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RICHARDSON Wealth

Market Ethos

The latest market insights from Richardson Wealth

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On the passage of time

Time has always seemed linear and constant. Just check your watch. However, your perception of time shortens and stretches as your brain codifies and references the flow of events. This can lead to the common phrase 'time flew by.' But during periods of emotional discomfort, it often feels like time slows or grinds to a halt.

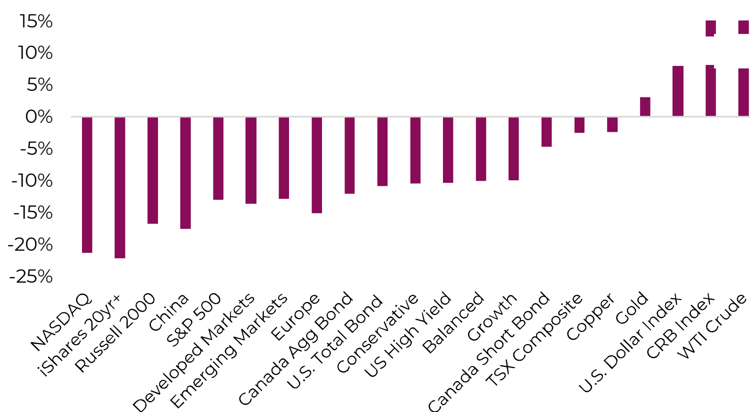
We are deep in a correction that encapsulates multiple asset classes. And it is not just weakness, the daily gyrations are truly breathtaking. Over the past 10 trading sessions, the S&P 500 has seen five sessions with daily returns +/- 2%, and intra-day moves often exceeding that. For investors, this is creating a great deal of uncertainty. Is my portfolio correctly positioned? Should I do something? To top it all off, time sure seems like it has slowed down.

Fear not. This too shall pass.

During periods of heightened volatility (aka markets dropping) the risk of making an emotionally induced behavioural mistake is the heightened. This often translates into making a portfolio mistake. Emotions are nice to have but tend to get in the way when investing. To help control our emotions, we turn to facts and a longer-term perspective. It may not make time speed back up, but it could help reduce the risk of making a mistake.

This is a dramatic price correction across most asset classes – We can attribute this drop in prices of assets to any number of factors. Inflation got a bit out of control, central bankers are pivoting from doves to hawks very quickly, valuations were stretched too far, the economy is

Very broad correction



Source: Bloomberg, Conservative/Balanced/Growth are ETF models from a large asset manager

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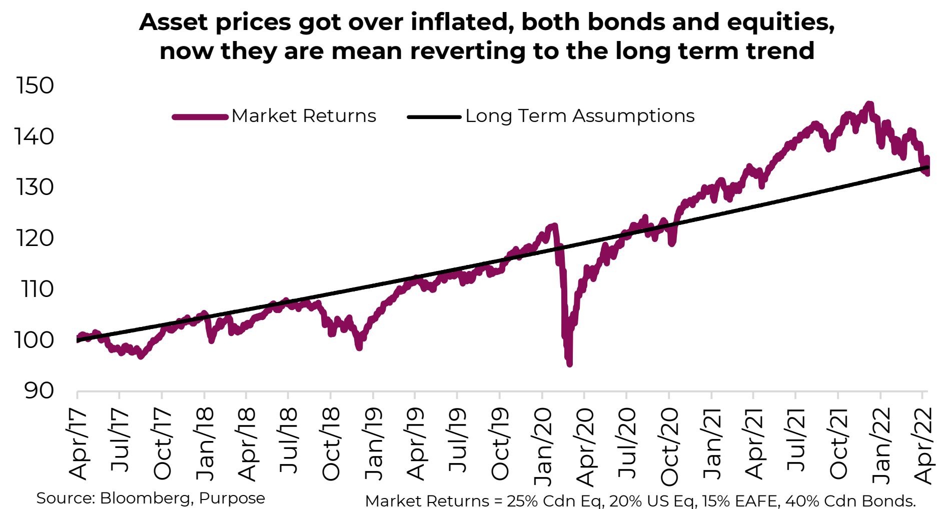
starting to slow, yields, both nominal and real, are rising. Then there is the war, the pandemic still is an issue and commodity prices have spiked higher. It is possible we missed a few.

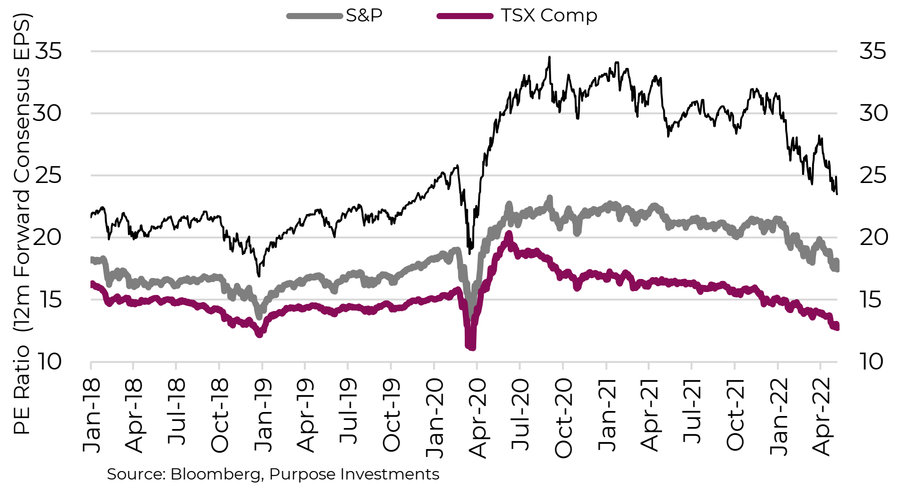
Let us not forget that markets, both equity and bond, enjoyed returns well above historical norms over the previous few calendar years [this is a brief repeat from last week, but worth reiterating]. If you assume long-term equity returns are 7% and bond returns 4%, that means a plain vanilla 60/40 portfolio (60% equity, 40% bonds) should deliver about 5.8% annually. Some years will be higher, some lower. However, the last few years have been higher, materially so. Annual returns for a plain vanilla balanced strategy have been +16%, +9% (including a bear market drop) and +12% in 2019, 2020 and 2021. Those are juicy returns or at least above norms. And while bonds fell 3% in 2021, 2019 was +7% and 2020 was +9%, both above norms.



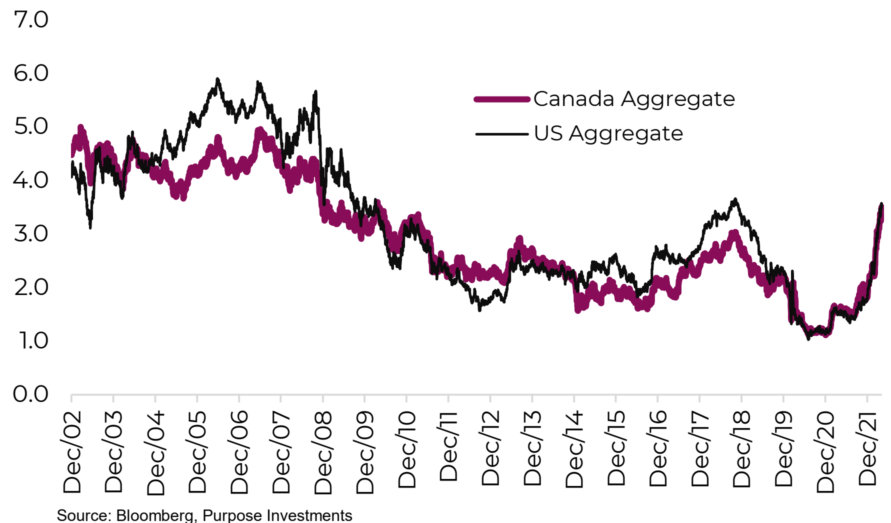
We are not saying bonds or equities can't go lower from here. Instead, we are suggesting putting the recent weakness in prices into a longer-term perspective. We all enjoyed outsized returns over the past few years due to a number of factors. Consumer behaviour pivoted to more goods spending over services, which is better for equity market earnings. Stimulus was unprecedented and left in place too long to help mitigate the impact of the pandemic. This weighed disproportionately on some cohorts of the economy while benefiting others. Altogether, this goosed asset prices from equities, to bonds, to real estate.

Now that spending is pivoting back to normal (normal balance of goods versus services spending) and central banks are removing stimulus, the goose is deflating. Stock and bond prices have reacted quickly, as the liquidity allows them to be almost instantly adjusting pricing. Real estate will be a longer adjustment process, a drawback to less transparent pricing.

Turning to valuations, it is safe to say much of the froth is now gone. In fact, valuations in equities have come down substantially. In late 2021, the Nasdaq was trading 35x earnings; it is now 24x. The S&P 500 has dropped from 24x to 18x and the TSX from 20x to well below historical norms at 13x. Valuations do not mark tops or bottoms in markets, but they do influence forward return expectations. Provided there is no full-blown recession looming, the return outlook has improved considerably.



Bond valuations (yields) are also becoming more enticing. When the price of bonds drops, the forward yields rise. Given the pain in bond land, yields are up substantially. The Bloomberg Canada Aggregate carries a yield to worst of 3.5%, the U.S. Investment Grade index has a yield of 4.4%. Don't forget in the earlier chart comparing returns to a longer trendline, that trendline used a 4% return for bonds as the assumption. We are almost there.



Investment implications

Given the price gyrations, there is no doubt emotions are elevated. Staying the course and not overreacting is often the best path through these kinds of markets. Or for those with the stomach, there are assets on sale out there. It may hurt a little bit to trade, but investing is often like going to the gym - if it doesn't provide a degree of discomfort, you are just not doing it right.

This correction has been tougher than most, since rebalancing opportunities usually come when one portion of a portfolio declines, and another one doesn't. There has been almost nowhere to hide, and even cash has been haunted by the "inflation erosion" narrative. Luckily, Canada has fared better than almost any country. While it feels good, this has likely left portfolios overweight Canada. A well-planned portfolio strategy, despite limited opportunities to rebalance from bonds to stocks, for example, will still have some options to take advantage of these market moves. With growth less expensive, and bonds finally offering some yield, some movement from value to growth, and from short duration to long duration may very well turn out to be fruitful.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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*This report is authored by Craig Basinger, Chief Marke t Strategist, Purpose Investments Inc. and James Price, SVP Investment Strategies, Richardson Wealth Ltd. Effective September 1, 2021, Craig Basinger has transitioned to Purpose Investments Inc.

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