Market comment

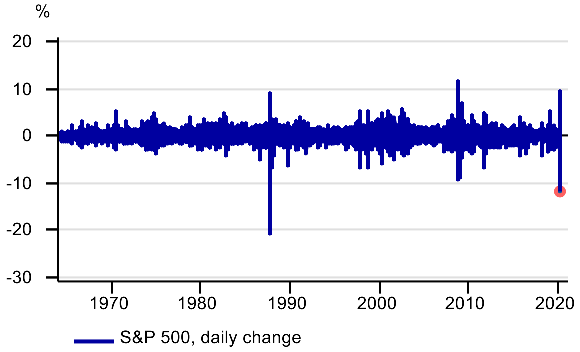
18 March 2020

Keep calm in the midst of the equity market volatility

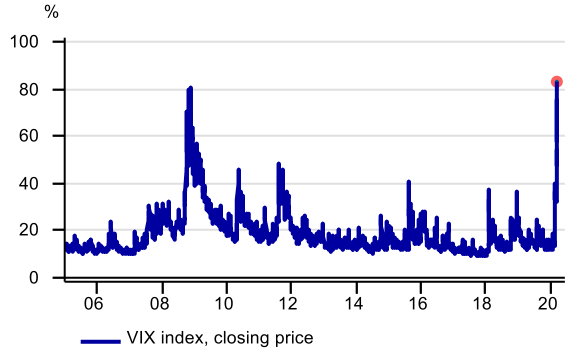
The US equity market experienced the second worst day in history on Monday, when stock prices plunged nearly 12%, driven by fears of coronavirus. Although the market is buzzing, we advise investors to keep calm in this environment. Risk-taking is an essential part of investing, and in the long run, the best returns come from cautiously increasing your investments as markets decline. However, finding the bottoms is difficult, and the bad news might well continue even as the market turns.

Black Monday

October 19, 1987, known as Black Monday, haunts the market history books for a long time. That day the US stock market saw its biggest one day collapse, as the broad S&P 500 index fell by more than 20 percent. This Monday's decline of nearly 12 percent comes second in the equity market statistics. Third place in that record is held by Thursday 12th March this year. At the same time, the third-highest rise in history in the United States was Friday the 13th, when equity prices in the New York Stock Exchange rose by more than 9 percent.



With the decline on Monday, the VIX index, the market's fear factor, rose to its highest levels ever. Only in the financial crisis in 2008 did we observe similar nervousness. It is fair to say that these are historical times in the financial markets. During the past nearly 60-year recorded history that we have available, US stock prices have risen by slightly above 6% on average annually. Dividends included, the annual return is estimated somewhere between 8 and 9 percent.



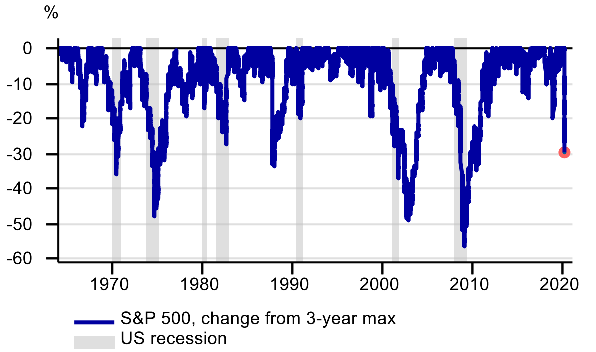
In other words, in this market situation, one day's average profit is made or eaten. This is why, especially in the midst of market uncertainty, it is good for the investor to hold on to his hat and accept the nervousness of the market. Incorrectly timed purchases and sales can very easily destroy multi-year returns.

Recession is here, are you ready?

The world economy has almost certainly plunged into recession as vast restrictive measures are deployed in the societies to fight the coronavirus. At the same time, the fundamentals of economic forecasts change every day and visibility is very poor. Uncertainty about the economic outlook naturally depresses stock prices, but the market has already priced in a rather weak economic outlook. Stock prices in the United States have fallen from their peak at the end of February by roughly a similar

Graph source: Refinitiv

amount as they have usually done during an average economic downturn.



We estimate that the market is already discounting a fairly grim economic outcome, so from this point of view, a significant part of the decline in the stock market is probably already behind us. The financial crisis, for example, saw the market turn around when the recession was deepest. However, continuing bad news will hold their grip on the market for a while still. When there is enough stimulus to reverse the economic effects of the corona slowdown, the market may turn around quickly. The same thing happens if investors' fears overshoot. There are already some indications of this. At the same time, however, it is good to remember that even extreme fear can persist for a good while.

There is hope amidst the horror

Amidst recession news and rattling stock market records, good news gets very little weight. These are undoubtedly monetary and fiscal stimulus measures done by central banks and governments, which will eventually put the economy on its feet and, at least temporarily, for faster growth. Likewise, the restart of the Chinese economy, the increase in the workforce of online retailers and the signs of a peak in new corona cases in Italy are good news the financial market pays little attention to at the moment. Of course, this is also natural, because in the short term, uncertainty outweighs the positive elements.

Before long, we think that also this crisis will prove to be a good opportunity for investors to add to their holdings, even though the uncertainty can feel daunting in the darkest moments. It is a good idea to diversify your investments over time and add investments little by little, taking advantage of the weak moments in the market.

Investments, Nordea Wealth Management, 18 March 2020

Graph source: Refinitiv

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