MAI Capital Management Insights

A Roadmap for a Volatile Market

There are a lot of reasons to hate volatile markets. They feel horrible to investors but, worse, they bring out emotions of fear and panic that can be detrimental to long-term capital appreciation. One dirty little secret is that investment advisors get scared too. The better ones don't let these emotions rule their actions. Instead, they study the current economic environment, the fundamentals of their investments and historical precedent. In addition, if they have been around awhile, they may call on their experience in the global financial crisis of 2008, the tech bubble of 2000 and more recently the COVID plunge of 2020. For those of us who are really old (and I say that with a smile on my face), these days it may be especially useful to recall the inflation scares of the 1970s and early 1980s.

Throughout these volatile events, and many other less volatile but still unnerving markets, it may be helpful to go through several 'rules for investing in volatile markets.' These aren't rules so much as a road map. They are not meant to be exhaustive, but they may be a helpful way to manage your emotions during a volatile time.

1. Freely acknowledge what you don't know. There are lots of things that we don't know. We don't know whether there will be a recession later this year caused by high oil prices. We don't know whether oil prices will go up or down. We don't know what the outcome of the war in Ukraine will be. We can make educated guesses about many of these things (and as Chief Equity Strategist, that's how I make a living), but in reality we can't know these things with any degree of certainty. Accepting this reality is actually an advantage in a marketplace filled with panic. It allows you to invest for the long term. If you make investments that can survive, say, a recession or high oil prices, you would probably be buying them now at more reasonable prices in all this uncertainty. We'll discuss this more in No. 4. Use the 'unknowables' to your advantage.

2. Be aware that we are in a unique moment, so don't invest with a "ruler". There is a tendency at times like this to "invest with a ruler." That is, to take current trends – like rising oil prices or falling stock indexes – and project them forward in a straight line. For that reason, over the past couple of weeks I have received many inquiries about whether oil-related investments would be attractive now, because the inquirer sees the price rising sharply (now over $110 a barrel) due to Russian oil supply disruptions. (By the way, I got no such queries in 2020, when oil was trading well below $40 a barrel.) The ruler would tell you that oil is going to $200, but the ruler doesn't account for a dynamic system -- $200 oil for any extended period would slow the global economy so much that oil would come crashing back down. Likewise, falling stock prices in an otherwise healthy economy can only go so far. And even in a recession, there is a clearing price for quality investments. Beware the straight-edge.

3. Don't be overcome with pessimism. Worst case Scenarios are not the base case. At times like this, it's always wiser to sound pessimistic, but it's not always right. There are several 'bear market myths' making the rounds that need rebutting. First, while we're on the topic, is the notion that $100 oil necessarily causes a bear market. That can be debunked in two ways. First, as a purely factual matter, it doesn't always happen: oil averaged $97 a barrel from March of 2011 to June of 2014, with plenty of time spent over $100. During that time, the S&P 500 Index rose 60%. Second, oil is much less a part of our economy now than it used to be, especially with the work-from-home trend we are seeing now, so its relative importance is diminished. Another 'bear market myth' is that when the Fed raises interest rates, the market has to go down. Again, historically that's just not true. From June 2004 to July 2006, the Fed raised interest rates 17 times in a row. The market rose about 20%. I'm not saying higher rates are good for the market, but they are often caused by a stronger economy with rising earnings and stock prices. Many times, those positive factors outweigh the negatives of higher rates.

4. Remember that the Single Most important secret to successful investing is Time not Timing. There's no better tonic for market angst than to focus on the long term, and to remember that you don't have to time the market. In fact, you can't, and neither can your advisor. Short term market movements are one of the unknowables that we discussed in No. 1. To underscore that time and not timing are important, simply look at the long-term performance of the S&P 500 Index. If you had invested in the index 30 years ago, it was during the 1992 recession and the Savings and Loan crisis. That was followed by this (inexhaustive) list of volatility causing events: The first Russian debt default of 1998, the 2000 Dot-Com bust, 9/11 and the War on Terror, the Global Financial Crisis, the downgrade of US sovereign debt, the election of Trump, the election of Biden, and of course the arrival of COVID. All of these events scared many investors. If you had allowed your emotions to win the day, you might have gotten out of the market at any of those points along the way. You may even have felt smart for a time, as the market continued lower. And in fact, the S&P 500 is down almost 5% so far this year, but even including the recent decline, it is still up 1,905% over that 30-year period (about a 10.5% annual return), while navigating all those downturns and geopolitical events. Time, not timing, is your friend.

This is an incomplete and imperfect list of guidelines for coping with your emotions during a downturn, but we hope it might help put things into perspective. Bull markets are great, but they don't prepare you for the volatility that comes after. In fact, they lull you into thinking that 'smooth sailing' is the default mode for investing. It isn't. We don't know how things will come out in the short term, but we have plenty of factual data that point to the virtue of sticking with a long-term investment plan.

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