informed investor

evolutionroad wealth management

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Welcome to our latest edition of the Informed Investor newsletter.

As always, should you have any questions or would like some further information, please get in touch and we'll be happy to help.

The pullback in shares – seven reasons not to be too concerned

The recent share pullback has seen much coverage and generated much concern. This is understandable given the rapid falls in share markets seen on some days.

Considerations for investors

Sharp market falls with talk of billions of dollars being wiped off shares are stressful for investors as no one likes to see the value of their investments decline. However, several things are worth bearing in mind.

First, periodic corrections in share markets of the order of 5-15% are healthy and normal. For example, during the tech com boom from 1995 to early 2000, the US share market had seven pull backs greater than 5% ranging from 6% up to 19% with an average decline of 10%. During the same period, the Australian share market had eight pullbacks ranging from 5% to 16% with an average of 8%. All against a backdrop of strong returns every year.

During the 2003 to 2007 bull market, the Australian share market had five 5% plus corrections ranging from 7% to 12%, again with strong positive returns every year. More recently, the Australian share market had a 10% pullback in 2012, an 11% fall in 2013 (remember the taper tantrum?), an 8% fall in 2014 and a 20% fall between April 2015 and February 2016, all in the context of a gradual rising trend. And it has been similar for global shares, but against a strongly rising trend. In fact, share market corrections are healthy because they help limit a build-up in complacency and excessive risk taking.

Second, the main driver of whether we see a correction (a fall 5% to 15%) or even a mild bear market (with say a 20% decline that turns around relatively quickly like we saw in 2015-2016) as opposed to a major bear market (like that seen in the global financial crisis (GFC) is whether we see a recession or not. Our assessment remains that recession is not imminent:

- The post-GFC hangover has only just faded, with high levels of business and consumer confidence globally only just starting to help drive stronger consumer spending and business investment.
- While US monetary conditions are tightening they are still easy, and they are still very easy globally and in Australia (with monetary tightening still a fair way off in Europe, Japan and Australia). We are a long way from the sort of monetary tightening that leads into recession.
- Tax cuts and their associated fiscal stimulus will boost US growth in part offsetting Fed rate hikes.
- We have not seen the excesses – in terms of debt growth, overinvestment, capacity constraints and inflation – that normally precede recessions in the US,

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globally or Australia.

Reflecting this, global earnings growth is likely to remain strong, providing strong underlying support for shares.

Third, selling shares or switching to a more conservative investment strategy or superannuation option after a major fall just locks in a loss. With all the talk of billions being wiped off the share market, it may be tempting to sell. But this just turns a paper loss into a real loss with no hope of recovering. The best way to guard against making a decision to sell on the basis of emotion after a sharp fall in markets is to adopt a well thought out, long-term investment strategy and stick to it.

Fourth, when shares and growth assets fall they are cheaper and offer higher long-term return prospects. So the key is to look for opportunities that the pullback provides – shares are cheaper. It's impossible to time the bottom, but one way to do it is to average in over time.

Fifth, while shares may have fallen in value the dividends from the market haven't. So the income flow you are receiving from a well-diversified portfolio of shares continues to remain attractive, particularly against bank deposits.

Sixth, shares and other related assets often bottom at the point of maximum bearishness, ie: just when you and everyone else feel most negative towards them. So the trick is to buck the crowd.

Finally, turn down the noise. At times like the present, the flow of negative news reaches fever pitch – and this is being accentuated by the growth of social media. Talk of billions wiped off share markets, record point declines for the Dow Jones index and talk of "crashes" help sell copy and generate clicks and views. But such headlines are often just a distortion. We are never told of the billions that market rebounds and the rising long-term trend in share prices adds to the share market.

If you still have concerns, please feel free to contact our office.

Source: AMP.

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