Groundhog Day and the Sunnier Days that Follow

It was one of the worst months ever for global equity markets. Fear had a stranglehold on capital markets as investors sold stocks due to concerns over projections of continuous Federal Reserve interest rate hikes in the teeth of a slowdown in China, crashing crude oil prices and weakening domestic economy. Then, a few short weeks later, the Fed suddenly pivoted away from their hawkish stance on interest rates – taking on a much more dovish tone that suggested the hike cycle was over. As recessionary (and inverted yield curve) fears were taken off the table, markets rebounded in a v-shaped recovery and marched higher.

That was 2016.

Fast forward two years and the end of 2018 might serve as a script for “Groundhog Day 2”; same plot but different characters, with Jerome Powell replacing Janet Yellen as Chairman of the Federal Reserve. Early in the quarter, he suggested the Fed was “far from neutral” and needed to hike rates well into the foreseeable future. Fears of a possible monetary policy mistake in the teeth of a weakening economy combined with a global slowdown (not to mention weak oil prices to further strengthen comparisons to 2016) caused investors to rush for the exits—pushing the sell button and asking questions later. Then, only a few months later, Powell pivots 180 degrees, just as his predecessor had done years earlier.
The 2016 and 2018 selloffs and v-shaped recoveries are eerily reminiscent of each other. In 2016 we stated, “our assessment is that the market is in the midst of a tantrum and that given all the positive fundamentals, longer-term investors would be well-served to stay the course and weather the short-term storm.” That was certainly true then (the S&P 500® now stands nearly 1000 points higher). But the million-dollar question is whether it’s true today. Although we are not necessarily calling a market top, expecting another 1000-point gain over the next two years may be a stretch. So, what are investors to do?

Just as a sunnier spring follows Groundhog Day, the equity markets have steadily warmed. However it’s now, with stocks back near their all-time highs (not amid Christmas Eve’s panic-induced 20% selloff) that investors should take a moment to reassess and revisit their longer-term plans and objectives—making any necessary portfolio adjustments. It may be wise to heed the famous words of John F. Kennedy in his 1962 inaugural State of the Union address: “The time to repair the roof is when the sun is shining.”

We need to be mindful that 2019 is three years further into an already prolonged economic expansion and thus three years later into a now aging recovery. While we still believe the expansion has room to run, a recession will ultimately occur at some point in the future (try as they might, venture capitalist and their tech firms have yet to disrupt and eliminate the business cycle). Yikes, we dared utter the R word! Yes, but rather than something to be feared, recessions can actually serve as creators of great wealth—if (and that’s a big if) you have the capital to deploy near the bottom. Whether it be single family residences, skyscrapers, or stocks, having the ability to be greedy while others are fearful can reap huge profits.

So, what to do now?

First and foremost, don’t get trapped into being a forced seller when assets are down 20-40%. How? The list is long but includes reducing or eliminating margin; having 3+ years of living expenses or cash flow needs invested into more predictable, stable, stay-rich type investments; and possessing the mental fortitude to be able to handle upcoming volatility.

Additionally, start taking profits from the last 10 years of gains and redeploy them into a more conservative account. Why rebalance? Because you will need this fund to deploy later in order to turn the fears embedded within the depths of a recession into the joys of generating great future profits by buying low. You’ll need a great deal of intestinal fortitude when the time comes. It’s a quality that runs counter to our human nature. Our ancient ancestors fled from danger in order to survive—and it
worked. As modern-day investors however, we need to run towards danger and put money to work when the math starts to rule the day and valuations become a no-brainer.

Just as late 2018 into early 2019 was a Groundhog Day repeat of 2016, don’t let a future recession become a repeat of the mistakes you might have made in 2009. You’re a decade older and a decade wiser. You’re also a decade wealthier, and as such, although the percentage declines this time might be smaller, the dollar losses could be greater. Plan now! Having the knowledge of these variables ahead of time will allow you to better control the situation not if, but when, it comes about.

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