SV Wealth - Newsletter

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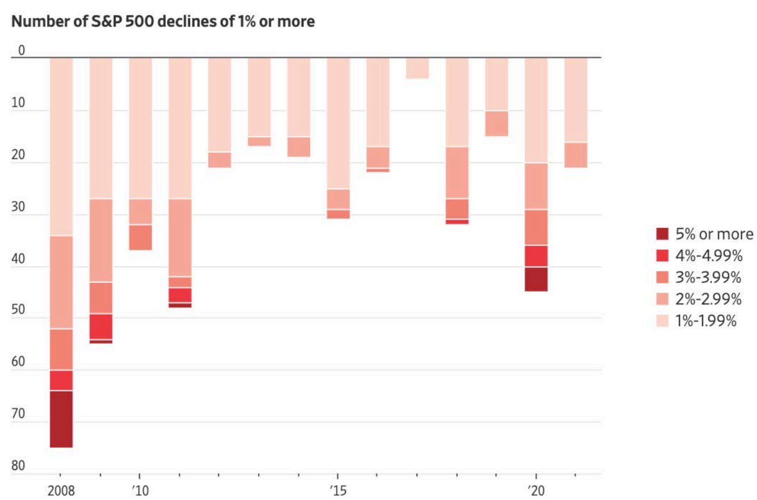
Volatility Strikes Back

The unusual calm experienced by equity markets for most of 2021 came to a crashing halt in January, with volatility returning with a vengeance. When volatility spikes, it makes for an uncomfortable and difficult time while investing.

How Volatile did it Get?

After posting a gain of 27% in 2021, the broad-based S&P 500 index was down as much as 10% in early January before staging a late-month rally and finishing the month down 5.3%. The tech-heavy Nasdaq staged an even more impressive rebound, gaining 6.6% in the last two sessions of January, but still closing down 8.5% for the month. All equity sectors were lower for the month, with the exception of energy, which helped the Toronto Stock Exchange outperform and close almost unchanged for the month (-0.6%).

The market's smooth sailing in 2021 may have left investors nervous at any sign of volatility, exacerbating the sell off. From the chart below, we can see that the S&P 500's worst day last year saw markets decline less than 3%. Contrast that with 2020 when investors saw a few days of losses greater 5%. The stability seen in 2021 usually makes investors complacent, leading to big changes once market expectations begin to change.



Note: Axis reversed to indicate the declines; through Jan. 27
Source: Dow Jones Market Data via FactSet

So What Happened?

With December's consumer price index reaching 7% in the US and 5% in Canada, the highest inflation readings since the early 80s, the Federal Reserve concluded that perhaps inflation was stronger and more durable than they expected. While the market expected rates to eventually increase, Fed Chairman Jay Powell was a lot more hawkish than expected, especially after calling inflation "transitory" for the greater part of last year. The markets were expecting three rate hikes starting in June 2022 but now expect four or more, with the first now coming in March.

Is the Bull Market Over?

Generally speaking, rising interest rates are a good thing as they indicate that the economy is strong. Rising rates are needed to cool down an overheating economy to avoid undesirable side effects, like inflation. The economy was indeed quite strong in 2021, with GDP gaining 7% in the US and 6.5% in Canada.

When it comes to individual companies, rising interest rates are a negative for some sectors of the market, but not all. For growth companies that need to fund their business expansion, rising rates are bad since it increases their cost of borrowing. For financial institutions, rising rates are a good thing since they make more money on their lending operations in said environment. As the trajectory of rate increases becomes clearer in the coming months, we expect to see a repricing of various stocks and sectors due to "multiple compression."

How Can SV Wealth Help?

When markets get volatile, the importance of staying invested cannot be overstated. Over the long run, equity markets tend to provide the strongest returns. If we look at the TSX over the last 10 years, we see an average return of 9.2% a year.

How do we stay invested in the face of volatility? We remain disciplined by following a rules-based approach that gives us the agility we need to reposition our portfolio when required, and to rotate into sectors best positioned to outperform.

Webinar: Maximizing Your Retirement Income

The main goal of investing is to build a nest egg that you and your family can rely on during your retirement years.

Join us for a live webinar on **Saturday, February 19 at 11am** about how to maximize your retirement income and live the lifestyle you dream of during retirement. We hope to see you there so sign up today!

We hope you have a wonderful February and look forward to hearing from you.