What to make of inflation, bear markets, and volatility

Tylar Lunke:

Hello everybody, and welcome to a real time update from RBC Wealth Management. We're recording this on Wednesday, May 25th, 2022. My name is Tylar Lunke and I lead the Managed Portfolio Strategies team, and I'm joined today by Janet Engels, head of the Portfolio Advisory Group, and we just want to say thank you to everybody for joining today. Our goal over the next 10 minutes or so is to provide some perspective on the markets given we're now in bear market territory, including a bit on what do past bear markets tell us, what are we hearing from clients, and close with thoughts about how to respond in times like these. So Janet, welcome. Thanks for your time and perspective today. Let's just get going here. The equity markets have continued their slide, and as the headlines tell us, we're now in bear market territory. So what does this mean and what can we learn from the past?

Janet Engels:

Well, thanks Tylar. It's a privilege to be on this call once again. So let's look at the S&P 500. As you mentioned, the headlines are talking about this bear market correction, and that is defined as a pullback or a drawdown of 20% from a market high. Now, for the S&P 500, that widely quoted index, we did touch on that level intraday on Friday, the highs were in January of this year. But I think it's more important to point out to clients that if we look not just at the index, but if we look at the median performance of stocks in the index and other indices, let's use the Nasdaq Composite, many of those have already been in bear market territory, meaning a decline of greater than 20%.

So what do we know about bear markets? Just like bull markets, they are all a bit different. From long lasting bear markets, and I can think back to the 1970s, and we can certainly think about the bursting of the .com bubble that brought in a rather long duration bear market, to other bear markets that have been short in duration. So think about Black Monday, the crash of 1987. But actually more recently, think about the bear market, so a drawdown of over 20% that we experienced, with the pandemic in the beginning part of 2020. But I'd like to bring everyone's attention to where we came from.

So if we think of those lows back in March of 2020, to the recent highs, and again, just looking at the S&P 500 as an example, the market was up over 110%. That is a very strong move from a bottom. In fact, we doubled in 353 days, one of the quickest doubling in markets in history, and this was the strongest rally since the 1960s in that duration period of time. So what can I say? This. Pullbacks should be expected. Pullbacks are the normal course of any market activity, and this one has in fact pulled back more than 20%.

Tylar Lunke:

Thank you for that longer-term perspective. It helps add some context when we're talking about different markets that we've experienced. So, well naturally with moves like this, it does lead to anxiety for clients. You've been on the road a bit recently talking with some of our clients, and simply what's on their minds, what are they asking you these days?

Janet Engels:

Sure. I did have the privilege of meeting with a number of clients last week, and that is always terrific, to get a real time view of what, as you mentioned, are on people's minds. So here are the topics. Volatility in the market, inflation, geopolitics, the performance of tech stocks in general. But I have to note one thing. There wasn't a single specific question or anxiety suggesting that the U.S. economy was already in recession, and I think that was very important to me. So maybe we could just look at a couple of those different topics and some of our vantage points.

So first of all, volatility was at the top of everyone's mind, and I'm not surprised by that because this has been a difficult beginning part of the year where investors, both equity and fixed income investors, and we can measure volatility in a number of different ways. But I'm going to look at it from the perspective of a down day in the market, meaning a decline of more than 1% in a day, and if we look at the last four and a half months, we have already exceeded the entire year of down days of 1% or greater for 2021. So this experience of feeling like the market is more volatile is absolutely spot on because it has been a much more volatile year for the market overall. So that's number one.

From a geopolitical standpoint, I think there's just a level of anxiety, concern, about the conflict between Russia and Ukraine, and then it comes out in the way of what is really taking place with commodity prices, and here we're really speaking specifically about what's happening with energy prices overall, not only here in the United States, but from a global standpoint, and the importance in terms of wheat production. We also know those figures of sunflower oil production, Ukraine pre-conflict, accounted for nearly 50% of sunflower oil production in the world. So this escalating, or what is this movement up higher in food prices and energy prices are all feeding back in to that geopolitical concern, and then we could also talk about really supply chain and the lockdowns in China and the impact that is having.

But what I would say that the biggest topic overall was inflation, and the inflation, again, the headline numbers of higher food and energy prices, how long will they last? And I think the key is we have to understand that they will stay uncomfortably high in our view for some time. But trying to separate those headline inflation from core inflation and acknowledging that we are beginning to see that shift in terms of the purchase of goods, which fueled inflation because of supply chain disruptions and the demand for goods, to now more experience or service-related inflation. Now where we're starting to see that clearly in the numbers, whether we see declines in used car prices, used truck prices, we're also seeing it in terms of even handheld devices.

We are beginning to see prices come down from a core perspective on goods. We are starting to see some move up in inflation on the services side. One notable number, I think of everyone who's taking a vacation or planning a vacation, airfares were up almost 18% on a month-over-month basis, up over 30% on a year-over-year basis. So that's been on everyone's mind. I think it's important to share our view. Our view is that inflation, from a core perspective, has maybe peaked or is close to peaking. But again, keeping in mind that the numbers will still feel uncomfortably high for investors as we go through the year.

Tylar Lunke:

So volatility and inflation, two of the bigger things that clients are thinking about these days. Thanks for walking through those comments. Now that you've provided context on clients' questions, as well as the bear markets, let's speak a little bit more practically. What's our advice for clients from here?

Janet Engels:

So Tylar, great way to end. We have to acknowledge, as I said in the beginning, that this has been a difficult year for investors. Not only have we seen a drawdown in equity markets, but fixed income investors have had one of their most difficult starts to the year as we've seen a backup in rates. We are not market timers at RBC. We believe that history demonstrates that time in the market is the more important thing for investors to focus on. Drawdowns are the normal course of any market cycle. Things are moving very, very quickly, and I think you remember, in the beginning of the year we coined the phrase shifting gears to describe 2022. We just simply did not realize how quickly those gears would be shifting, and that has added to volatility and anxiety and some turbulence in the market overall. So what is our view?

Recession is not our base case, and that's important, but we do acknowledge that the economy is in a slow down mode. But a recession is not our base case. Tylar, I can't tell you if we've reached a bottom in the market. At this point, no one has that crystal ball that I'm aware of. But I can point to a number of different indicators that would suggest that we are indeed closer to the bottom. Just a couple of them. Sentiment is very weak, and that is typically a contrary indicator. So when sentiment is very weak, it tends to be bullish for the market. We can look at the performance of markets after inflation peaks. So if we're right, and inflation has peaked and we look at over the next 12 months markets have actually increased on nearly 20%, our view continues to be that this is a growth scare, and that means that the economy is weakened but we don't go into a recession, and when we look at environments around growth scares, the performance of stocks over the next 12 months or so has been a gain of better than 20%.

So I'm not sure that we're quite at the bottom. We think we are closer to the bottom than we were before. For investors, it's important to keep a longer-term perspective, and quite frankly, look for opportunities.

Tylar Lunke:

Always a good reminder, that longer-term perspective, and also time in the market versus timing the market. So thank you Janet for the perspective today, and we do want everybody to know we'll continue to provide updates as well as special reports as volatility persists. But some of the most recent content is linked from the audio player for this recording. In addition, keep an eye out for articles published within the global insight suite, as well as from across RBC, and of course as a reminder, if you have questions about your investments we would encourage you to stay in touch with your RBC financial advisor. Thank you all for your time today. Take care and have a great day.

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