RETIREWELL

WEALTH MANAGEMENT SOLUTIONS

eNewsletter

Exclusive Client Email Newsletter

29 June 2022

To Clients and Friends of Retirewell,

An Update on Markets - Key Things For Investors To Keep In Mind During Times Of Market Turmoil

Key Points

- Share markets fell sharply in mid-June, continuing the plunge that started early this year due to worries about inflation, monetary tightening, recession and geopolitical issues including the invasion of Ukraine.
- It's still too early to say markets have bottomed.
- This will weigh on super returns for this financial year.
- Key things for investors to bear in mind are that: share pullbacks are healthy and normal; in the absence of a recession, a deep and long bear market in shares may be avoided; selling shares after a fall locks in a loss; share pullbacks provide opportunities for investors to buy them more cheaply; shares still offer an attractive income flow; and to avoid getting thrown off a long-term investment strategy it's best to turn down the noise.

Introduction

Usually share markets are relatively calm and so don't generate a lot of attention. But periodically they tumble and generate headlines like "billions wiped off share market" and "biggest share plunge since..." Sometimes it ends quickly and the market heads back up again and is forgotten about. But once every so often share markets keep falling for a while. Sometimes the falls are foreseeable (usually after a run of strong gains), but rarely are they forecastable (which requires a call as to timing and magnitude).despite many claiming otherwise. We have all seen many periodic sharemarket tumbles.

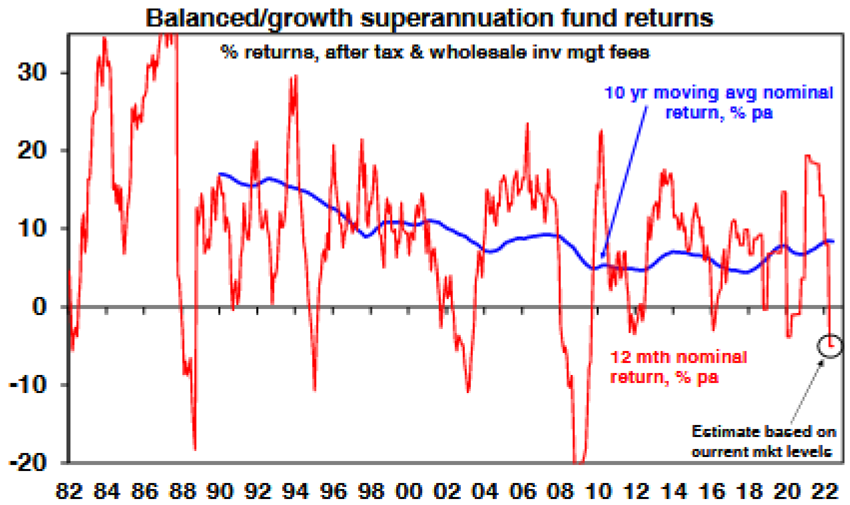
And so it is again - with sharemarkets starting the year on a sour note and despite a few bounces along the way having several legs down, with another sharp fall in early June, followed by a bounce back over the last couple of days. From their all-time highs to their lows in mid June, US shares have fallen 24%, global shares have fallen 21% and Australian shares have fallen 16%. Always the drivers are slightly different. But as Mark Twain is said to have said "history doesn't repeat but it rhymes", and so it is with share market falls. This means that from the point of basic investment principles, it's hard to say anything new. Which is why this note may sound familiar with "key things for investors to keep in mind", but at times like this they are worth reiterating.

What's Driving the Falls in Share Markets

The key drivers of the fall in shares remain:

- Shares had very strong gains from their March 2020 lows and speculative froth had become evident in tech stocks, meme stocks and crypto, and this left them vulnerable.
- High and still rising inflation flowing from pandemic distortions made worse by the war in Ukraine and Chinese lockdowns. US inflation rose further in May to 8.6%, its over 8% in Europe and looks to be on its way to 7% or so in Australia (not helped by our own electricity crisis and floods).
- The ongoing upside surprises on inflation have seen central banks become more aggressively focussed on pulling it back down and so stepping up the pace of rate hikes with: the US hiking by 0.75% last week; Canada, NZ and the UK all continuing to raise interest rates; the ECB moving towards rate hikes from July; and the RBA hiking rates by 0.5%.
- The increasing aggressiveness of central banks in the face of higher inflation is in turn raising the risk of triggering a recession, which could depress company profits.
- Rising bond yields in response to rising inflation and central bank tightening is adding to the pressure on share markets by making them look relatively less attractive which is driving lower price to earnings multiples.
- The ongoing war in Ukraine along with tensions with China are adding to the risks.
- As always, the most speculative "assets" are getting hit the hardest by rising interest rates, including the pandemic winners of tech stocks (with Nasdaq having fallen 34% given that many companies are not yet making a profit) and crypto currencies (with Bitcoin down 70% from its high last year). Crypto currencies surged with semi-religious fervour around the claimed marvels of blockchain, decentralised finance and NFTs (non-fungible tokens - cryptographic assets on a blockchain with unique identification codes and metadata that distinguish them from each other), as well as freedom from government, an inflation hedge, etc, only to become a speculative band wagon fuelled by easy money and former low interest rates. Trying to disentangle its true fundamental value from the speculative mania became next to impossible. And now the easy money and low rates are reversing, pulling the rug out from under the mania and driving mishaps along the way. Fortunately, the exposure of major banks and mainstream investors to crypto is still relatively low so this is unlikely to be another GFC moment.

Reflecting the sharp falls in share markets and in fixed interest investments (which suffer a capital loss as bond yields rise), balanced growth superannuation funds are down by 5% or so for this financial year to date and are on track for their first financial year loss since 2019-20 (due to the pandemic) & their worst financial year loss since the GFC. See the next chart.

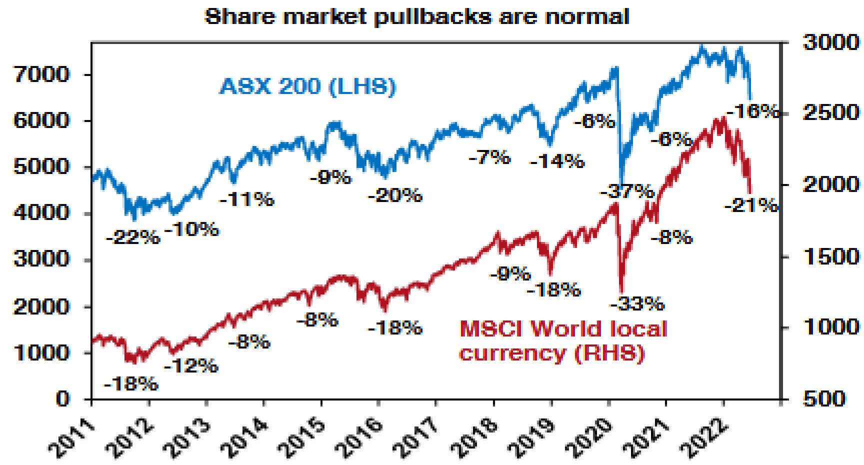


Source: Morningstar, AMP

Key things for investors to bear in mind

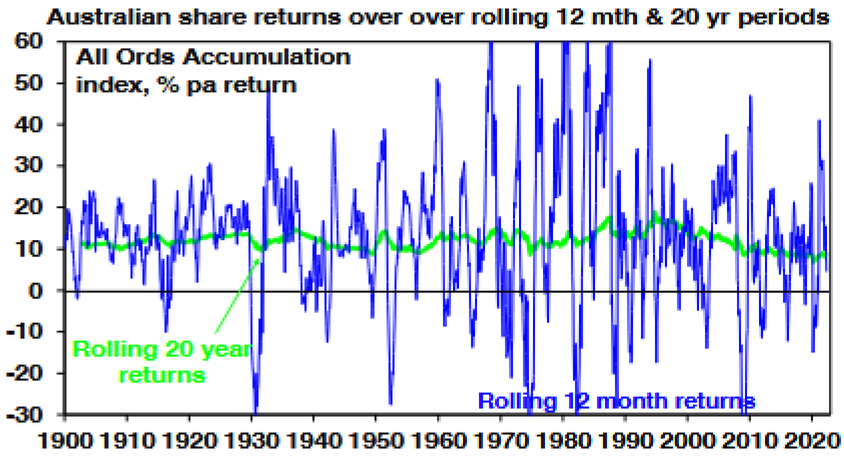
Sharp market falls are stressful for investors as no one likes to see their investments (including their super) fall in value. But there are some key things investors should keep in mind:

First, while they unfold differently, periodic share market corrections and occasional bear markets (which are usually defined as falls greater than 20%) are a normal part of investing in shares. For example, the last decade regularly saw major pullbacks. See the next chart.



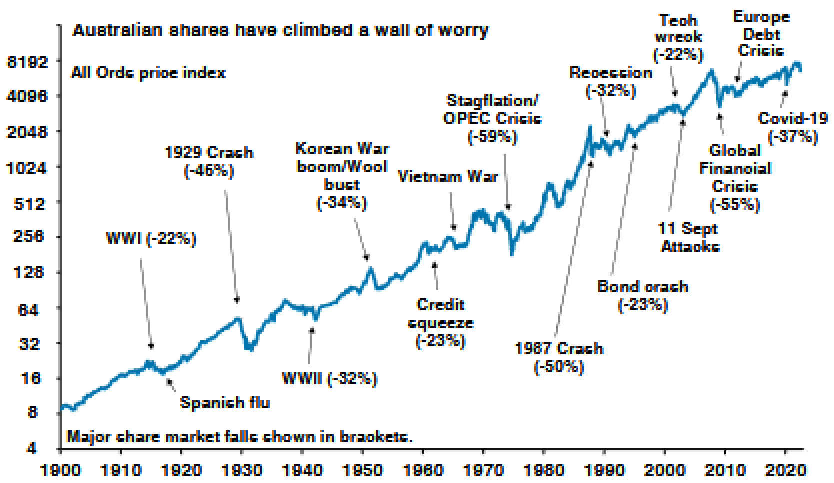
Source: Bloomberg, AMP

And, as can be seen in the next chart rolling 12 month returns from shares have regularly gone through negative periods.



Source: ASX, Bloomberg, AMP

But while the falls can be painful, they are healthy as they help limit excessive risk taking. Related to this, shares climb a wall of worry over many years with numerous events dragging them down periodically (next chart), but with the long-term trend ultimately up and providing higher returns than other more stable assets. As can be seen in the previous chart, the rolling 20-year return from Australian shares has been relatively stable and solid. Which is why super funds have a relatively high exposure to shares along with other growth assets. Bouts of volatility are the price we pay for the higher longer-term returns from shares. As can be seen in the first chart in this note while this financial year has been rough for super funds longer term returns have been solid & so recent weakness has to be seen in perspective.



Source: ASX, AMP

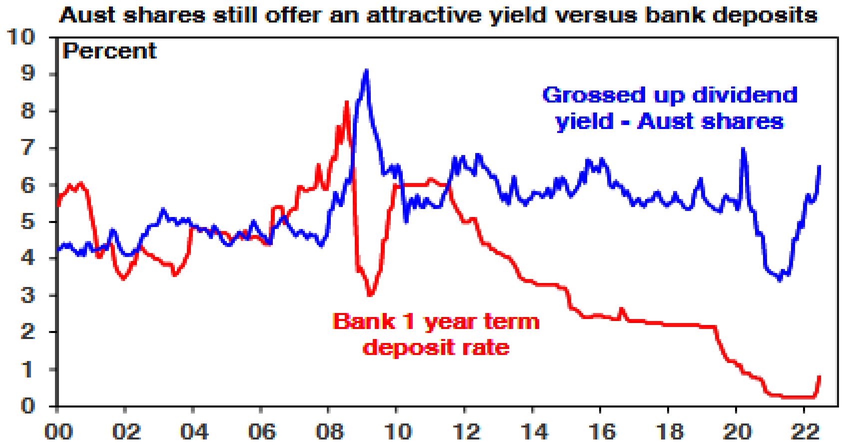
Second, historically, the main driver of whether we see a correction (a fall of say 5% to 15%) or even a mild bear market (with say a 20% or so decline that turns around relatively quickly like we saw in 2015-2016 in Australia - which may be called a "gummy bear market") as opposed to a major ("grizzly") bear market (like that seen in the mid-1970s or the global financial crisis when shares fell by around 55%) is whether we see a recession or not – notably in the US, as the US share market tends to lead most major global markets. AMP Capital remains of the view that a global recession can be avoided - if inflation starts to slow later this year or early next (as supply improves) taking pressure off central banks and in Australia as growth initially cools faster than expected (as the plunge in consumer confidence suggest that it will) putting a cap on how much the RBA needs to hike interest rates allowing it to avoid triggering a recession. But with inflation still surprising on the upside and central banks hiking rates aggressively, the risks have increased to the point that its now a very close call. Either way it's still too early to say that shares have bottomed.

Of course, short-term forecasting is fraught with difficulty and should not be the basis for a long-term investment strategy, so it's better to stick to long term investment principles.

Third, selling shares or switching to a more conservative superannuation investment strategy whenever shares fall sharply just turns a paper loss into a real loss with no hope of recovering. Even if you get out and miss a further fall, the risk is that you won't feel confident to get back in until long after the market has fully recovered. The best way to guard against deciding to sell on the basis of emotion after falls in markets is to adopt a well-thought out, long-term strategy and stick to it.

Fourth, when shares fall, they're cheaper and offer higher long-term return prospects. So, the key is to look for opportunities that pullbacks provide. It's impossible to time the bottom but one way to do it is to "average in" over time. Fortunately, the Australian superannuation system does just that by regularly putting money into shares for workers (via their super) effectively taking advantage of the fact they are cheaper.

Fifth, while share prices have fallen dividends have not and so the dividend yield has increased. Australian shares are offering a very attractive dividend yield compared to bank deposits despite rising deposit rates. Companies don't like to cut their dividends, so the income flow you are receiving from a well-diversified portfolio of shares is likely to remain attractive.



Source: RBA, Bloomberg, AMP

Sixth, shares and other related assets often bottom at the point of maximum bearishness, that is, just when you and everyone else feel most negative towards them. So, the trick is to buck the crowd. "Be fearful when others are greedy. Be greedy when others are fearful," as Warren Buffett has said.

Finally, turn down the noise. At times of uncertainty like now, the flow of negative news reaches fever pitch. Talk of billions wiped off share markets and of "crashes" help sell newspapers and generate clicks. But less newsworthy are the billions that market rebounds and the rising long-term trend in share prices add to the share market. Moreover, media reports generally provide no perspective and only add to the sense of panic. All of this makes it harder to stick to an appropriate long-term strategy – which is particularly important when it comes to super as it has to be seen as a long-term investment, except for many of those near to retirement. So it is best to turn down the noise and watch the new Elvis biopic or the new Thor movie, which will hit the cinemas on July 6.

Acknowledgement: *The primary source of information for this eNewsletter is Dr Shane Oliver, Head of Investment Strategy and Economics and Chief Economist at AMP Capital, from an Investment Insight Report dated 20 June 2022, supported by input from Retirewell internal research.*