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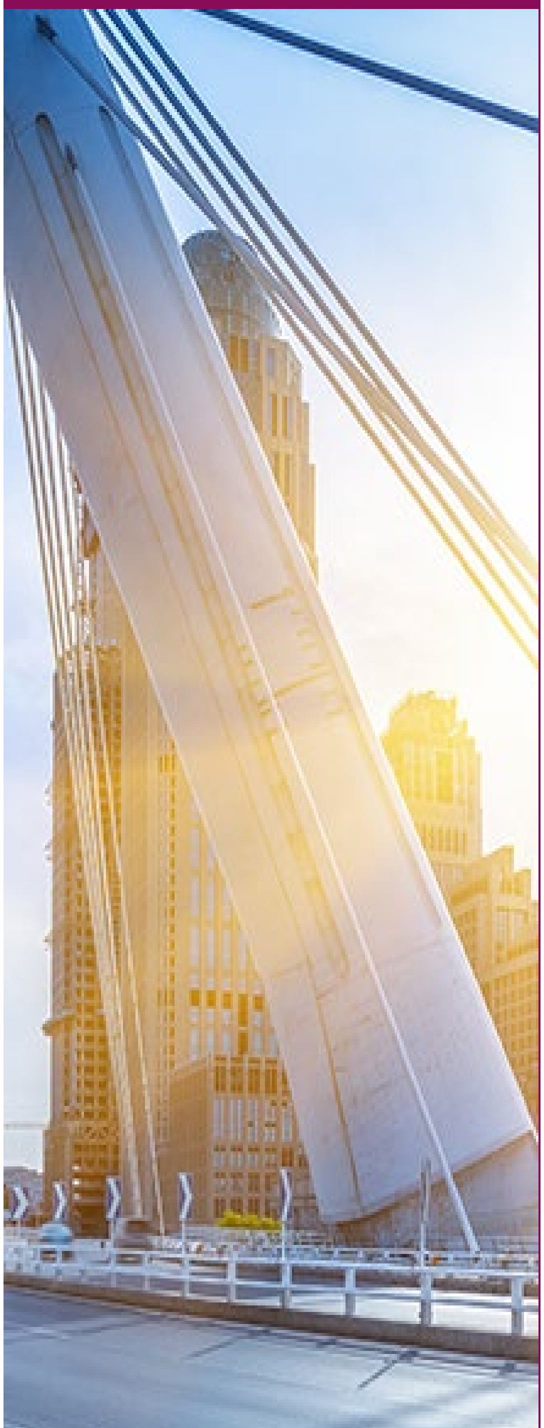
# Market Ethos

The latest market insights from Richardson Wealth



Craig Basinger

RICHARDSON Wealth

## Taking stock

The S&P 500 is roughly where it was two years ago, around 4,000. Since then, it has visited 4,800 (+20%) and 3,600 (-10%) – clearly not a flat journey. The TSX has fared better, starting at 18,500, rising to 22,000, back down to 18,500 and then up to 20,000. Meanwhile, most bonds lost a little money in 2021 and a sizeable amount in 2022 … certainly a challenging investment market. Of course, we have seen worse periods for markets, and fortunately, we have often seen better. But even if your portfolio has become a tad smaller over the past two years, there is a silver lining. The scenario of events has created a great environment to understand yourself as an investor (or understand your clients' behaviours better).

The past two years have seen big ups and downs across many parts of the market. From rampant speculation to despair in certain areas. From free money to money that has a real cost again. Growth to value, QE to QT, peace to war. Add in bonds not protecting the portfolio very well and rising inflation. This market, with all its crazy moves of late, has been near perfect for helping you understand what kind of investor you are.

| **Quantitative** | | | **Qualitative** | |
|---|---|---|---|---|
| | **2021** | **2022** | **2021** | **2022** |
| S&P | 29% | -18% | Peace | Less peace |
| Nasdaq | 21% | -33% | Quantitative easing | Quantitative tightening |
| TSX | 25% | -6% | Crypto Summer | Clearly Winter |
| World ex US | 20% | -18% | Meme stocks | oil |
| Canadian Bonds | -3% | -11% | Real estate rush | Nobody is moving |
| US Growth vs Value | 7% | -24% | | |

Source: Bloomberg, local currency

Were you enticed by the high-flying meme stocks of 2021? Or the profitless tech disruptors that sounded like they were about to change the world? Flying autonomous taxis and such. Or even the more 'conservative' dabbling in those mega-cap tech names? Did you feel like or take on more market exposure during the upswing in 2021?

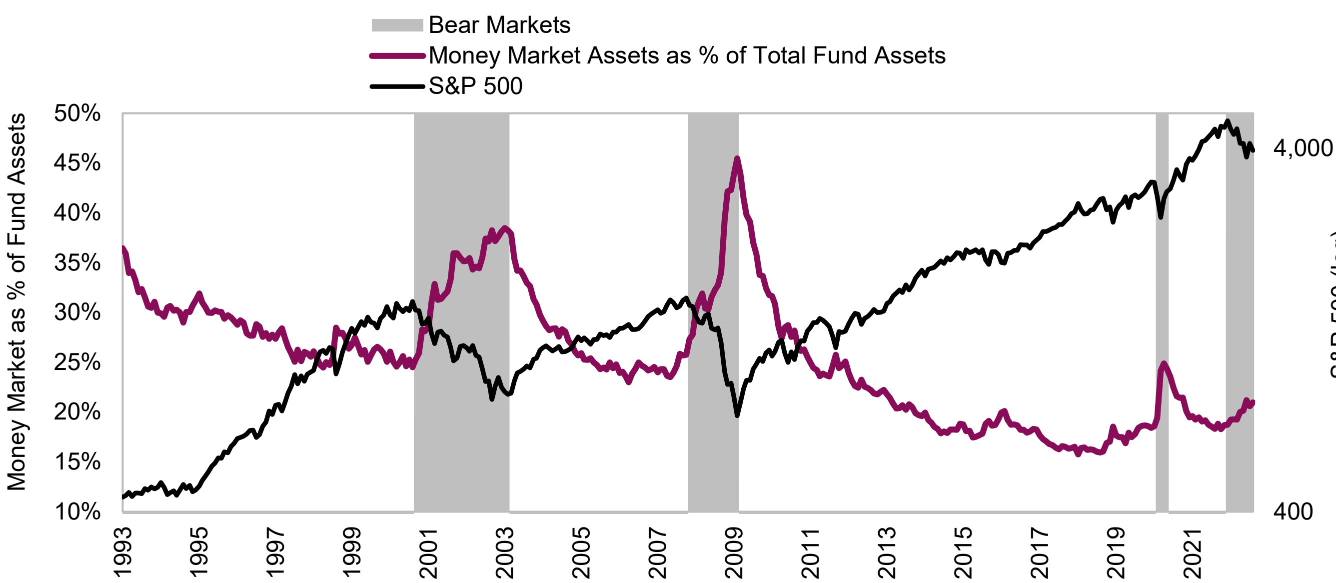
Turning to 2022, had you considered selling? After all, cash now pays 4%+, so who needs this market risk anymore? And there could be a recession coming. Maybe the flying cars are not imminent, or maybe the market is starting to value Tesla as a company that makes cars. Or those bonds that really dropped the ball as a portfolio stabilizer in 2022 – are we done with them and moving to those that did better? Those happen to be the strategies with more credit exposure.

### Following positive performance is human nature

The simple fact is we are naturally drawn to investments that have performed better and away from those that have performed poorly. And during the past two years, many investments have flip-flopped from good to bad or vice versa. This created a ripe environment to either test your fortitude to remain on your financial plan or entice you to go off that plan in the hopes of gains or ending performance pain.

Unfortunately, positive performance chasing or poor performance fleeing are two behaviours that can really mess with long-term returns. Dalbar Inc. analysis highlights this behaviour with their money flow analysis showing the average U.S. equity investors experienced 7.1% annualized gains over the past 30 years while the S&P 500 index gained 10.6%. This is due to performance chasing in both directions. This can also be seen in mutual fund allocations over time. While this is U.S. data and only incorporates funds, the lesson remains valuable.

Money market allocations tend to trough at market peaks and peak at market troughs. Literally buying high and selling low.

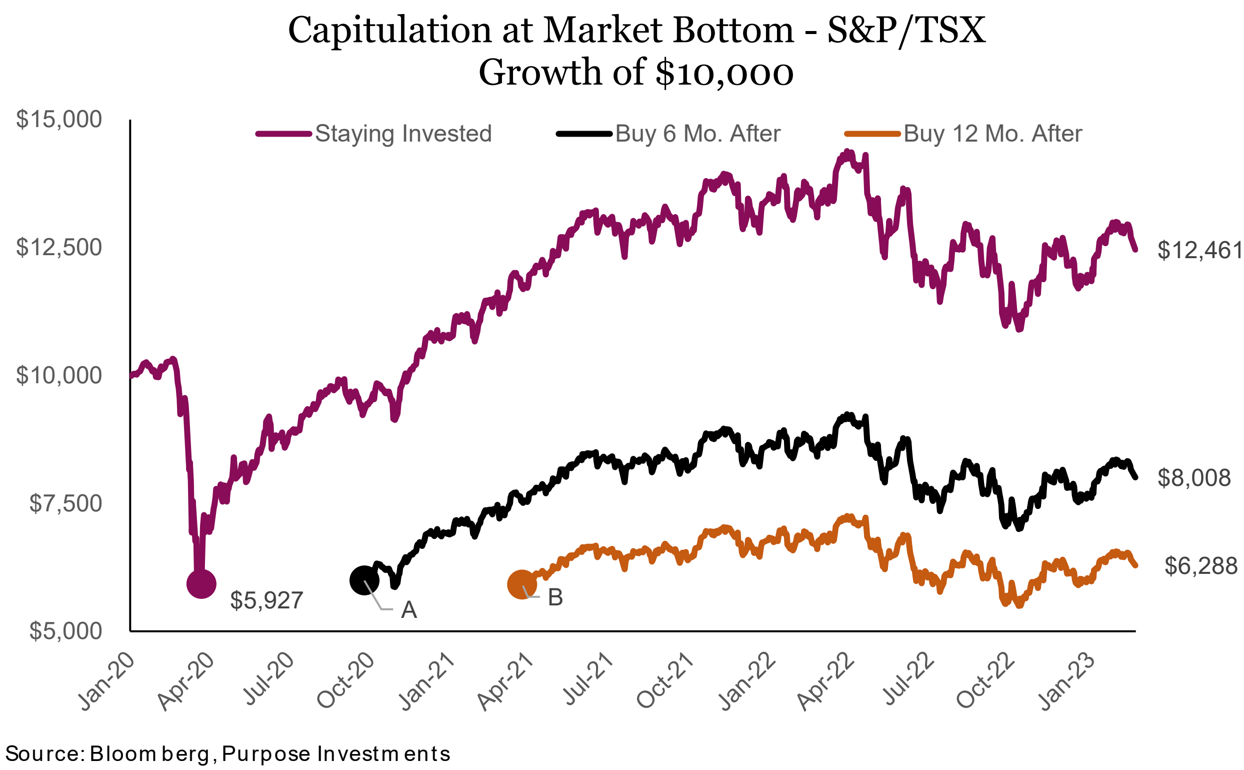



Source: Bloomberg, ICI, Purpose Investments

### Behavioral coaching

Of course, examples of the "average investor" often elicit the response, "well, that isn't me." So, to make it a bit more salient, consider the wealth damage capitulation can cause.

Take the example in the chart on the next page. Investors A & B capitulate at the bottom of the pandemic, and who would blame them? Those were scary times, and for an investor with little experience in significant market corrections (the last one being way back in 2008), emotions can take over and cause a mistake. However, to an inexperienced investor, it does not feel like a mistake at the time. You initially invested $10,000, and it is now below $6,000; you just want the bleeding to stop. Therefore, the band-aid for an investor is to sell the investments and go to cash.




Fast forward to the future, as Investor A reinvests the same capital six months later. In this scenario, the market has largely recovered to pre-pandemic levels. However, they have missed out on much of that initial growth off the bottom and end up in a significantly worse position today than if they had the wherewithal to remain invested. Investor B is in a similar position, but instead of waiting six months, they wait a full year until they are comfortable. This allows them to miss out on approximately $6,100 of capital gain in the market.

### The cost of fear

This is what we like to call the "Cost of Fear." For investment professionals, charts like this one have been around for a long time. It is not a new or revolutionary concept. But it visually represents a common mistake investors make: selling low and buying high. Market corrections happen, and they are healthy for an efficient market environment. But if you leave the market, I hope you have an expensive crystal ball because it is nearly impossible to pick the correct time to return.

This is where investing and psychology have an immense overlap. Money is emotional, and for the most part, the stock market is not a tangible purchase you can touch, like real estate or a painting. For some reason, we as investors feel we need to value our portfolios daily, checking stock prices etc. Conversely, those tangible investments we are comfortable with, we check the value maybe once a year, probably every two years. So, what about the stock market makes us feel like we have some form of control? The market will do what it wants to do. The mistakes come from investors admitting defeat. This is why investment and portfolio construction advice is paramount, avoiding those A & B return paths and reaching retirement goals faster than expected.

## Final thoughts

Financial advice takes many forms, from planning, tax, and portfolio construction, to mention a few. However, during times like the past few years, behavioural coaching may add the most value by helping investors avoid making those emotional mistakes that can cause long-term portfolio performance damage. We are not saying the market will go up from here in either equities or bonds. But focusing on the long-term journey can help mitigate the dangerous tendencies that market volatility can elicit in the short term.

Take stock of your behaviours and feelings about investing over the past few years. Understanding your personal tendencies with an objective lens can really help your own decision-making process during periods of market volatility. And understanding can help avoid or mitigate damaging performance behaviours.

***"To know thyself is the beginning of wisdom." - Socrates***

**Source**: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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*Authors:
Purpose Investments: Craig Basinger, Chief Market Strategist; Derek Benedet, Portfolio Manager
Richardson Wealth: Andrew Innis, Analyst; Phil Kwon, Head of Portfolio Analytics; Mark Letchumanan, Research; An Nguyen, VP Investment Services

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