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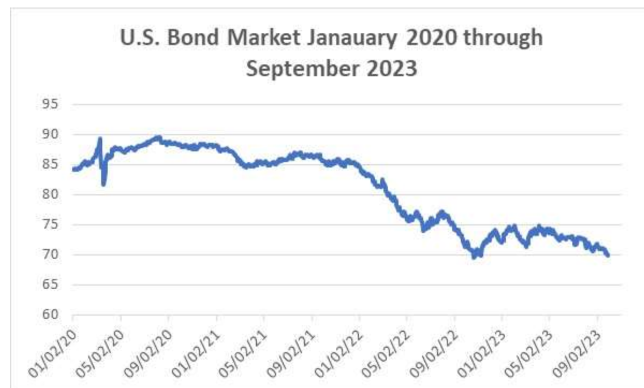
September 2023 Crescent Commentary

How should you invest during stagnant investment markets?



Source: Yahoo Finance

It's been a long time since U.S. financial markets have done nothing for years. Unfortunately, as the two charts to the left show, that's the situation investors currently face. Despite large swings, U.S. stocks have been flat for 2 ½ years now. U.S. bonds sit below the high level they set more than three years ago. Private assets are valued using the same metrics as public assets, and they, too, peaked during the 2021 market euphoria. What should investors do during the current stagnant financial markets? We can look to past time periods of financial market stagnation to determine the best course of action. The most recent was the 2000 to 2005 time period following the bursting of a bubble in technology stocks. Over those five years, U.S. stocks as a whole declined 15%. But specific sectors generated substantial gains, including consumer staples, financials, industrials, and health care. So one key to avoiding a prolonged period of stagnation is to avoid the most popular and overvalued investments and stick to boring investments that are reasonably priced. It's a matter of the tortoise versus the hare.(1)(2)

A second time period of financial market stagnation we can point to is the 1972 to 1982 time period, when the Dow Jones index was flat for ten years. Again, overvalued investments were a big cause of this stagnation, as many investors flocked to the "Nifty Fifty" stocks during the 1960s and drove up prices to unsustainable levels. Despite the Dow's flat return over ten years, investors who reinvested dividends earned a 69% return over those ten years. How did this happen? The return was not linear. In other words, dividend reinvestors did not earn a 7% return annually. The way it worked was that dividends were continuously reinvested, including during several periods of market decline. And when financial markets finally started

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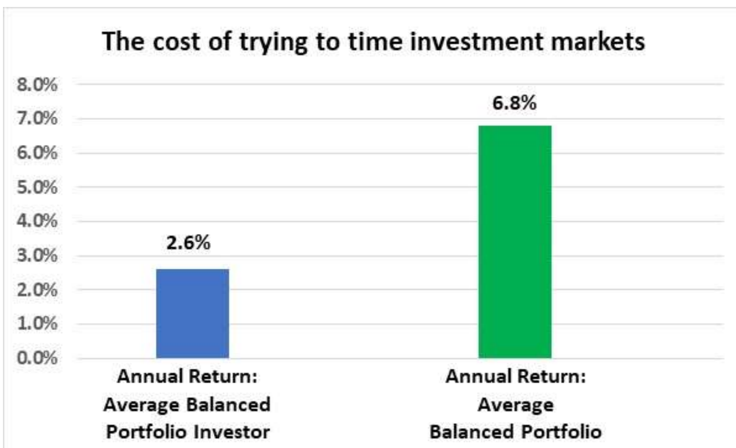
to recover in 1982, the additional investments bought with dividends at depressed prices allowed those investors to reap substantial gains.[3][4]

The largest ever study of investor results reinforces the importance of remaining invested and reinvesting dividends and interest during choppy and stagnant financial markets. DALBAR conducted a study of individual investors from 1998 to 2017. Unfortunately, DALBAR found that the average investor in a balanced portfolio of half bonds and half stocks earned only a 2.6% annual return over that time period. The balanced portfolio itself earned a 6.8% annual return. What this means is that the average investor in a balanced portfolio should have gotten a 6.8% annual return over those twenty years, but instead they only received a 2.6% annual return. Why this divergence? Investors on average tried to time financial markets, but instead ended up selling investments after markets declined and buying them back after markets recovered. This resulted in buying high and selling low, rather than buying low and selling high. So, investors who stayed the course with their investments and reinvested dividends and interest earned an adequate return on their investments, while those who sold or tried to time markets earned less than inflation. Keep in mind that this time period included two of the worst financial market crashes in U.S. history: the bursting of the technology stock bubble and then the home price collapse / financial crisis. Despite those awful crashes, investors who were fully invested near the peak of financial markets in 1998 – and who held through the crashes and reinvested dividends and interest – ended up getting a nearly 7% annual return.[5]



Source: RBC

It's easy to look back and say "stay the course" with your investments during horrendous corrections. The much harder task is to remain invested and reinvest dividends and interest through the current financial market correction and stagnation. Financial markets were pampered from 2010 to 2021, as inflation was low, and the Fed found almost any excuse to cut interest rates. All asset prices went straight up. What's happened over the past few years of stagnation represents more of a normalization towards historical average economic conditions. We don't know how long the current financial market correction and stagnation will last. But we do know that for both bond and stock investors, the opportunities for reinvesting dividends and interest are the best that we've seen in years. We will help you stay the course with a sound investment allocation through current and future choppy investment markets, so that you emerge as a winner from the current market stagnation, and not a victim.

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Sources:

(1) Yahoo Finance
(2) Richard Bernstein Advisors
(3) Roger Thomas
(4) Bridgeway Capital Management
(5) RBC Wealth Management

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