Strategic Wealth Market Update

23rd June 2022

Market corrections, while always uncomfortable are common. Correctly managed, they can provide an opportunity to increase long term returns.

In the last 15 years, we have had six market corrections, including two large corrections of almost 40%-50%, being the Global Financial Crisis in 2008 and the Covid-19 recession in 2020. We have also seen four smaller corrections ranging from 15% to 25% in equity markets for various reasons other than recession. The depth and length of these corrections is always difficult to predict but in time, they have always presented an opportunity to buy equities cheaply and increase returns through the cycle.

ASX 200 Index: 2005-2022

Markets this year have fallen sharply, predominately due to actions by Central Banks that over-stimulated the global economy following the Covid-19 recession. They are now required to sharply tighten financial conditions (raise interest rates and shrink their large balance sheets) to reign in the high inflation.

The tighter financial conditions become, the more economic growth (and inflation) will slow. This will reduce demand for housing (slow housing construction activity) and also reduce discretionary spending given higher home loan repayments. It will impact both business and consumer confidence, which can then be self-fulfilling. There is however, a lag between tightening conditions and underlying economic activity.

As the Central Banks try to catch up by implementing sharp interest rate increases, they risk over-tightening and inducing a recession over the next one to two years. This risk may be higher for the US than Australia.

Equity markets (particularly the US market) have fallen significantly this year. While we can't accurately predict the low point, valuations have improved compared to earlier this year. For those invested in the market, our position is to hold those investments and ride out the cycle. For those with surplus cash, buying opportunities are emerging and may continue to do so over the next three to six months.

Predicting short term market directions is extremely difficult. Further, the rebound from the low point (when it occurs) is likely to be more constrained than back in March 2020 when interest rates were cut sharply, and Central Banks supported the market with capital injections. It is hard to see them taking these actions this time given that they are trying to control inflation.

If you are interested to read more, the attached Market Update article from Shane Oliver from AMP Capital provides a good summary of the current correction and history of market cycles.

Everyone's situation is different and the actions that you should take will be dependent upon your personal circumstances. Please contact us if you have any question or concerns to discuss.

Kind regards,

Peter Wilson CFP®, Dip FP, B.Sc
CEO & Principal Adviser
Strategic Wealth Pty Ltd
Authorised Representatives
Oreana Financial Services
Australian Financial Services Licensee

AMP CAPITAL

The plunge in shares & flow on to super - key things for investors to keep in mind during times of market turmoil

20 JUNE 2022
EDITION 21

Key points

> Share markets have fallen sharply in recent weeks continuing the plunge that started early this year due to worries about inflation, monetary tightening, recession & geopolitical issues including the invasion of Ukraine.
> It's still too early to say markets have bottomed.
> This will weigh on super returns for this financial year.
> Key things for investors to bear in mind are that: share pullbacks are healthy and normal; in the absence of a recession a deep and long bear market in shares may be avoided; selling shares after a fall locks in a loss; share pullbacks provide opportunities for investors to buy them more cheaply; shares still offer an attractive income flow; and to avoid getting thrown off a long-term investment strategy it's best to turn down the noise.

Introduction

Usually share markets are relatively calm and so don't generate a lot of attention. But periodically they tumble and generate headlines like "billions wiped off share market" & "biggest share plunge since…" Sometimes it ends quickly and the market heads back up again and is forgotten about. But once every so often share markets keep falling for a while. Sometimes the falls are foreseeable (usually after a run of strong gains), but rarely are they forecastable (which requires a call as to timing and magnitude)…despite many claiming otherwise. In my career, I have seen many periodic share market tumbles.

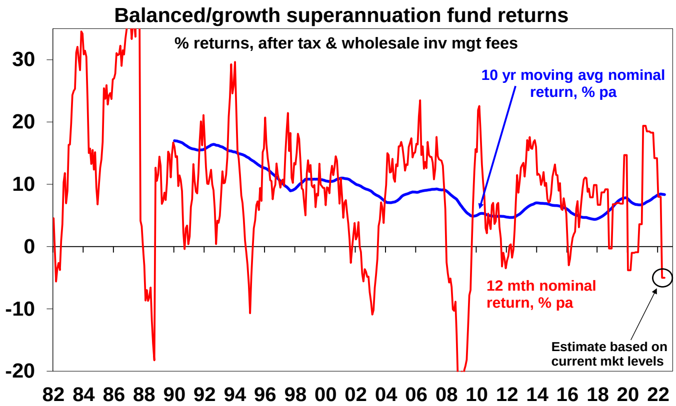
And so it is again - with share markets starting the year on a sour note and despite a few bounces along the way having several legs down with another sharp fall over the last two weeks. From their all-time highs to their lows in the past week US shares have now fallen 24%, global shares have fallen 21% and Australian shares have fallen 16%. Always the drivers are slightly different. But as Mark Twain is said to have said "history doesn't repeat but it rhymes", and so it is with share market falls. This means that from the point of basic investment principles, it's hard to say anything new. Which is why this note may sound familiar with "key things for investors to keep in mind", but at times like this they are worth reiterating.

What's driving the plunge in share markets

The key drivers of the fall in shares remain:

- Shares had very strong gains from their March 2020 lows and speculative froth had become evident in tech stocks, meme stocks and crypto, and this left them vulnerable.
- High and still rising inflation flowing from pandemic distortions made worse by the war in Ukraine and Chinese lockdowns. US inflation rose further in May to 8.6%, its over 8% in Europe and looks to be on its way to 7% or so in Australia (not helped by our own electricity crisis & floods).
- The ongoing upside surprises on inflation have seen central banks become more aggressively focussed on pulling it back down and so stepping up the pace of rate hikes with: the US hiking by 0.75% last week; Canada, NZ & the UK all continuing to raise interest rates; the ECB moving towards rate hikes from July; and the RBA hiking rates by 0.5%.
- The increasing aggressiveness of central banks in the face of higher inflation is in turn raising the risk of triggering a recession, which could depress company profits.
- Rising bond yields in response to rising inflation and central bank tightening is adding to the pressure on share markets by making them look relatively less attractive which is driving lower price to earnings multiples.
- The ongoing war in Ukraine along with tensions with China are adding to the risks.
- As always, the most speculative "assets" are getting hit the hardest including the pandemic winners of tech stocks (with Nasdaq having fallen 34%) and crypto currencies (with Bitcoin down 70% from its high last year). Crypto currencies surged with semi religious fervour around the claimed marvels of blockchain, decentralised finance, NFTs, freedom from government, an inflation hedge, etc, only to become a speculative bandwagon fuelled by easy money and low interest rates. Trying to disentangle its true fundamental value from the speculative mania became next to impossible. And now the easy money and low rates are reversing, pulling the rug out from under the mania and driving mishaps along the way (eg, Terra, Celsius Network and Babel Finance). Fortunately, the exposure of major banks and mainstream investors to crypto is still relatively low so this is unlikely to be another GFC moment.

Reflecting the sharp falls in share markets and in fixed interest investments (which suffer a capital loss as bond yields rise) balanced growth superannuation funds are down by 5% or so for this financial year to date and are on track for their first financial year loss since 2019-20 (due to the pandemic) & their worst financial year loss since the GFC. See the next chart.



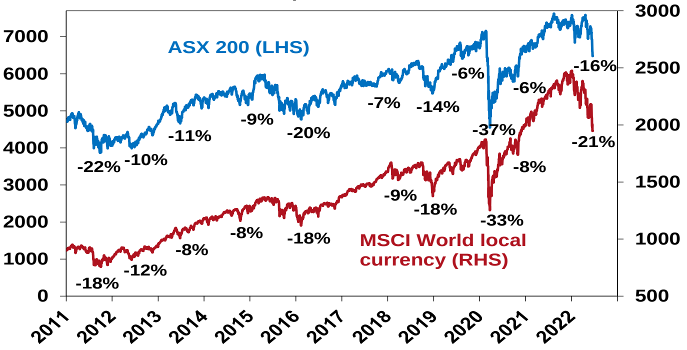
Source: Morningstar, AMP

Key things for investors to bear in mind

Sharp market falls are stressful for investors as no one likes to see their investments (including their super) fall in value. But there are some key things investors should keep in mind:

First, while they unfold differently, periodic share market corrections and occasional bear markets (which are usually defined as falls greater than 20%) are a normal part of investing in shares. For example, the last decade regularly saw major pullbacks. See the next chart.

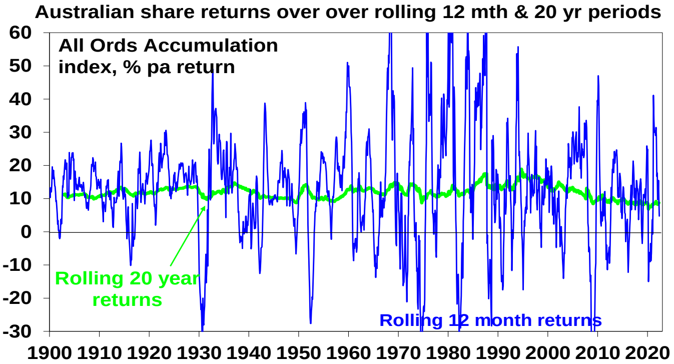
Share market pullbacks are normal



Source: Bloomberg, AMP

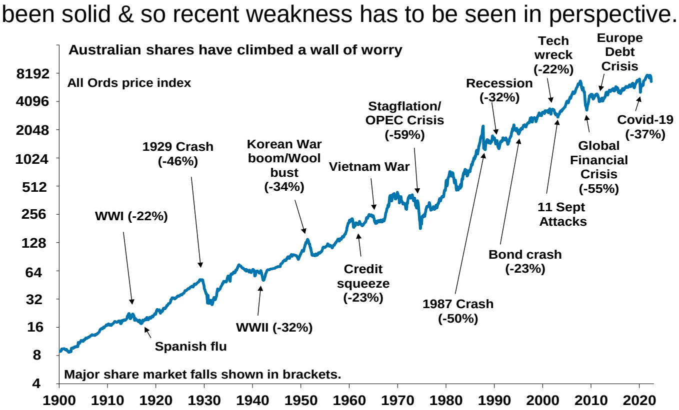
And, as can be seen in the next chart rolling 12 month returns from shares have regularly gone through negative periods.

Australian share returns over over rolling 12 mth & 20 yr periods



Source: ASX, Bloomberg, AMP

But while the falls can be painful, they are healthy as they help limit excessive risk taking. Related to this, shares climb a wall of worry over many years with numerous events dragging them down periodically (next chart), but with the long-term trend ultimately up & providing higher returns than other more stable assets. As can be seen in the previous chart, the rolling 20-year return from Australian shares has been relatively stable and solid. Which is why super funds have a relatively high exposure to shares along with other growth assets. Bouts of volatility are the price we pay for the higher longer-term returns from shares. As can be seen in the first chart in this note while this financial year has been rough for super funds longer term returns have been solid & so recent weakness has to be seen in perspective.



Source: ASX, AMP

Second, historically, the main driver of whether we see a correction (a fall of say 5% to 15%) or even a mild bear market (with say a 20% or so decline that turns around relatively quickly like we saw in 2015-2016 in Australia – which may be called a "gummy bear market") as opposed to a major ("grizzly") bear market (like that seen in the mid-1970s or the global financial crisis when shares fell by around 55%) is whether we see a recession or not – notably in the US, as the US share market tends to lead most major global markets. We remain of the view that a global recession can be avoided - if inflation starts to slow later this year or early next (as supply improves) taking pressure off central banks and in Australia as growth initially cools faster than expected (as the plunge in consumer confidence suggest that it will) putting a cap on how much the RBA needs to hike interest rates allowing it to avoid triggering a recession. But with inflation still surprising on the upside and central banks hiking rates aggressively the risks have increased to the point that its now a very close call. Either way it's still too early to say that shares have bottomed.

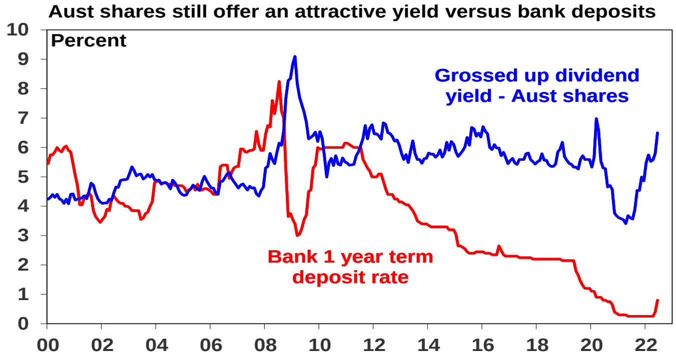
Of course, short-term forecasting is fraught with difficulty and should not be the basis for a long-term investment strategy, so it's better to stick to long term investment principles.

Third, selling shares or switching to a more conservative superannuation investment strategy whenever shares fall sharply just turns a paper loss into a real loss with no hope of recovering. Even if you get out and miss a further fall, the risk is that you won't feel confident to get back in until long after the market has fully recovered. The best way to guard against deciding to sell on the basis of emotion after falls in markets is to adopt a well thought out, long-term strategy and stick to it.

Fourth, when shares fall, they're cheaper and offer higher long-term return prospects. So, the key is to look for opportunities' pullbacks provide. It's impossible to time the bottom but one way to do it is to "average in" over time. Fortunately, the Australian superannuation system does just that by regularly putting money into shares for workers (via their super) effectively taking advantage of the fact they are cheaper.

Fifth, while share prices have fallen dividends have not and so the dividend yield has increased. Australian shares are offering a very attractive dividend yield compared to bank deposits despite rising deposit rates. Companies don't like to cut their dividends, so the income flow you are receiving from a well-diversified portfolio of shares is likely to remain attractive.

Aust shares still offer an attractive yield versus bank deposits



Source: RBA, Bloomberg, AMP

Sixth, shares and other related assets often bottom at the point of maximum bearishness, ie, just when you and everyone else feel most negative towards them. So, the trick is to buck the crowd. "Be fearful when others are greedy. Be greedy when others are fearful," as Warren Buffett has said.

Finally, turn down the noise. At times of uncertainty like now, the flow of negative news reaches fever pitch. Talk of billions wiped off share markets and of "crashes" help sell copy and generate clicks. But less newsy are the billions that market rebounds and the rising long-term trend in share prices add to the share market. Moreover, they provide no perspective and only add to the sense of panic. All of this makes it harder to stick to an appropriate long-term strategy – which is particularly important when it comes to super as it has to be seen as a long term investment, except for many of those near to retirement. So best to turn down the noise and watch the new Elvis biopic!

Dr Shane Oliver
Head of Investment Strategy and Chief Economist, AMP