AUGUST 9, 2024 THE REGAN GROUP, INC. VOLUME 27.2
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Regans' Notes

10 Things to Remember About Market Corrections and Volatility

(Source: Compliments of our colleagues at Invesco Investment Management)

1. Market corrections happen almost every year. Since the early 1980s, there's been a greater than 5% drawdown in the S&P 500 Index in every year but two (1995 and 2017).[1]

2. Market volatility and corrections don't emerge out of nowhere. They tend to be the result of policy uncertainty. The US market has been expecting multiple rate cuts by the US Federal Reserve (Fed), which haven't yet emerged but are likely forthcoming.[2]

3. Of all the indicators, the bond market tends to get it right most often. The bond market is signaling that US nominal growth (real economic activity plus inflation) may be weak -- US long rates have plunged.[3] The 2-year US Treasury has fallen by even more.[4] The bond market is ahead of the Fed and intimating that multiple rate hikes could be imminent.

4. Market cycles don't die of old age. They're typically murdered by the Fed with interest rate hikes. Herein, lies the rub. Has the Fed kept interest rates high for too long, and what damage has it done to the global economy? Fortunately, many of the "early warning signals" that we track don't appear to be suggesting that a recession is imminent.

5. The corporate bond market has been the "canary in the coal mine." Corporate borrowing costs relative to the risk-free rate tend to provide an early warning sign, rising significantly ahead of a recession. Currently, the spread between high-quality corporate bonds and the risk-free rate are rising but remain below average. In short, we believe the corporate bond market is signaling a worsening economic backdrop, but not a recession.[5]

6. The stock market has historically recovered quickly from corrections. The average time to recovery from a 5%-10% downturn is three months. The average time to recovery from 10%-20% correction is eight months.[6]

7. If a recession occurs, markets typically fall by more and take longer to recover. The average decline during the more-mild recessions of 1957, 1960, 1980, 1981, and 1991 is nearly 20%. The stock market recovered, on average, within one to two years.[7]

8. The best days in the market often happen near the worst days of the market. Investors likely know that returns can be significantly impaired if they miss the best days in the market, but they may not realize that the best and worst days tend to group together. In fact, of the 30 best days in the stock market in the past 30 years, 24 happened during the "tech wreck," the Global Financial Crisis, and the COVID-19 pandemic.[8]

9. It's typically been better to add to portfolios after severe down days. Long-term investors have usually been better served by adding to portfolios rather than by withdrawing money during corrections.[9]

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10. Time in the market has generally been better than timing the market. On days when the headlines look dire, our action biases implore us to make changes to our portfolios. However, numerous studies, including one from Dalbar, concluded that investors who remained committed to their investment plans have typically fared better than those who have attempted to time the market.[10]

Footnotes

1 Source: Bloomberg, as of 8/2/24, based on the S&P 500 Index.

2 Source: Bloomberg, as of 8/5/24, based on Fed Funds Implied Futures.

3 Source: Bloomberg, as of 8/5/24, based on the 10-year US Treasury rate.

4 Source: Bloomberg, as of 8/5/24.

5 Source: Bloomberg, as of 8/5/24, based on the Bloomberg US Corporate Bond Index option-adjusted spread.

6 Source: Bloomberg, as of 8/5/24, based on the Dow Jones Industrial Average Index drawdowns and market cycles since 1945.

7 Source: Bloomberg, as of 7/31/24, based on the S&P 500 Index and recession dates defined by the National Bureau of Economic Research: Aug. 1957 – Apr. 1958, Apr. 1960 – Feb. 1961, Dec. 1969 – Nov. 1970, Nov. 1973 – Mar. 1975, Jan. 1980 – Jul. 1980, Jul. 1981 – Nov. 1982, Jul. 1990 – Mar. 1991, Mar. 2001 – Nov. 2001, Dec. 2007 – Jun. 2009 and Feb. 2020 – Apr. 2020.

8 Sources: Bloomberg and Invesco, as of 8/5/24.

9 Source: Bloomberg, as of 7/31/24, based on S&P 500 Index returns since 1995. The analysis determines whether investors were better served by adding or withdrawing money following the 50 worst days in the market since 1995.

10 Sources: Dalbar, Bloomberg, as of 12/31/23. The study is based on a comparison of the return of the S&P 500 Index versus the average asset allocation investor return based on an analysis by DALBAR, Inc., which utilizes the net of aggregate mutual fund sales, redemptions, and exchanges each month as a measure of investor behavior.

End of Invesco Investment Management comments.

Current Economics

After a strong start to the year, the labor market has cooled off. The unemployment rate is up to a fresh cyclical high of 4.3%, while the pace of job creation slowed from +267,000 per month in Q1 to +114,000 in July.
Source: Nuveen Investment

As the labor market has cooled, wage inflation has slowed encouragingly. This is feeding through to lower services sector prices, including housing. Although the pace of housing inflation is still too high to be consistent with the Fed's overall inflation target, it has already achieved roughly 80% of the needed deceleration. Source Nuveen Investment At the same time, goods price inflation remains low. Overall, core inflation has slowed to around 2.5% annualized, and remains on track to return to target by next year.
Source: Nuveen Investment

Softer labor markets and slower inflation are a mixed blessing for the U.S. consumer. On the one hand, slower job creation could pressure confidence and exacerbate areas of stress. As unemployment has risen, consumer delinquency rates have moved higher, to above pre-Covid levels. Source: Nuveen Investment

On the other hand, lower inflation supports real incomes and, by extension, overall spending. Real consumption is growing around 2.6% year-over-year, down from last year's breakneck pace, but still healthy.
Source: Nuveen Investment

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