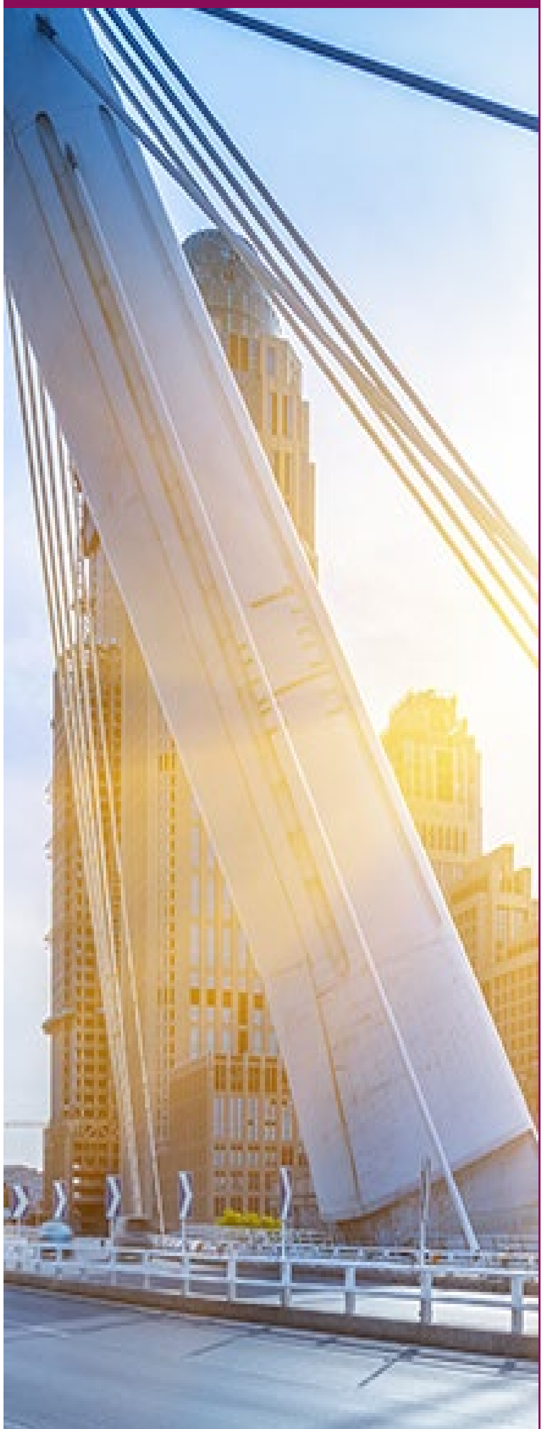
11 December 2023

Market Ethos

The latest market insights from Richardson Wealth



Craig Basinger

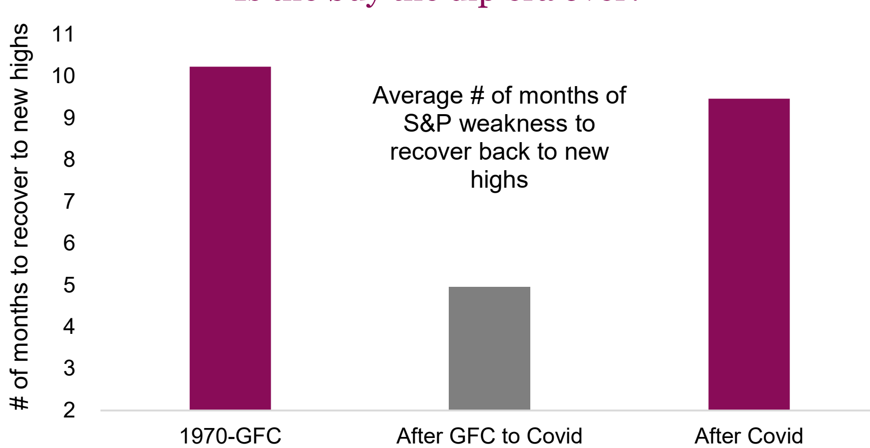
Goodbye to 'buy the dip'?

2023 may not be over yet, but with only a few weeks left it appears to have been a great year to be an investor. Global equities are up about 15%, led by the S&P and Europe at +20%, followed by Japan +13% and the TSX at +7%. Keep in mind the TSX held up much better in 2022, so don't fret too much. The news keeps getting better– bonds went up too. Looking at the broad market ETFs, Canada is up 5% while U.S. bonds are up 4%. The cherry on top is you also got paid to sit in cash somewhere in the 4-5% range.

Despite all these healthy 2023 returns, anecdotally investors seem a bit disgruntled. This is our impression from speaking with advisors and speaking at client events. So why are investors not enthusiastic about what appears to be a pretty darn good year? It could be inflation makes people less happy, or all the recession talk. However, we think it is something even simpler. Despite the gains this year, it has just taken too damn long for markets to recover back to previous highs. Global equities, S&P, TSX are all still below their previous highs reached at the end of 2021, or even longer for bonds back to 2020.

This is now the longest drought without all-time highs since the great financial crisis of '08/'09. Investors clearly expect better from their investments – likely a learned response from the 'buy the dip' era. The 'buy the dip' (BTD) mantra was steadily reinforced during the bull market from 2009-2020, and then reinforced with concrete + rebar during the Covid market drop and recovery. The lesson was simple: if the market goes down, buy some. If it goes down more, buy more. Then sit back and wait a few weeks for prices to recover, wait a few more weeks and watch new highs start to pile up. Easy-peasy.

Is the buy the dip era over?



Source: Bloomberg, Purpose Investments, S&P 500 drop of 5% or more

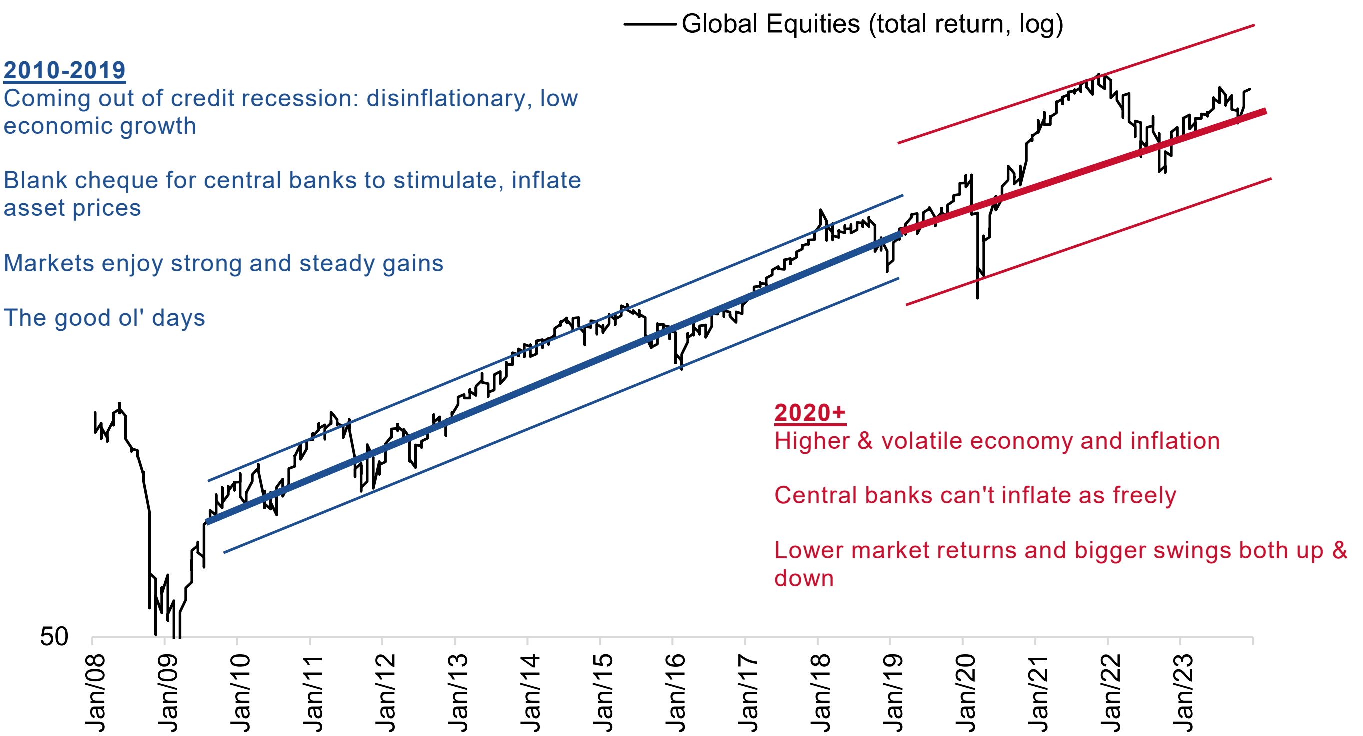
Unfortunately, the BTD era may be over and not simply because it has been almost two years since equity markets made a new high. The BTD era was created thanks to a confluence of factors:

1) Following the 2008 credit recession, there was a disinflationary blanket on the economy, as consumers and banks reduced leverage, creating a lower growth world with a greater risk of deflation vs inflation. This helped yields gradually move lower and allowed central banks to stimulate (QE) any time the economy or market stubbed its toe.

2) Valuations at the start of the BTD dip era were very low, well below historical averages. Valuations often revert to the mean and this provided an added steady positive influence on asset prices.

This created a market, both equities and bonds, where weakness proved very short term as there were factors or stimulus that would mitigate any pain and speed the recovery along. It was a great time to be investing and an even better time if you enacted the BTD strategy.

In case you missed the memo, the market has changed



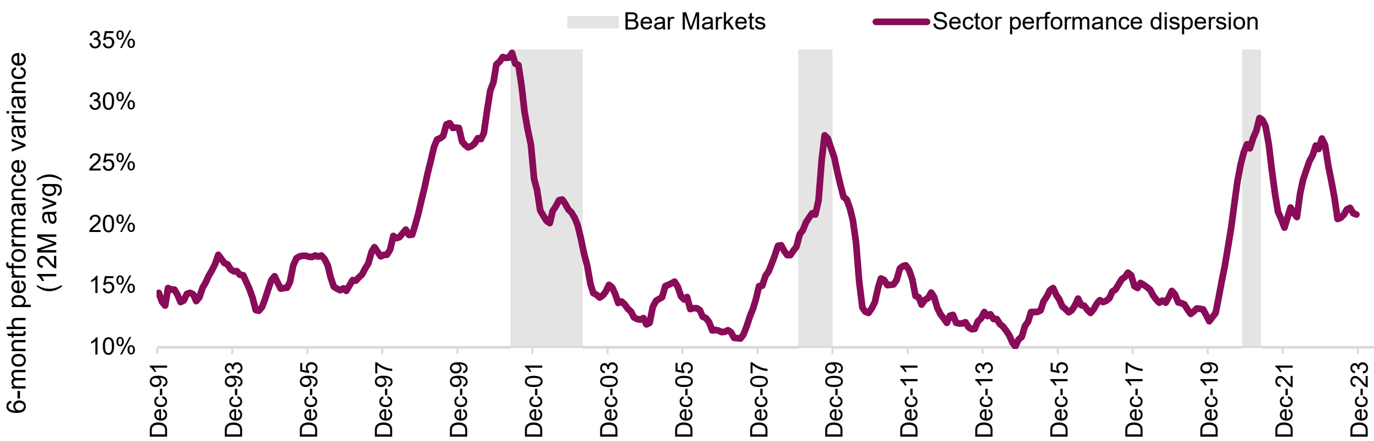
Source: Bloomberg, Purpose Investments

The current market is certainly different. The disinflationary blanket that enabled central bank free stimulating ways is over as inflation is now a thing again (just like before the BTD era). Central banks now have to balance price stability with economic growth. Speaking of economic growth, it too has started to become more volatile. Just look at negative GDP in Germany, Japan and Canada, flat GDP in the UK and still strong GDP in the U.S. Plus, valuations are now more on the expensive side of historically averages.

The ingredients for the BTD era appear to be gone. It was fun while it lasted. There is something else afoot though, dispersion. The BTD era enjoyed less dispersion than normal. Dispersion across markets, across asset classes, across sectors and across equities, was lower. The simple explanation for this was it was a more macro-driven market. The macro-dominated performance, often dwarfed things like company fundamentals or valuations. That actually made investing easier, you just needed market exposure or beta. It didn't matter as much how you got it.

The chart below is the S&P 500 sector performance dispersion over time. Recessions or bear markets certainly make dispersion spike higher as defensive sectors hold up better than those more economically sensitive (usually). More importantly, looking at non-recession periods, current dispersion is much higher than before.

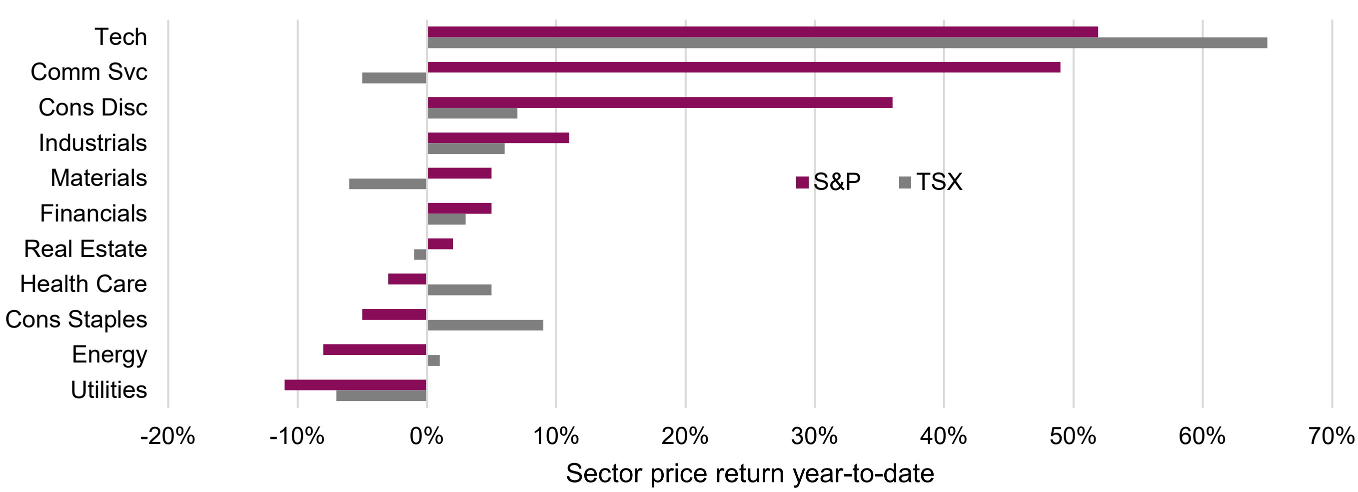
S&P 500 Sector Dispersion remains much higher than before



Source: Bloomberg, Purpose Investments

Now you may be thinking, why should you care about dispersion? It is evidence that the market is becoming more micro driven. Company fundamentals are starting to matter more, leverage matters again, how a company or investment can handle higher yields or inflation matters. During the 2010-2020 period, it was more a macro beta driven market. Not saying the macro drivers are gone, but it would appear there is more of a balance between the macro and the micro. Just look at the dispersion in performance in 2023 among sectors for the S&P and TSX … it's HUGE.

Winners vs losers, the spread is huge



Source: Bloomberg, Purpose Investments

Final thoughts

Don’t get us wrong, we are not saying buying into market weakness isn’t going to work or won't enhance longer-term performance. But it may not be as quick a positive feedback experience as it has been over the previous decade. Nor are we saying the macro drivers are not still very impactful on performance. But the micro is starting to matter more again.

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

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*This report is authored by Craig Basinger, Chief Market Strategist at Purpose Investments Inc. Effective September 1, 2021, Craig Basinger has transitioned to Purpose Investments Inc.

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