GAVIN HOCKEY WEALTH SPECIALISTS

Maintaining A Balance

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COVID-19 – The first quarter of 2020 will forever be synonymous with COVID-19. The rapid spread of this strain of coronavirus coincided with a swift decline in major asset classes as economies around the globe were forced to shutdown. The S&P 500 for example registered its worst quarterly return since Q4 2008, entering its first bear market in over 10-years.

Commodity prices, other than gold, fell sharply over the quarter. On top of a demand shock, oil was crippled when a price war erupted between OPEC and Russia. The price crumbled by more than 60%. The Canadian dollar declined against the US greenback by over 8%. Meanwhile gold prices rose 3.7% in US dollar terms.

Government bonds provided some protection during the equity and commodity rout, as central banks cut interest rates and restarted quantitative easing.

INDEX TOTAL RETURN	1Q20	1-YEAR
MSCI All Country World Index (USD)	(21.36%)	(11.25%)
S&P 500 Index (USD)	(19.60%)	(6.98%)
S&P/TSX Compostie Index (CAD)	(20.90%)	(14.21%)
MSCI Emerging Markets (USD)	(23.60%)	(17.69%)
MSCI EAFE Index (USD)	(22.83%)	(14.38%)
Barclays Global Agg Bond Index (USD)	(0.33%)	4.20%
Barclays US Agg Bond Index (USD)	3.15%	8.93%

Source: Bloomberg

The Non-linearity Of Market Returns – The old adage to "not let your highs get too high and lows get too low" is often cited by coaches to remind athletes about maintaining a balance. Over confidence often leads to poor habits while the psychological impacts of losing hope can become self-fulfilling. Whether it is sports, diets or investing, results are maximized when interests are aligned and participants abide by a precise process.

When analyzing US equity returns over the past two decades, it is easy to see how opinions about markets are formed based on individual experiences. Investors who began investing on 31-Mar-00 have a 20-year annualized return of just 4.9%. This is less than half the long-term average and the results achieved by an investor who started on 31-Mar-10. Furthermore, the investor from the March 2000 experienced two routs that caused their life savings to be cut in half twice within the first ten years of investing. Meanwhile, the latter experienced only one drawdown greater than 20%, and this occurred after compounding capital for over 9-years at 13.1% annually.

Looking back at market history, this type of return profile is far from unique. Gains over the average investment lifespan tend to cluster, in non-linear fashions. Even the strong periods face uncertain timing. For example, the more fortunate 2010 investor's average annual return would drop from 10.2% to 6.4% if they missed the five best trading days. Five days astoundingly accounts for less than 2% of the trading days over a ten-year period.

Adding further mental strain is the period when the most pronounced gains occurred. The three worst bear markets, defined as a 20% decline, include the 1929 Great Depression, the 1972 decline which involved the Watergate scandal and Vietnam War and the more recent 2008 Global Financial Crisis. As bull markets often follow bear markets investors who sold at the bottom of these markets faced significant long-term impairments to their capital. While bull markets often last for years, a significant portion of the gains typically accrue during the early months of a rally.

Despite facing 10 drawdowns of 30%+ over the past 150 years, US equity markets have compounded capital at over 10% per annum. Throughout this period the investors made it through two world wars, a cold war, rampant inflation, extensive conflicts in the Middle East and terrorist attacks, among others. All this suggests non-linear returns tend to be the norm more often than the exception.

In today's context, investors who have become discouraged because three years of gains were wiped out in one quarter, should not risk harming long-term returns by making short-sighted, emotional decisions. Certainly, these events can be frightening, but history shows that risk is rewarded for those who stay committed to the equity market for the long run. This is perhaps truer today than in the past, as just 5 stocks account for over 20% of the S&P 500. This is the highest level of concentration in its history. Accordingly, opportunities are becoming plentiful.