer active investors in the market. So while investors (retail and professional alike) were enjoying a relaxing hot summer - amplified by a significantly lower COVID count - the markets lower overall liquidity made the markets more prone to bigger swings.

So how should investors be positioned in today's markets?

My opinion is that, overall and assuming no change in one's circumstances, investors should do nothing (see quote from 'Sometimes no-action can be the best action – Investor Insights' article in next section). 'Doing nothing' is not the same as 'you should not be investing'. 'Doing nothing' in the context of this discussion simply means keeping one's investment portfolio relatively intact and having the patience to ride out this period of uncertainty.

In the short-to-medium term, we are probably as likely to get positive news as we are negative news. Consequently, we may be stuck in a trading range, i.e. in the near term we will most probably not experience any significant declines nor significant advances. I would however be paying particular attention to signs of lower inflation e.g. lower oil prices. Decreasing today's high inflation rate is the key to the current central bank battle, in which it is using interest rate increases to lower the inflation rate. As Powell stated, we are and will continue to feel pain. But the optimist in me feels that the major part of the stock market pain may already be behind us.

Looking out six months from today, I read with great interest today that respected money manager Cathie Wood, CEO of ARK Investment Management, believes she '*would not be surprised to see a significant policy pivot in the next three to six months….The surprise could be deflation...by year-end*'. (Source: CNBC PRO, 'Cathie Wood calls for a significant Fed policy pivot', Sept 8, 2022) If Cathie is correct then, in my opinion, this could lead to a significant upward move in the markets.

Finally, I would like to offer my own personal perspective, partly based on past experience:

Bad economic news on the front page of the newspaper might turn out to be good news for the markets. Why? Because the markets tend to look out ahead into the future (six-to-nine months). Today's bad economic news might force the central banks and governments to rethink their current contractionary economic policies, which would probably be good for the markets. Furthermore, the bad economic news one might be reading typically tells us what has already happened. The markets are much more interested in what may happen in the future, especially in relation to current expectations. Bad news does not have to disappear in order for the markets to do well. But when actual news becomes a bit less bad than anticipated, the markets often do well.

Looking at it from a slightly different angle and putting it in very simple terms, the stock market (a leading indicator) forecasts future corporate profits. Corporate profits forecasts the economy. And the economy forecasts the unemployment rate (a lagging indicator). So….it is not the economy that forecasts the stock market. It is typically more the other way around, i.e. the stock market forecasts the economy. And even if this is not always the case, I believe it is better to think of the stock market as a leading indicator of the economy, and not a lagging indicator.

Should you have any questions or concerns, please feel free to reach out. And as always, we encourage you to contact us if there has been an important change in your financial situation.

Wade Brown Wealth Management
September 14, 2022

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Insights/Opinions from Experts

In this section, as I often do, I would now like to offer a few very recent quotes/insights/observations from respected market experts that hopefully provide useful perspective during these very uncertain times.

"On the positive side, corporate liquidity, a strong commercial banking system and the spending power of the top quintile of the U.S. population, may enable the upcoming recession to be shallow….Generally cleansed of debt by year-end 2022, we expect the energy sector will gush cash back to shareholders during 2023."
Source: Andrew McCreath, CEO of Forge first Asset Management, September 13, 2022

"We hit peak fear in a lot of ways during the summer months"
Source: Eric Sheridan, Goldman Sachs, Managing Director, CNBC, September 12, 2022

"I still believe we've seen the lows of this tough market."
Source: Jim Cramer, CNBC, September 11, 2022

"Inflation is problematically high, but tentatively peaking….bonds endured their worst sell-off since the early 1980s...if the recent surge in inflation proves transitory, yields are likely close to where we would expect them to settle over the medium to longer term….we have taken steps over the past several months to further narrow our bond underweight as yields have risen, sourced from cash and equities. Over the long term, we continue to expect that stocks offer superior return potential versus bonds and we are maintaining a slight overweight allocation to equities as a result. Our current recommended asset mix for a global balanced investor is 61.5% equities (strategic: "neutral": 60%), 37.5% bonds (strategic "neutral": 38%) and 1.0% in cash"
Source: Market Update, RBC Global Asset Management, authors: Eric Savoie, Investment Strategist and Daniel Chorneous, Chief Investment Officer at RBC GAM, September 2, 2022

"Looking at seasonality for the last 50+ years, the period of September through October has historically been one of the worst for equity markets….We are entering one of the most difficult periods of the year for markets, but it's also important to remember that equity indices have recovered from every historical event….So far 2022 has been a year many investors would rather forget as both bonds and stocks have lost money at the same time, which is not often the case. The main reason for this, of course, has been the dramatic moves from global central banks that are in the process of removing pandemic stimulus programs to try to put the inflation 'genie' back into the bottle."
Source: Greg Taylor, Chief Investment Officer, Purpose Investments, Reuters, September 1st, 2022

"The first seven months of 2022 have been challenging. This has left many investors wondering what, if any, action to take. For some, their first instinct may be to change course and wait in cash until the direction of markets feels safer. While it can be tempting to try and time the market, history suggests that maybe the best course of action is to take no action at all….while markets have risen considerably over the last 20 years, stretches of negative short-term performance can be more common that you might expect"
Source: 'Sometimes no-action can be the best action – Investor Insights', RBC Global Asset Management, August 2022