A SIMPLE RECIPE FOR INVESTING SUCCESS OVER THE LONG-TERM

Mix patience with optimism for the long-term.

It is not the good years (e.g. 2021) that cause investors to worry. But a trying year such as 2022 does remind us that investing is not always easy. We all know that it is easy enough to find bad news and negative opinions during difficult times. Patience and optimism for the long-term will help investors deal with the bad times and eventually prosper.

In my opinion, patience and optimism actually outweigh knowledge in terms of important attributes for long-term investment success. Knowledge is definitely a plus. But 'knowing every tidbit of publicly available information and opinion' does not necessarily lead to making the best investment decisions. In fact, information overload can actually lead to investment paralysis. One can always find a reason not to invest. To paraphrase a quote from General Patton, a good plan today is better than a perfect plan tomorrow.

Now let us turn our attention to today's markets.

Why are the markets down in 2022? The main reason is a sharp rise in interest rates. Market interest rates have actually been steadily rising since August 2021. Many of the central banks started to increase their rates earlier this year, e.g. the U.S. Federal began increasing its rate in March. Central banks probably kept their rates too low and for too long as a result of the COVID crisis. Today, it seems like many central banks have been playing catch-up, and wish to continue increasing their rates and keep them high for longer, in their attempt to tame inflation.

This hawkish/restrictive monetary policy has caused almost all asset classes to decrease in value in 2022. Even real estate prices have come down from their peak levels (source: CBC Business, Real estate slowdown continues, with average price down 22% since February, Sept 15, 2022), and are expected to fall even further in 2023 (source: Globe and Mail, CMHC says house prices likely to fall 15 per cent by mid-2023, October 14, 2022). To the long-term optimist, a positive element about the decline in asset values in 2022 is that it will contribute to slowing down inflation, which in turn will most probably make the central banks end their current rate tightening cycle, and possibly even begin to decrease rates at some point in 2023. Many experts actually believe there is a risk that the central banks can cause a major recession if they increase rates too much and keep them high for too long.

Ironically, while I am not necessarily optimistic about the economy over the next 12-to 18 months, I am more positive on the markets, recognizing that it is difficult to predict markets over the very short-term.

While it is impossible to predict market bottoms, we are seeing more and more indicators - many of them being contrarian ones - that point to the markets probably having suffered the bulk of the damage from the 2022 bear market. Consider the following:

- Pessimism is at an extremely high level. One only has to verify the weekly AAII Sentiment survey that show bullish (i.e. optimistic) readings amongst the lowest in the survey's history, which dates back to 1987. One can also look at the extremely heavy buying of put options (which are 'negative' bets) by retail traders (source: Jason Goepfert, Twitter, Sept 24, 2022), along with strong money flows into money market funds (source: CNBC, Goldman says retail investors are near capitulation as they flood billions into cash, Oct 10, 2022).
- The stock market no longer seems to panic over the strength and persistence of inflation, as witnessed by an increase in stock prices on October 13th despite the release of strong inflation data in the U.S..
- For those who follow technical signals, I would point out that (1) the U.S. has not had a significant decline below the mid-June lows, and (2) the VIX Index - which tracks volatility levels - has been high for quite some time now, and this has typically been more associated with market bottoms.
- And for those who track historical patterns, I would point out that (1) the average return in the U.S. stock market has been 4% in the last quarter of the year over the past 20 years , and (2) the average return in the U.S. stock market has been 6% in the last quarter of a year in which a U.S. mid-term election is held - which is the case in 2022 (source: CNBC , Joe Terranova , Virtus Investment Partners, September 30, 2022).

I am optimistic for the long term for a number of reasons, one of them being that the 2022 market decline has brought stock and bond prices down to more attractive levels from which future expected returns are likely to be better than they were earlier in the year. In fact, the average U.S. S&P 500 index 12 month return after a 20% market decline is 17%, while the 3 year annual return is over 12% (source: RBC Global Asset Management, Volatility in Perspective , October 2022).

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
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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.

"*With most western central banks intent on pursuing aggressive policy tightening despite slowing economies, the probability of recession has increased. Much of this outlook seems to be reflected in current valuations, which have already been compressed by the higher rates…"*
Source: RBC Wealth Management, Monthly Global Insight, October, 2022

"As Sevens Report's Tom Essaye puts it, 'Sentiment, meanwhile, has become extremely negative. While we can't say the bottom is in, we do feel that we are closer to the end of this than the beginning...'
Source: Barron's, Market Sentiment is Bad. Why That's Good for Stocks, Sept 26, 2022

"*Unloading into a falling market is one of the worst mistakes an investor can make. 'Reducing market exposure through ill-conceived selling - and thus failing to participate fully in the market's positive long term trend- is a cardinal sin in Investing,' Howard Marks, the billionaire co-founder of credit fund Oaktree Capital Management, wrote in a recent instalment of his widely followed newsletter*"
Source: Globe and Mail, Please don't sell your stocks in times of stress, October 10, 2022