On The Mark

Investing Is Hard

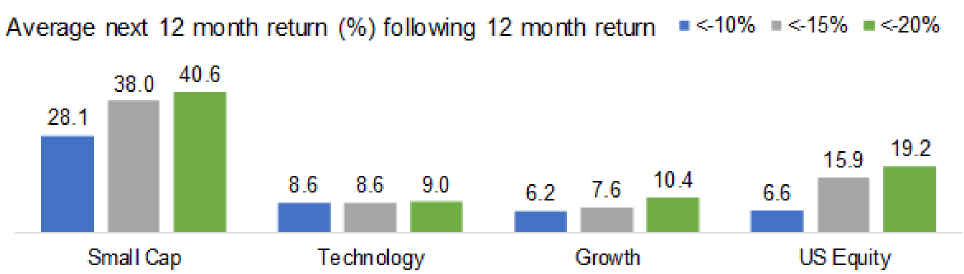
Special Edition

Investing seems easy when markets rally and are generally calm. But markets don't just move up or in a single direction. Markets adapt, gyrate and create new cycles with each being slightly different than the one before. It's during the more tumultuous periods of a market cycle when investing is hard. How investors confront the challenge of downturns determines the outcome and success of portfolio performance over the long run.

Markets on Sale

As markets recovered from the COVID-19 crisis, everyone dove into technology and large-cap growth stocks, so much so that the top 10 holdings of the S&P 500 were mega-cap, technology-related names becoming 30% of the index and drove broad market returns. As these stocks continued to surge, investors didn't stop the buying frenzy despite lofty valuations and high prices. These stocks and higher-risk areas of the market fell the most during the recent market correction and could now be viewed as being on sale. So why are investors unwilling to take advantage of these sale prices? Emotions!

Equity Market Falls and Rebounds (1995 – 2022)[1]



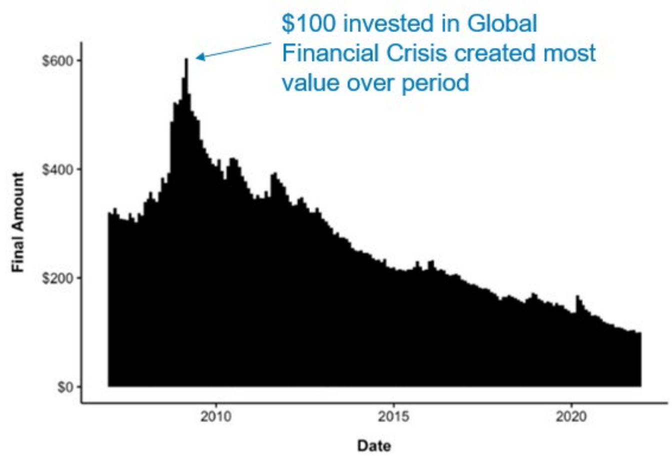
Historically, we've seen markets rebound after significant downturns. For example, as seen above, on average, small-cap equities rally by 40.6% over the 12 months following a 20% market decline. These sharp rebounds are not only tied to specific styles and sectors, but also to the broader equity markets. Looking at the 20 worst quarterly returns since 1926 (which ranged from -14.1% to -37.7%), the subsequent one-year, three-year, and five-year returns averaged 18.6%, 39.8% and 65.1% respectively[2]. Periods of sharp declines are often followed by some of the strongest returns seen in the market. If investors let emotions drive their decisions by sitting on the sidelines or moving out of the market, it could mean missing out on those high-growth periods and giving up potential returns. It comes down to an investor's time in the market rather than trying timing the market.

Market Drops Provide Opportunities

Could things get worse and markets fall further? Sure. But the good news is that it typically takes longer to enter bear market territory than it takes to hit the actual bottom of a bear market cycle. Looking at the last 12 bear markets, seven reached the market bottom 46 days after the start of the bear market. In contrast, the longest period from a bear market's inception to the market bottom was 19 months during the 2000-2002 crash[3]. So, while investing can be challenging for a period, we need to keep the nature of market cycles in mind—what goes up must come down and vice versa.

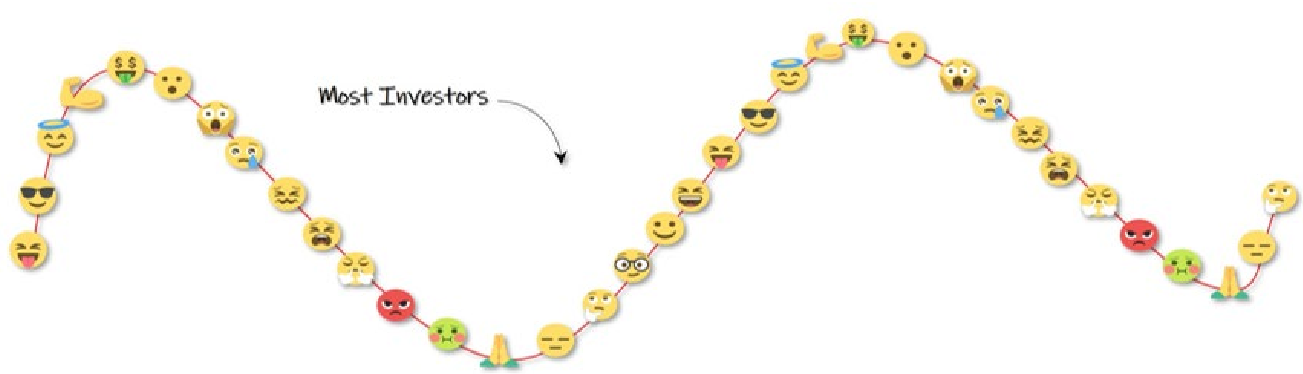
On average, it's taken about two years to recover from a decline of over 20%[2]. If we happen to hit the average bear market loss of -33%, to break even would require a 22% annualized return over two years, or 14% annualized return over three years or 11% annualized return over four years. How should an investor interpret this? Investing and leaning into market drops, while stomach-churning, can provide some of the greatest value in an investment portfolio over time. This can be seen in the chart below which shows the growth of $100 invested in the stock market in each month starting in 2007[4]. It's clear that investments made during the depths of the Global Financial Crisis provided tremendous benefit for investors. Buying into the market during a down cycle allows investors to participate and take advantage of the next up cycle.

Final Value of Each $100 Monthly Investment into S&P 500 starting in 2007[4]



When looking at long-term returns, investors need to remember that those returns include the ups and the downs of markets. During bear markets, that means staying disciplined and not making hasty short-term decisions with long-term capital meant to achieve long-term goals. By sticking with your plan and tried-and-true investment strategies, you can avoid the emotional roller coaster that many investors fall prey to and continue working steadily toward your financial objectives.

Roller Coaster of Investor Emotions[5]



Sources:

1. AssetMark, Zephyr Style Advisor
2. Ben Carlson, “On the Inevitability of Bear Markets”, July 6, 2022
3. Ben Carson, “How Long Does It Take for Stocks to Bottom in Bear Market”, June 19, 2022
4. Ben Carlson, “The Best Investment Strategy for This Market”, May 19, 2022
5. Niligan Financial

AssetMark, Inc.

1655 Grant Street
10th Floor
Concord, CA 94520-2445
800-664-5345

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