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November 2022 Crescent Commentary

We hope you and your loved ones had a wonderful Thanksgiving. While economic news and data remained choppy in November, and will likely remain that way for some time, we did begin to see some signs of light at the end of the tunnel in terms of inflation. In the U.S., the monthly inflation rate in October decreased to 7.7%, the lowest level of price increase since January. In Europe, the level of price increase declined for the first time in 17 months. Financial markets responded positively to the signs of easing inflation, with U.S. stocks experiencing their largest daily gain since 2020[1][2].

These inflation numbers are significant in that they show inflation may have peaked, which means central banks around the world can potentially reduce the pace of interest rate increases which they have implemented to fight inflation. Interest rates act as gravity in relation to all financial assets. That means rising interest rates bring down the value of everything from stocks to bonds to real estate, which is why stocks increased last month following the news that interest rate increases may lessen.

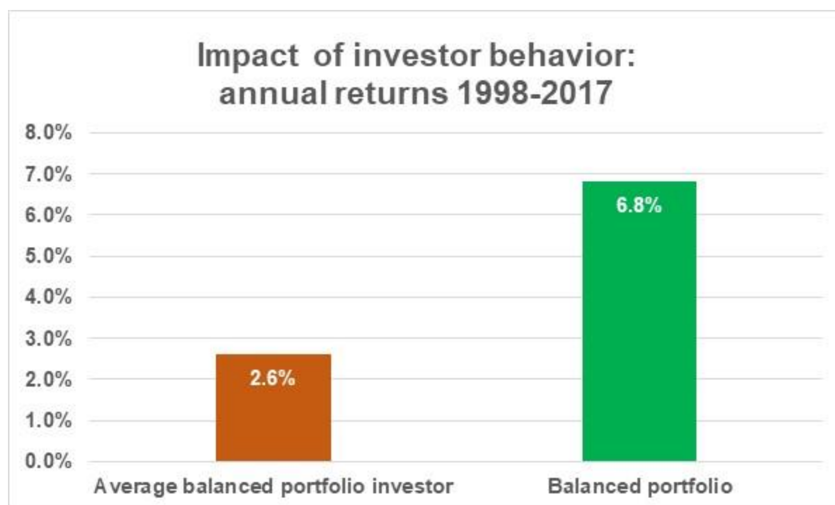
For the past 12 months there's been endless amounts of time, energy, and effort thrown at guessing what impact rising interest rates will have on the economy and financial markets. The problem is that no one can accurately guess what will happen. This year we've seen the crypto bubble burst, the bubble in speculative and popular stocks burst, and bonds decline substantially. But there's no predetermined level to which financial markets must decline. Last year, our Group predicted trouble ahead for popular and speculative investments, but we couldn't predict specific numbers. It turns out that many popular and speculative investments have fallen 70%, 80%, and 90% since then. The Crypto 200 Index declined 75% from its peak through November 30th. So, the trouble we predicted certainly has materialized. Yet the U.S. economy has held up through it all so far[3].

It's important to remember that every financial correction is rooted in unique circumstances, and therefore each correction plays out differently. Even some of the wealthiest investors get it wrong when they make specific predictions. In April of 2020, billionaire hedge fund manager Paul Singer publicly stated he expected stocks to crash 50% or more as a result of COVID-19. Instead, stocks fell 35% – a level reached only briefly – and then moved up to new highs for the year[4].

While the 1970s certainly provide useful and helpful lessons on how to invest during periods of rising interest rates and high inflation, today's inflation problem so far differs from that of the 1970s. While U.S. inflation reached double digits in the 1970s, inflation has shown some signs that it has peaked in the U.S. around 8% and is now lessening. While the Fed used an ineffective start and stop approach to fighting inflation in the 1970s, it has recently acknowledged that such an approach prolonged inflation in the 1970s and that it is committed to fighting inflation more effectively this time around. The Fed's lessons learned are actually part of the reason why the COVID crash wasn't as bad as the 2008/2009 crash – the Fed learned lessons on what to do during the 2008 crisis and was able to quickly apply them during the COVID crash, thereby quickly stopping the panic(5).

This year's large decline in popular and speculative asset values has helped reduce inflation. When consumers feel less wealthy, they spend less money. That has helped ease demand for goods. At the same time, supply chain disruptions from COVID-19 have recently begun to ease, which increases supply of product. The combination of less demand with better supply of goods has helped our inflation problem.

Given the inability to predict short-term financial market movements, and given the uncertain climate of high inflation and rising interest rates, what should investors do? If you're properly allocated to sound assets, you should stay invested. We don't know what financial markets will do over the short term, but we do know that investors who try to jump in and out of investments based on short-term predictions don't do well. DALBAR research has shown that the average investor in a balanced portfolio of stocks and bonds earned a 2.6% annual return for the twenty years ending 2017, compared to a 6.8% return for a balanced portfolio of stocks and bonds. DALBAR found that investors underperformed their buy-and-hold allocations due to decision making: investors in general bought investments during periods of optimism when markets were high and sold during periods of pessimism when markets were low(6).



2.6% a year is less than the average long-term inflation rate. It's also far below the current inflation rate of nearly 8% and does not adequately protect and preserve your wealth. In previous commentaries, we've shown another study showing that investors who miss just the ten best trading days during a period of 20 years get almost half the return they would have gotten if they bought and held. All the data point to the same conclusion. Investors who stick to a sound allocation through thick and thin do overwhelmingly better than those who try to move in and out of their investment allocation on the basis of emotions and predictions. If you aren't fully invested and you have concerns about the current economic uncertainty, then you should consider coming up with a plan to invest your cash at regular intervals over a predetermined period of time, also known as dollar cost averaging(7)(8).

Aside from sticking to a sound long-term investment allocation, we also recommend owning a mix of assets, both growth-oriented and staid dividend payers. As a result of this year's fallout, many growth-oriented businesses are available at attractive prices, which presents long-term opportunity. We fully expect the global economy to be larger in ten years than it is today, and it's important to have a portion of your assets positioned to maximize the benefit of that economic growth. On the other hand, we learned from the experience of the 1970s and the 1999 to 2009 time periods that steady dividend paying assets provide a cushion during times of turmoil, so we also recommend investors maintain a sizable allocation to such assets(9)(10).

We have no doubt that financial markets will remain choppy. They always have been, and always will be. And while no one can know what financial markets will do over the short-term, we're confident that sticking to a sound investment allocation will do the best to help you succeed with your long-term financial plan. We will work with you to help you stay committed to such an allocation.

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Sources:

(1) The Wall Street Journal
(2) CNN Business
(3) Yahoo Finance
(4) Reuters
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(8) Franklin Templeton
(9) Roger Thomas
(10) Richard Bernstein Advisors

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