Client Update
September 20, 2021

Volatility Returns to Markets

After a highly unusual streak of seven straight months of gains (and nine of the last 10 months), global equity markets corrected during the past two weeks, and it looks as though the correction may continue for a bit of time. When a correction begins, it is always tempting to look for a direct cause. As usual, there is no shortage of candidates. Issues currently weighing on investors' minds include the following:

- Over-valuation of equity and fixed income markets
- Rising inflation
- Prospect of higher interest rates
- Spread of Covid variants
- Slowing of the US/global economy
- Record levels of margin debt
- We are entering a period of seasonal weakness for financial markets
- Withdrawal of the fiscal and monetary stimulus programs which were put in place last year. There is often a financial crisis when such measures end.
- A Chinese real estate firm (Evergrande) is experiencing financial problems and there are concerns that the contagion could spread to global markets.
- There has been widespread speculation in many financial markets including many asset classes such as low-quality stocks, cryptocurrencies, SPACs (special purpose acquisition companies), real estate and meme stocks.
- There is a chance of a political crisis in coming weeks over raising the US debt ceiling, passing a budget or some other matter.

All these concerns are serious, and anyone of them could trigger a stock market correction. That said, all these issues have been present to some degree throughout this year, and markets have risen anyway.

It should be noted that the most speculative assets have been underperforming throughout this year. An article in last week's Wall Street Journal pointed out that many asset classes are already more than 20% below their highs, meeting most definitions of a bear market. If this is the case, why have the broad indices only begun to retreat? The reason is that the largest capitalization shares (mostly large cap growth stocks) have continued to rise, along with cyclical stocks that rose earlier in the year while the economy was recovering. This makes some sense as these companies have generally seen good financial results so far in 2021.

We may now be entering a period where a focus on the negatives causes a period of correction. Given the level of the market and the amount of time since a correction, a substantial correction lasting for a period of months can't be ruled out.

What action should investors take? Our advice would be to keep in mind what market corrections typically look like when making investment decisions and invest accordingly. Since 1926 there have been 18 bear markets with an average length of 15 months and an average decline of 36%. During this period there have been 19 bull markets with an average length of 48 months and an average gain of 161%. Importantly, the fastest market rises typically occur right at the beginning of the next market cycle. (Recall that last year the market rose 40% in the 10 weeks after bottoming in March. Investors who sold during the market decline most likely missed out on much of the ensuing recovery.) Given this market history, we don't recommend trying to time the market.

In valuation terms, our favorite area for investment continues to be high-quality dividend paying stocks. Companies in this sector have consistent earnings, a good track record of treating shareholders well and proven business models. Importantly, they have not been subject to as much speculation as other parts of the market and are selling at relatively attractive valuations. In the longer term, the greatest wealth creation will most likely come from investment in high quality growth companies.

Market corrections set up opportunities to purchase great companies at attractive prices. Investors who are patient over the next few months may have just such a chance.

Thank you as always for being a client. We are available to speak to clients during times like this or at any other time. Please feel free to reach out to Roger or me.

Best Regards,

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