



April 2022: Too Soon to Dwell Only on Bleak Outcomes



The broad US stock market is in negative territory as we head into the second quarter of 2022. Measured by the S&P 500 index of large US company stocks—that’s a negative 7% in a little over three months. Markets tumble from time to time and they do so more often than investors often recall. There is plenty of bad headline news to blame. Emotion has plenty to do with market results. It’s too soon to say that the remaining three quarters of 2022 will disappoint. But what if they do?

Well then, as usually happens, we will eventually move beyond the bad news and our portfolios will move back up into attractive territory. Sometimes the recovery takes a few months. Sometimes a year or so. Sometimes it takes a handful of years.

Here is a brief selection of current headline worries along with some bad times investors have lived through.

China

Isn’t China out-distancing America on many fronts? On some fronts yes—on others, sooner than we would like, according to China observers. But with respect to the stability of our investment markets and our currency, not for decades to come. It is the US dollar’s dominance as the currency used for global trade that allows us to print money, take on debt and not look back. US military strength, political stability and established trade relations are not about to be dealt a knockout blow, even if the dominance we have enjoyed since WWII isn’t sustained. Along the way to China gaining ground or surpassing us, China will likely face troubles of its own making, along with its geographic challenges. Famine, demographic stressors, recessions, and political upheaval are possibilities cited by others.

If you need something to keep you up at night now, maybe it’s Vladimir Putin.

Russia

Ukraine does offer the powerful dictator who dreams of a restored empire a path to much-needed warm water shipping ports on his South, buffer territory to help defend his western border, and one of the world’s major agricultural producers of grain and corn. Maybe more pieces of Ukraine will satisfy him. And if not?

Miscalculations are made. Accidents happen. These are among the ways that major wars have started.

I have no expertise in geopolitical analysis or the psychology of world leaders. I can’t predict the impact of a global military and economic crisis on the markets. But an old-time market observer who I respect once offered something like this:

“Don’t rush to sell when the missiles fly.” Why? Because if the missiles strike where you are, it won’t matter. And, if they miss, you will have unfortunately sold out of panic, locked in your losses, and missed the opportunity to take part in the recovery to come. Bravado in such a view, but wisdom as well.

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Here is what the Market Outcomes of past crises suggest we might expect:

Covid 19

Headlines in 2020 suggested that Covid 19—like the black plague—would wipe out vast numbers of the US population until, a few months later, it hadn't. The stock market had tumbled. And then it was suddenly back. The S&P 500 finished up at about 18% that year. A year later 2021 finished up over 21%.

Financial Crisis circa 2008

At one point the S&P 500 was down over 40%. Easy credit and overzealous lending were among the culprits. It took unprecedented government intervention and almost six years to climb back to “break-even”. The following year (2013) the S&P 500 returned over 32%. The averaged return for a balanced portfolio of stocks and bonds over those ugly six years for the patient? For most investors a tolerable 5% per year.

The Great Depression

Popular belief and a quick look at a stock chart for the period suggest that it took 25 years for the stock market to recover. But it was more like four or five years. Call me if you would like an explanation. Here's a hint. It's the difference between nominal returns and inflation-adjusted returns.

Let's hope that current generations avoid the nightmare economy that did drag on. But for too many times to list here, the world's end has been announced as imminent by the perennial doomsayers. Then it hasn't turned out that way.

World War II

Now we are really thinking bleak thoughts. Millions dead and crippled. Lives and economies decimated. But this is a letter about investment outcomes. The average return for the US stock market from 1939 to 1945? About 7% per year.

Anything else to worry about? Well, yes:

Interest rates and Inflation

Raising or lowering interest rates has long been the Federal Reserve's primary tool. Lowering interest rates, as the Fed had done since 2008 can serve to save and rekindle the economy. It can encourage reinvestment in the real economy (housing, manufacturing, small business, key services like health and education) as well as encourage investment in the stock market.

But it can lead to unwanted results. Throw in pent-up demand for goods and services that can't be met by production. Hobble that production by shipping delays. High inflation is the result.

The antidote?

Raise interest rates. *It's about the only tool the Fed has left in its toolbox.*

As a result, and for the first time since the early 80's investment-grade bond funds have delivered returns so poor that they rival the negative returns of stocks year to date! The major bond index of

investment-grade bonds is down about 8%. That's worse than the S&P 500's negative 7%. Raising interest rates to tame inflation hobbles bond performance, even for shorter-term investment-grade bonds.

It explains why your diversified and balanced portfolio is in the red this past quarter, stocks along with bonds.

Bonds and bond funds, along with cash and other selected products have long served to offset undesirable stock volatility, to provide a source of income, and as a reserve with which to restore your target allocation to stocks when stocks tumble. At present, it's hard to serve those several purposes as well as they once did.

What to expect?

It's time to pay the piper for Fed strategies stemming back to the financial crisis of 2008, compounded by the impact of understandably necessary Fed moves to get us beyond 2008 and Covid 19. It will take some time for bond managers to unwind the holdings in their funds and replace them with competitively priced quality and attractive yields.

You can also continue to expect, as may be appropriate for you, some judicious use of lesser-known and lesser utilized investment tactics to accompany our longer-standing investment discipline.

Patience, I remind myself and others, remains a central part of a sound investment strategy.



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