WEALTH MANAGEMENT

Investing In The New Normal

We will eventually return to some form of normality and be back in our daily routine. There will be some changes that we will have to incorporate into our routine like social distancing and maybe wearing face masks about our daily business. There are other areas that might be longer-term, such as businesses encouraging their workforce to work from home, and speaking with your doctor through video.

So, when it comes to investing what does the new normal look like? Well, little is known about when global economies will be fully back up and running, how quickly unemployment will reverse from its all-time highs to the lower levels seen before the pandemic and governments ease their stimulus packages. With so many variables, uncertainty about the future has increased. This level of uncertainty has led to volatility rarely seen in the history of the markets. Over the past few months we have seen some of the fastest falls in markets ever recorded. In March, it only took 16 days for the S&P to fall into a bear market (a drop of 20% or more) from its high. To put this into context, the two next fastest falls of the S&P were in September 1929 and August 1987, when it took just under 50 days to drop 20%.(1)

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US oil prices turned negative for the first time in history, meaning producers of oil were effectively paying buyers to take it off their hands. The VIX index (Chicago Board Options Exchange's (CBOE) volatility index) also known as the 'Fear Index' also weighed in on the uncertainty in investor sentiment by hitting highs not seen since the financial crises in 2008. In March, the VIX hit 82.69% volatility. This was four times higher than the long run average of just under 20% volatility. The last time it hit comparable levels was in 2008.(2)

Despite this uncertainty and heighted volatility there are some things we do know; there will always be winners and losers when it comes to investing. Becoming a winner is only possible by taking part. And, there are things one can do to tilt the odds of becoming a winner over the long-term. Market volatility can provide opportunities for those with cash on the side, waiting to be put to work.

Market Crash – Time To Invest Cash?

For investors who have cash and would like to invest but have been wary about investing when markets have been hitting record highs – a dip in the market does present an opportunity to put money to work. Before deploying cash into a downward trending market and taking advantage of cheaper prices, it is important to understand one's financial situation. It may not be sensible to invest if there are large debts to pay back, especially high interest debt. Cash should always be set aside for emergencies or the unpredictable such as a pandemic. If after this there is no upcoming short-term cash flow need, it might be a good time to seize the opportunity. Personal and financial goals, investment time horizon, capacity for loss and emotional tolerance to risk are key factors that will help determine the level of risk that can be afforded. Investors with a longer investment time horizon generally can afford to take more risk, increasing the probability of achieving higher expected portfolio returns.

Making the decision to invest during times of volatility is different than trying to time the market. Past evidence has shown that trying to buy when the market is at its bottom, or sell when it is at its peak, proves detrimental to portfolio returns over the long run. In his recent article, Rob Arnott (founder of Research Affiliates) 'With Volatility Comes Opportunity', sums the problem with market timing well - "It's impossible to pinpoint peaks and troughs. We don't believe we have any special knowledge or skill to divine peaks or troughs ahead of the pack, but we do have the discipline to buy the assets people fear most, and sell the assets that are most beloved".(3) With the volatility recently experienced, investors may feel uncomfortable investing in one lump sum, investing regularly but systematically can reduce the emotion of investing in one go. Volatility also provides opportunity for investors already invested.

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Rebalancing – Is It Necessary?

Many investors understandably become nervous during market sell-offs and consider whether they should rebalance their portfolio or not. When uncertainty increases, the perception of risk increases, in turn leading to risky assets to become cheaper as investors sell their investments to reduce this risk. Although the risky assets that have fallen now mean investors expect and demand a higher expected return to compensate them for the risk, a fall in the riskier asset part of the portfolio means that now the risk being taken could be too small, potentially leaving investors short of their end goals.

Before deciding on the next steps, one must understand their financial position and make sure that the portfolio goals, tolerance for risk, and time horizon, still remain the same. Vanguard produced a short paper in 2015 called 'The Best Practices for Portfolio Rebalancing', that conveys the importance of why investors should rebalance. Market volatility and crashes make investors nervous and lead them to make irrational decisions like fully liquidating their holdings in a panic. Making emotional decisions like this reduces the odds of investors achieving their goals. If investors remain rational, disciplined, and follow the plan, the odds of having a successful experience are increased. Rebalancing the portfolio allows for the risk level to be brought back to an acceptable level that is aligned to the objective of the portfolio. Rebalancing systematically, or in times of extreme volatility, means that investors are more likely to have a successful investment experience and achieve their goals.(4)

For the near-term anyway, the new normal looks certain to include increased volatility with faster falls and rebounds in global stock markets. For those with a longer investment time horizon, volatility can be absorbed. For those with a shorter investment time horizon, or more emotionally sensitive to seeing their portfolio change in value on a daily basis, it is important to remember that investment principles remain – stay rational, maintain diversified portfolios and systematically rebalance. The new normal might mean more frequent cash flow planning and reviewing portfolios at times of volatility. Reacting to every market swing can prove costly and destroy wealth. Keeping portfolios aligned to targeted levels of risk, ensuring financial situations are kept current, allows one to embrace increased volatility without acting irrationally.

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