FROM THE DESK OF

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AVOID COSTLY BEHAVIOURAL MISTAKES DURING THE STOCK MARKET STORM

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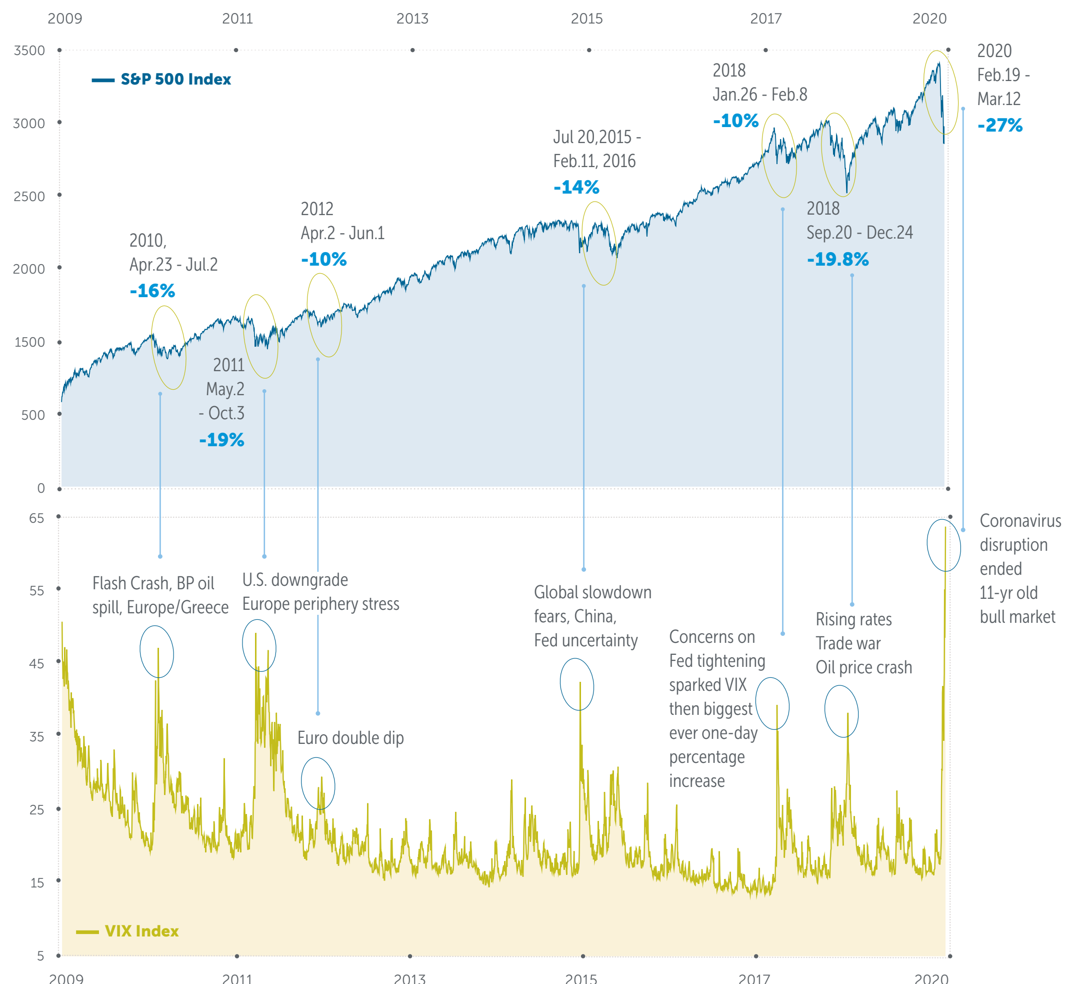
Global equities suffered a significant sell-off from the second half of February, sparked by fears that the fast-spreading coronavirus will hit global economic growth. The six consecutive days of decline from the February 19 peak sent the S&P 500 Index into a correction (defined as a pullback of at least 10%). Equity markets were further rattled following an unexpected oil price war begun by Saudi Arabia. The S&P 500 Index continued to plunge in the next ten trading days, crossing the bear market threshold (defined as a decline of at least 20% from its previous peak) on March 12, a day after the World Health Organization declared the coronavirus outbreak a pandemic. This marked the S&P 500 Index's sharpest correction and quickest crash into bear market since the Great Depression in the 1930s. The CBOE VIX Index, also known as the fear index, which is derived from 30-day options written on the S&P 500 Index, surged to its highest levels since 2009. The bull market that started 11 years ago came to an official end, after six corrections in the cycle, as shown below.



Source: Bloomberg as of Mar 12,2020

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What do the past pullbacks and corrections tell us? First, they suggest that volatility this sharp is relatively rare, but definitely recurs. Second, they show how equity markets respond to different short-term uncertainties. The wild swings of the market's movement are often driven by sentiment rather than long-term fundamentals. Third, they show that once volatility spikes, it takes an average of three months for the elevated VIX Index to fall back to its previous low level.

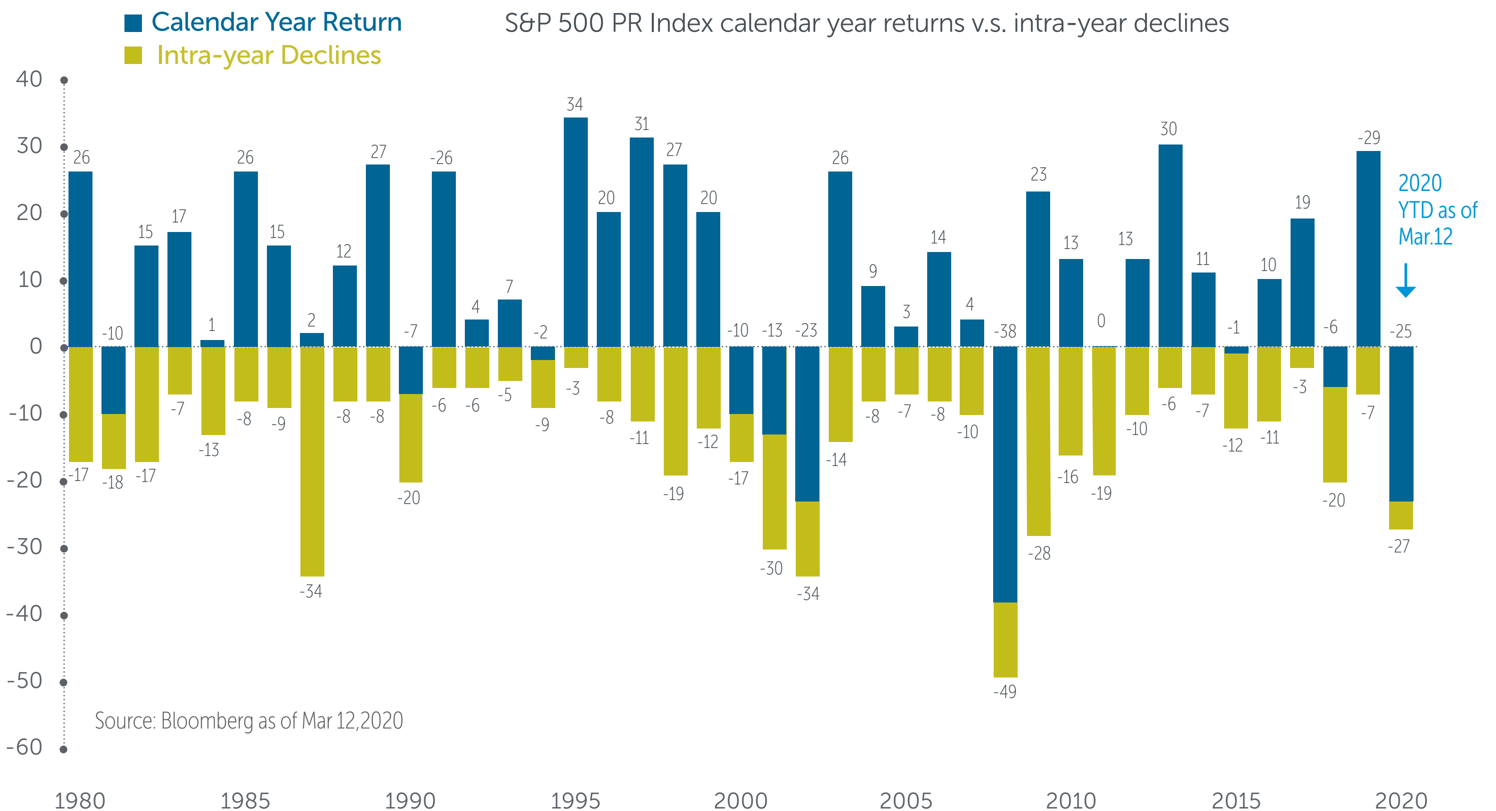
We are currently seeing one of the swiftest downward spirals in market history, reflecting investors' anxieties about rising risks for the U.S. and global economy due to the coronavirus. Changes in market structure are another reason for the frantic market activity: ETFs and computerized trading are exacerbating a market swing that is even more volatile than the financial crisis of 2008. At that time, many businesses suffered from the credit crunch, and economic activity was at risk of falling into a deep stall.

The current turmoil, however, is less likely to become a systemic failure. Even though it is too early to estimate the duration of the pandemic and the ultimate impact it will have on corporate earnings and the economy, I believe the coronavirus represents demand delayed, but not demand destroyed. The virus' economic impact will likely fade, and the economy will bounce back, the question is - how long will this take?

The painful stock gyration may continue as the ramification of the virus plays out. While nobody is absolutely immune to behavioural biases – particularly retail investors – this may be the best time to remind investors to avoid costly behavioural mistakes that will lead them to react in ways they may regret for a long time.

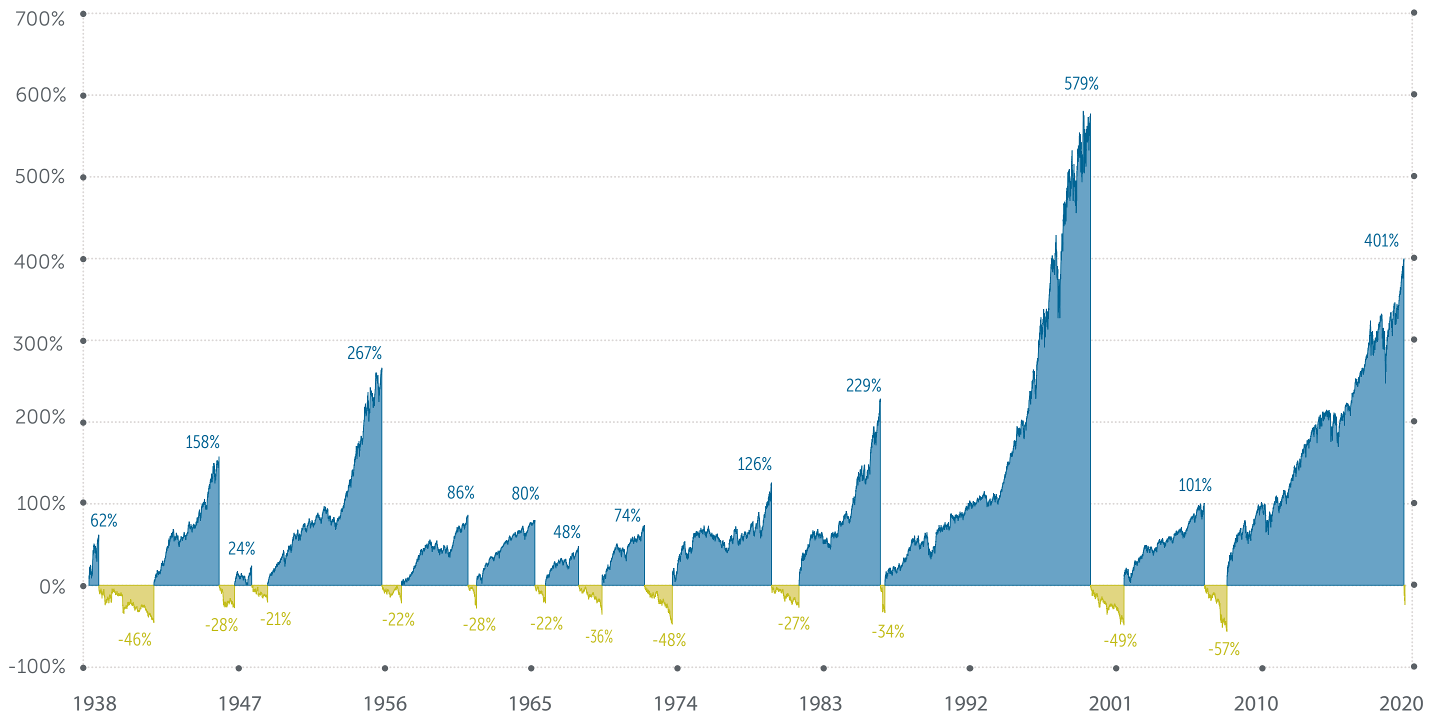
First of all, don't panic. The worst thing to do is to sell into a market decline when your long-term objectives haven't changed. It has been well researched and reported that panic selling has a devastating effect on the financial health of investors with a long investment horizon. Despite good advice, some investors still tend to put money in the stock market when it rises and pull money out as the market falls. They eventually tend to buy at market tops and sell at market bottoms. But long-term investors who believe the coronavirus will not change the long term economic and business outlook don't need to sell their investments based on today's headlines.

Second, get a better understanding of, and reasonable expectations for, market volatility. The S&P 500 Index has returned about 9% annually since 1980. But those returns are not linear. The average intra-year drawdown of each calendar year during the same period is about -14%. In seven out of eight calendar years between 2012 and 2019, intra-year declines were well below the long-term average. The higher-than-normal volatility we are experiencing now is a wake-up call – and perhaps a necessary one – for many investors accustomed to years of steadily climbing markets.



Market volatility is a normal and sometimes healthy part of investing that allows investors to buy high-quality companies at a more attractive price. As difficult as it is to endure, market volatility could benefit disciplined long-term investors focusing on value and quality.

Third, remember that history has shown that equity markets always recover their losses. Bull markets last longer than bear markets. Over time, the bulls have it all over the bears. If they had the staying power, investors were far better off sticking it out, rather than trying to properly time the market.



Source: Bloomberg as of March 12,2020

Last, and most important, focus on your financial goals and timeline, not your emotions. It is always important to review an investment plan to make sure the portfolios are properly constructed based on investment objectives, risk tolerance, investment horizon and overall financial situation.

It is at times of stress like this that investors realize that being calm, and leveraging the tools of asset allocation, diversification and periodic rebalancing, is the best way to weather the market storm.

We thank you for your support,

Ian Hardacre

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