Wealth Management

The Crescent Group

RBC Wealth Management

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August 2022 Crescent Commentary

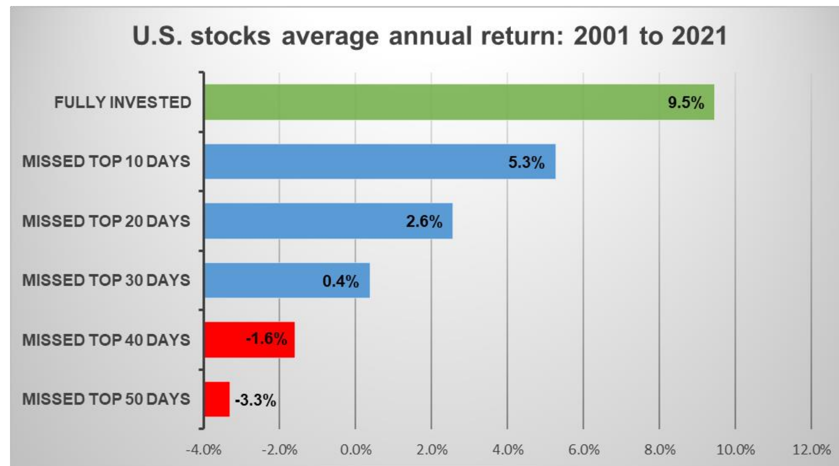
In last month's Commentary, we talked about one of the central realities of investing: success is not a straight line. Investment markets certainly reflected that reality in July and August. While July was the best month for investment markets since November 2020, August 2022 was the worst August since 2015, with global stock markets falling 5%.[1][2]

The driving force behind these up and down market swings has to do with speculators and gamblers trying to guess what direction the Federal Reserve will take with economic stimulus. In July, the Fed said it could slow its stimulus reduction if it sees progress in lowering inflation. Speculators took this to mean that the Fed would start lowering interest rates again. Low interest rates are a form of economic stimulus—they make it cheaper for consumers to borrow to buy homes, cars, and other goods, and for businesses to invest in new opportunities. Conversely, higher interest rates have the effect of reducing stimulus and slowing down the economy. So, speculators pushed financial markets higher in July based on an offhand comment by the Fed Chairman. Then in August, the Fed made a speech making it clear that it has a lot more work to do in bringing down inflation, and that it will likely need to continue reducing stimulus / increasing interest rates. Based on this new information, speculators pushed markets down in August.[3]

That's what happened last month. Now let's forget about the speculators. What does a time period of high inflation and higher interest rates mean for investors like us who are focused on the long term and retirement planning? We have to go back more than forty years to find a time period with these attributes. During the 1970s, the Federal Reserve increased interest rates substantially in order to fight stubbornly high inflation. The 30-year mortgage rate rose above 18% by the early 1980s. Inflation and high interest rates took their tole on the economy, and you can see this in the behavior of the Dow Jones stock index, which was flat for the ten years from 1972 to 1982. If the Dow didn't move up over ten years, then what did work with investing over that time period? It turns out that dividends worked. While the dow was flat for ten years, investors who reinvested their dividends over that ten year period earned a 69% return. This is one of the reasons our Group recommends investments paying steady and rising dividends, and currently has a large allocation to such investments.[4][5]

In drawing parallels to the 1970s, we are not specifically predicting that a time period of similar economic hardship lay ahead. The 1970s had its own unique set of challenges, including OPEC's oil embargo, which drove inflation well into the teens. Currently, inflation in the U.S. reached the high single digits this year, and appears to show signs that it has peaked. Oil prices have declined markedly from their peak earlier this year. But there's no question that our country will have to go through a period of adjustment as we work through excessive economic stimulus, high inflation, and higher interest rates. It seems unlikely that the next several years will resemble the large gains of the past several years for investment markets and the economy.(6)

Aside from investments that pay steady dividends, the second piece of advice we have to successfully navigate the current period of economic adjustment is to sit still with your investments. When markets become turbulent, investors understandably become nervous, and many start to wonder if they should sell their investments and wait for more clarity. All the data point to the same conclusion – trying to time investment markets does not work and will make you financially worse off.



Source: Franklin Templeton

As this graph shows, if you missed just 10 key days in financial markets over the past 20 years, it nearly cut your annual return in half. That's just 10 days out of a total of about 5,000 trading days. Obviously, you risk missing some of those ten key days if you're attempting to move in and out of your investments.(7)

While sitting still with your investments is a simple concept, it's not always easy to do, especially during years like the present when stocks fall 24% and experience large swings. Market declines like the one we've had this year take an average of 27 months to recover. We're almost 9 months into the current market decline, so our patience as investors will likely continue to be tested a while longer. But we are confident that the factors we've outlined above – allocating your assets to sound investments paying steady dividends, reinvesting those dividends, and sitting still with your investments – will position you for success after our economy works through the current period of adjustment. We will work with you to help ensure that your investments remain correctly positioned to endure through the current period of volatility and emerge in a position of strength when the recovery occurs.(8)

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Sources:

(1) Reuters
(2) Yahoo Finance
(3) The Wall Street Journal
(4) Board of Governors of the U.S. Federal Reserve System
(5) Roger Thomas
(6) The Wall Street Journal
(7) Franklin Templeton
(8) Invesco

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