

## Client Update – Comment on Recent Market Developments

### Timely perspective

Following our recent communique on the fallout from the Covid-19 crisis, we felt it is timely to comment on the updated situation from an investment and financial planning point of view. We offer you a perspective as to what may lie ahead based on historical evidence and recent events.

### Deja vu

The first point to note is that we have been here before. This is in terms of experiencing significant falls in financial asset values and volatility. We will most likely experience this again in the future.

### High impact - uncertainty

Financial markets are heavily influenced by human behaviour, which can be irrational in times of crisis. The evidence, supported by external research, demonstrates that financial markets can be highly irrational over the short term. Conversely, they tend to be rational in the long term. Markets do not like uncertainty. We are currently experiencing markets reacting adversely due to the high level of uncertainty surrounding the impact of the Coronavirus.

Here's what recent history tells us. The performance of the global stock market index over the last 15 years is illustrated in the chart below:



### Confidence can be taken from the key points in the above chart:

1. Stock markets fell significantly in value in 2008-2009 during the worst of the financial crisis. However, by 2011, the **markets had recovered from most of the losses.**
2. Whilst the recent falls over the last number of weeks have been sharp and severe, the markets have **only fallen back to 2017 levels.**
3. Going back further, the US has had 10 recessions over the last 70 years or so (since WW2) – the **average length has been 18 months** and the average fall in US stock markets, as measured by the S&P 500 index, has been 32%.

- The US stock market recently has fallen by more than 24% – however over the last two days (Tuesday 24<sup>th</sup> and Wednesday 25<sup>th</sup>) **markets increased by approximately 10% from their lows**, in response to the significant US government stimulus package that was announce. This underscores the very high levels of market volatility at the moment – both negative and positive.

**Amidst the perceived gloom and pessimism, we should not lose sight of some important facts:**

**Always recover**

- Stock market cycles are a fact of life. Each one may feel different. The early part of a severe downturn can be frightening but equities and economies always recover eventually. This is because recovery from adversity is an intrinsic human trait and lies at the heart of capitalism.

**Bad news already priced in**

- Markets are discounting mechanisms, always looking at the future rather than the present. The response to a threatened recession can be early and savage. The lowest point is often passed even while the fundamental news flow is getting worse. With global equities down more than 30% from their all-time high in February, much bad news is already priced in.

**Fundamental values vary little**

- The long-term valuation of equities has become much more attractive than it was. Yes, near- term profits will be less than anticipated a few months ago, and there will be some dividend cuts, but the fundamental value of large companies does not vary too much with the economic cycle.

The table below shows the long-term valuation metrics of the FTSE World Index (dividend yield and price-to-book ratio) as of yesterday (March 16th); then at end-January 2020 (near the all-time market high), and at end-May 2009 (just after the global financial crisis market bottom).

***FTSE World Index – Valuation Metrics***

Date	Dividend Yield	Price-to-Book Value
16-Mar-20	3.3%	1.8x
31-Jan-20	2.4%	2.5x
31-May-09	3.3%	1.7x

Source: FTSE Russell.com

A quick glance at the table suggests that we are much closer in **valuation terms** to the market low of eleven years ago than the market high of one month ago. The dividend yield on global equities is now 3.3%, in line with the 3.3% of the last bear market low and much higher than the 2.4% at the recent all-time high. The price-to-book value ratio shows a similar pattern.

**Valuations may not be a reliable guide to short-term timing, but it is the best indicator of long- term return prospects.**

### **Here's what the nervous investor should ponder**

There's an understandable urge to run for cover by switching out of equities and other higher-risk assets. Markets could well fall even further in the near term, but the long-term investor who switches out of equities now must switch back again at a lower price to justify the move. And the second leg of that trade is the difficult one; it is psychologically daunting to re-enter a market when it is close to its cyclical lows. Invariably, **the private investor who exits equities at this point ends up repurchasing them at higher prices** when the recovery is already well under way.

Many of us with pension plans, investments and investment savings accounts have recently experienced falls in values. Switching to low risk assets, such as cash, in times of crisis can be very appealing.

### **Stick with your investment**

However, correctly timing the switch back out of low risk assets is very difficult. Many such investors "miss the boat" when markets recover. In this regard, we generally advocate sticking with your investment strategy. For those in cash looking at getting back into the markets a **phased investment approach** may be appropriate.

### **Buy in cheap**

For pension plan investors who are making ongoing contributions, **e.g. on a monthly or yearly basis**, it is important to note that going forward you may benefit from investing in assets that have fallen in value. That is, your future contributions may benefit from "buying in cheap", with an averaging investment effect over the longer term.

### **Realistic and optimistic about recovery**

Obviously a crystal ball answer does not exist. The Coronavirus pandemic may worsen before improving. This will fuel more uncertainty and the potential for further market falls. However, we remain both realistic and optimistic about the future. We believe that investment values in time will recover from this crisis.

Take care and, as always, please contact me with any queries.

**Ronan McGrath**

**Managing Director**

**Oakwood Financial Advisors**

M: +353 (0) 86 6098615

E: [ronan@oakwoodfinancial.ie](mailto:ronan@oakwoodfinancial.ie)