Feature | Oakwood

What to do when the market is turbulent?

Emotional issues can lead to irrational decisions in investing, so it's best to have a clear strategy and not to divert from it by ups and downs in the market which are not indicative of long-term performance or growth, writes **Ronan McGrath**

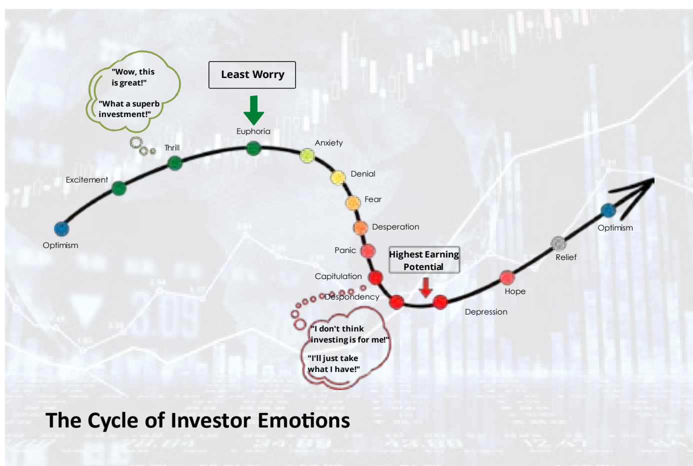
The financial news today can be a little unsettling. These are tough, emotional times for investors, particularly for those close to or in retirement. 2022 has been very challenging for investors, with negative returns year to date for nearly all asset classes. While there were a lot of moving parts in the markets, not least the war in Ukraine, the core narrative is very simple. The apparent persistence of high and rising inflation has spurred Central Banks to a hawkish stance. Such sharp increases in interest rates are rarely welcomed by investors.

Factors contributing to inflation

The impact of the Russian invasion of Ukraine has impacted on energy, fertilizer, commodity and food prices. This has exacerbated the increase in inflation. When combined with Central Banks, increasing interest rates and reversing Quantitative Easing policies, the money supply is reducing. Global supply bottle necks, and the continuing Covid lockdowns in China, has led to a rapid rise in inflation globally to levels not seen for several decades. A very problematic and uncomfortable scenario.

Emotions can lead to unwise action

Without doubt, emotions play a part when we invest. This can cause us to make irrational decisions. When such emotions take over they lead to decisions that are not conducive to good investment outcomes. Investors can panic when they see values decline and, unwisely, feel they must do something.



The Cycle of Investor Emotions

Take the long-term view and wisely hold your nerve

Holding firm, once you have invested in line with your long-term strategy, is the most rational thing you can do. One can't accurately time, entry into and out of, markets. It just doesn't work. When faced with short-term, headline-grabbing media reporting, it is easy to lose sight of the potential long-term benefits of staying invested. While no--one has a crystal ball, adopting a long-term perspective can help change how you view market volatility and help you to look beyond misguided headlines.

US market and Nasdaq down 20%+

From an investment perspective, the impact has been more varied than the news might suggest so far this year. Global equity markets have handed back some of the, perhaps, unexpected gains of 2020-2021, but not in a uniform manner. Of note, high-growth stocks with poor or non-existent profits have been particularly hard hit, impacting the US broad market (down 20%) and the tech-oriented Nasdaq (down 28%).

Global stocks held firm or improved

Yet, if we look at global markets and the FTSE Work Index, these are down only 9% or so (in Euro terms). It is worth noting that a well-constructed exposure to global value stocks has potentially held its value or delivered a small return so far this year, from which diversified investors will have benefited. A similar value outcome has been seen in emerging markets.

Over the longer time horizon that most investors face, equity assets should provide inflation-plus returns to protect the value of wealth. Unfortunately, there are no certain inflation hedges.

Value v Growth

Within equity markets, the relative recovery of the value style continued in emphatic terms. The MSCI World Value index fell 4.5% compared with a 22.6% drop for its growth counterpart. Some of the divergence was related to sector-specific factors; the environment of strong commodity prices and prospective interest rate increases was supportive to a number of classic value sectors such as energy, basic materials and financials.

Superior Return Potential – in the long-term

Growth stocks are those companies that are considered to have the potential to outperform the overall market over time. This is because of their future potential. Value stocks are classified as companies that are currently trading below what they are really worth and will thus provide a superior return.

Value Stocks

Our leaning in portfolios towards Value Stocks since the first half of 2021 benefited our clients. This has cushioned them from the brunt of the equity market drops in the first half of this year.

Safe Haven Assets

Among other asset classes, commercial property was something of a safe haven while financial markets tumbled. Looking at the main Commercial Property Funds, there was an average return of a circa positive 2% for the first half of the year.

Commodity Gains – Mixed Performance

The other asset class to register gains over the first six months was commodities, and for obvious reasons. The Rogers Commodities index gained 23.1% in the first half. Within that, it peaked in early June, and retreated 13% from there, as the Fed's mounting hawkishness raised recession fears.

Our favoured bonds are yielding more

The fears of inflation have pushed bond yields higher, with resultant falls in bond prices. Bonds would traditionally be seen as a safe haven asset but have suffered significant declines. Shorter-dated, higher-quality bonds – favoured in client portfolios – have been impacted to a lesser degree than long-dated bonds. The positive is that – going forward – bonds are now yielding materially more than a year ago.

Inflation may have peaked

Developments in the commodity markets over the past few weeks are also interesting. General commodity prices, including oil and gas prices, have sold off sharply over the past fortnight. This may be an initial indicator that inflation peaked.

Inflation is the greatest threat to your savings

The Economic and Social Research Institute (ESRI) has recently warned that the Russian invasion of Ukraine may usher in 1980s-style inflation in Ireland. While inflation, due to the surge in energy prices, is expected to peak at about 9%, the projection in Ireland for 2022 is around 6.5%.

Strong performance a likely expectation

All-in-all, a well-diversified global equity portfolio, with exposure to value stocks and holding shorter-dated high-quality bonds, has probably been more solid than the news might suggest. Performance certainly sits well within the bounds of expectation.

Here are some tips to help keep things in perspective at this challenging emotional time:

Tips for unsettling times

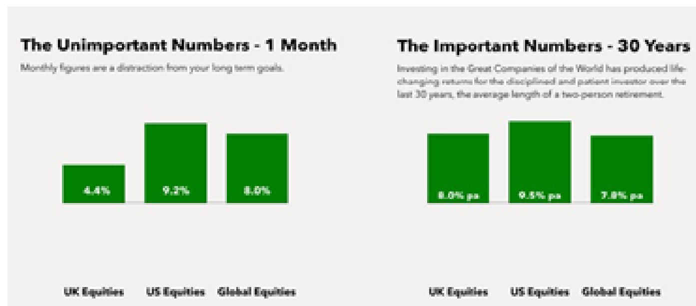
1. Accept the uncertainty of markets. Your well-diversified portfolio protects you from any one area of the markets suffering particular pressures. Your portfolio will probably be performing better than the headlines suggest.
2. Don't measure your portfolio's performance from the previous top of the market. Assess it over a longer, more sensible timeframe, and from where you started. The last few years have been really good to investors. Giving a little back is part of any provident investing journey.
3. Try not to look at your portfolio too often. Get on with more important things in your life. A review once a year is more than enough. This takes some willpower!
4. Accept that you cannot accurately time when to move in and out of markets. It's simply not possible. Resign yourself to this fact. Then investing will be much less stressful for you.
5. If markets have fallen, remember that you still own everything you did before i.e. the same number of shares in the same companies, and the same bonds holdings.
6. Most crucially, a fall does not turn into a loss unless you sell your investments at the wrong time. If you don't need the money, don't foolishly sell.
7. The balance between your growth (equity) assets and defensive (high quality bond) assets was established by your adviser to make sure that you can withstand any temporary falls in the value of your portfolio - both emotionally and financially. A recent fall in the markets does not change this prudent rationale.
8. Be confident that your (boring) defensive assets will come into their own. Thus protecting your portfolio from some of the pain of material equity market falls, should such occur.
9. Your adviser should be there – at any time – to support you. If you have the right, experienced financial advisor, they are a comforting source of fortitude, patience, and discipline on which you can confidently rely.

For the best results, stick to the plan

Success in investing is dependent on your appetite for volatility (the inevitable ups and downs of the market). The smooth stuff is not where you make money. Especially with inflation running at over 8% year to date. You're not going to keep pace with inflation by investing in government or corporate bonds. The ability to take a level of risk and have success depends on a set of human relationships just as much as it does on the mathematics of it. Holding your nerve during these ups and downs produces the best results in the long-term.

Anytime volatility (fluctuation in asset price) picks up or the market makes a big move higher or lower, investors should remember that the market sets prices based off of ***the collective wisdom and foolishness from millions of decisions***.

The Stock Markets (updated July 2022)



Long-term investment achieves your goals

If you are a long-term investor, if your fund will continue to be invested into perpetuity (ARF investor), then we must not overreact to volatility. Short-term volatility is irrelevant. **Your key benchmark should be to achieve all of your financial goals and not run out of money.**

Opportunities are out there if you move out of hoarding cash

The current volatility is offering up opportunities to invest in asset classes that protect against inflation. As mentioned previously in our article, **Value based equities** have given a level of stability in the current market. For those with funds in cash or overly exposed to bonds, now is an opportunity to rebalance towards those **equity funds offering superior** value. Cash is dropping in value continuously.

The Silent Impact of Inflation

€1,000 in Jan 2021 was worth €950 in Jan 2022 due to the negative impact of inflation. If this years inflation rate comes in at the expected 6.5% then that €1,000 will be worth less than €890 in Dec 2022. In two years a loss of €110 on €1,000 by just leaving funds on deposit.

Attractive value exists – talk to your financial advisor

While it may not feel like it, due to the negative headlines, it's not all doom and gloom. Certain equity funds are now offering value which we haven't seen since before the Covid Pandemic. These are unsettling times, but your best defence is to keep to your plan, remain invested in a well-diversified, robust portfolio and lean on your adviser if necessary. IMT

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Information

Oakwood Financial Advisors are specialist financial advisors to the medical profession, with a unique understanding of both the GMS Pension Scheme and also the Health Service Executive pension benefits.

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