The Economy is STILL not the Market: The importance of "now" vs. "historically"

Just a couple of months after COVID-19 reached American shores in 2020, we published a similarly titled and timely piece. It is reprinted at the end of this update for easy reference. We felt a refreshed version appropriately addressed many of the most common questions we field from clients today. The 2020 article pointed to the challenges and flaws of reacting to every news headline. Today's follow-up focuses on the importance of not trying to directly parallel today's economic challenges and market volatility with past episodes to draw what are often extremely flawed and scary conclusions.

Post WWII comparisons

These are among the most relevant when it comes to the artificial stimulus in the system, as well as the supply challenges we still face. But post WWII was different in innumerable ways. Women in the workforce, globalization, technological innovation and mobility, connectivity of people are just a few huge differences between the eras. Economically, both the US and the rest of the world exhibit few similarities to nearly 8 decades ago.

1970's Carter-era challenges

It's undeniable that early 2022 oil shocks remind some of the shocks of 1973-74 and 1979-81. In 1973, the Syrian and Egyptian land grab sparked an oil embargo, stagflation, and a 43% selloff in equities. Today's rate of home ownership, interest rates, employment conditions, savings, corporate balance sheets offer a far more favorable backdrop for investors. Energy spending in 2022 is a far smaller percent of income for most US households than in the 1970's. Geopolitics and market "shocks" cannot ever be ignored but must also be looked at through a balanced lens by investors.

Tech Bubble 2.0

When the Nasdaq correction began in Q4 of 2021, headline after headline sought to remind investors of the nearly incomparable pain of the 1999-2000 Tech Bubble bursting. The Nasdaq lost nearly 80% of its value between early 2000 and October 2002 largely because many component companies lacked business leadership, credible balance sheets, earnings and a business model that was sustainable. Pets.com folded 9 months after its 2000 IPO.

The recent Tech selloff, while undeniably painful for many investors, has seen companies like Amazon, Salesforce, Meta (formerly Facebook), Microsoft, and Google prices drop 20% or more, it's reasonably easy to see the difference in these businesses and the Tech Bubble culprits. Yes, some SPACs sold off more than 50%, many Covid darlings lost 75% from their peak value, and Bitcoin lost 60% in a quarter…but each of those investments was widely known to have high risk/reward characteristics. Those losses, while painful, only truly shocked those who chose not to acknowledge the risks.

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GFC 2.0: another housing bubble

The strongest, most palpable memories are also often associated with the most painful moments in one's life. For many investors, the fall of 2008 began an episode they won't soon forget. Nor should any of us…we should learn from it! That doesn't mean that the recent move in mortgage rates and a couple of negative months of housing starts will precipitate another massive housing crash. Unemployment remains low, wages are growing, debt service is still healthy, and the average mortgage rate by a US homeowner is well below 4.5% (with < 4% of all outstanding mortgages variable vs. 1/3 in 2007). The differences between 2007-08 and today are far greater than the similarities…but for some investors (and media outlets) they're inescapable.

It's different this time?

The phrase was drilled into investors' minds in the late 1990's. Valuations didn't matter. Price didn't matter. The business didn't matter. Yields didn't matter, because "it's different this time." Again and again, investors heard and said it and have subsequently been taught to hate this terminology.

Nevetheless, in truth, it's always somewhat different each time through. History is only as valuable as the lessons we gleem from it. A decade from now, we feel confoident in a few things:

- Stock market prices will reflect the earnings power of the companies comprising the index
- Interest rates will go up and down as the Federal Reserve wrestles with inflation
- We are likely to see at least 1 (if not 2) recessions
- History suggests that equities, broadly, are likely higher than where they are today
- We are likely to see new leadership at the top of the S&P 500 (because for decades that has been the case!)

We still believe that owning a diversified portfolio of stocks, bonds, and alternatives makes sense. We don't advocate trying to time one's buying and selling decisions based upon the next economic data point. Remember, the stock market is the collection of the opinions of all investors putting their money where their mouths are. The market is also highly forward-looking. Said another way, the market today is nearly always pricing in what it anticipates happening in the coming quarters and NOT what happened today. Every day there are winners and losers in the markets, but over time the greatest probabilities favor those willing to be resilient and disciplined.

It's human nature to try to draw parallels between today's market and those of the past. In some ways it's a healthy exercise, but one that should be used carefully. Too often investors will credit a move in the markets to a data point that may or may not have had any bearing on that move. Last week's Federal Reserve move to raise 75bp higher would intuitively move interest rates. The week that followed saw rates drop and rebound to essentially trade where they were before the announcement. As we've emphasized many times, correlation and causation should not be confused.

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The Economy is NOT the Market:
Why the headlines can be misleading for investors

Suggesting that the economic headlines over the Summer months will likely be terrible is no great leap. There will be unavoidable and unmistakable comparisons to the 2008 Financial Crisis, 1987 Crash, the 9-11 Tragedy, and even the Great Depression. These parallels will likely continue! *Wherever there's an eye-catching headline, there's a reporter looking for eyes.*

The key we ask you to consider is whether a headline conveys anything new. Does the headline or the article it broadcasts provide any facts and figures that were not already known or at least postulated? Is there truly news or just more facts and figures to draw eyes? Is there directional change?

It's undeniable that **FEAR** sells newspapers and advertisements. People are instinctively drawn to historic moments and jaw-dropping facts and figures. Human nature is bent toward self-preservation and risk avoidance. Neither of these are bad traits, but as investors, one must be keenly sensitive to and monitored. ***As professionals, we believe our advice during these moments is most valuable and most needed!***

We do not dismiss or discount the scope and human tragedy that has been the Covid-19 story. We are not pushing aside the devastating economic damage that has been done. Instead, we seek to help investors recognize that the markets (both equity and fixed income) have the tendency to look well beyond where most investors are initially inclined to look. ***If one is purely looking at economic data to make investment decisions, he may be well behind the market in doing so!***

The markets historically attempt to price in the most likely scenarios, both when the uncertainty and fear are peaking (March's historic drop) as well as once more clarity and data becomes available (the historic April 2020 rebound). As the data and thesis evolves, the markets most often digest the new data and reprice accordingly. Suffice it to say, the markets have already priced in a substantial global economic hit from response to Covid-19. Enough? Only time will tell.

Over the last 6 weeks, we have reported 6 historic multi-million initial jobless claims figures. On four of those days, the S&P 500 has closed the day higher. It isn't that the data was positive, but rather largely expected and already priced in.

An even more dramatic story played out in 2009. The economic data in the Spring of 2009 was nothing short of gut-wrenching. Negative 8.5% GDP (initial) was followed by another negative in Q2. A positive headline was difficult to find and skeptics were NOT! BY mid-2009, the S&P 500 was up year-to-date and by October 1 it was +60% from its lows. The data was still not great and the headlines remained largely negative, but the market was pricing for what lay ahead rather than looking in the rear-view-mirror.

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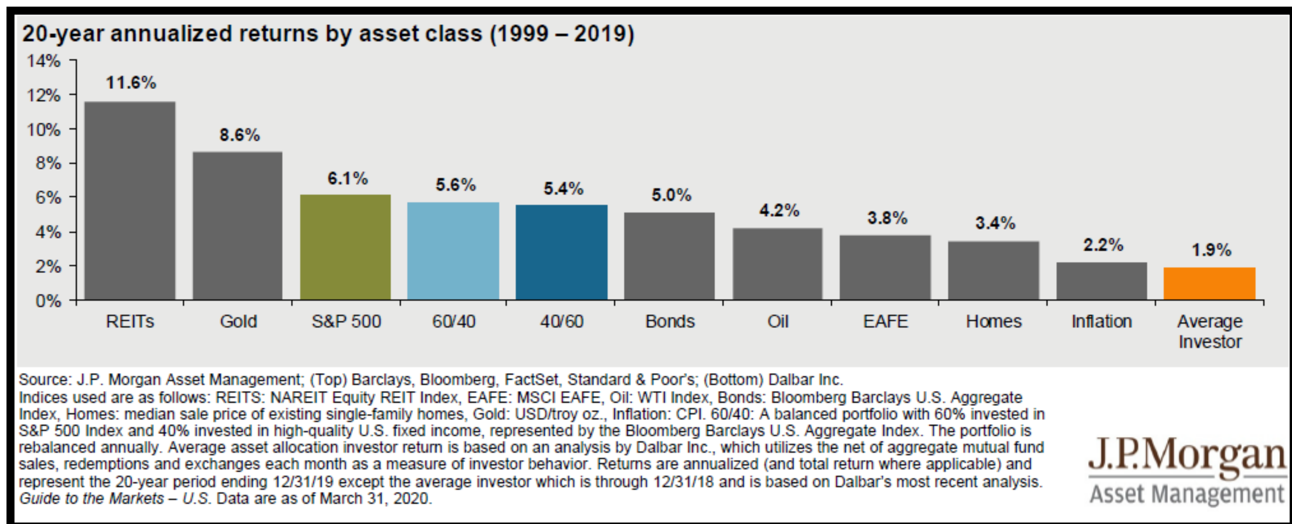
Confidence in Your Investments: Retirement Plans, Financial Planning & Wealth Management

During turbulent times, it is prudent to remain on alert. There's merit in being nimble and maintaining increased positions in cash. We also believe there's opportunity and we fear some investors' emotions will get the best of them. As the chart below illustrates, human behavior has a lot to do with ultimate investment outcomes.



Too often we find that investors convince themselves that they are being prudent when they are actually being fearful. Likewise, we hear investors talk about "sure things" and "can't miss technologies" as evidence for reckless optimism. Our hope is to lend perspective and resources that can help you make informed and intentional decisions that match your risk tolerance and that align properly with your objectives.

Unfortunately, there are investors out there going it alone and who haven't yet found us. We ask for your help by passing this along to someone you know who would benefit from a quick call with a member of our team.

From the initial publishing of the 2020 article (5/18/20) through the market close on 8/5/2022, despite the fear and uncertainty in every walk of life, the S&P 500 posted gains of 40.3% plus dividends. Discipline and resilience were rewarded!

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