Portfolio Manager Insights

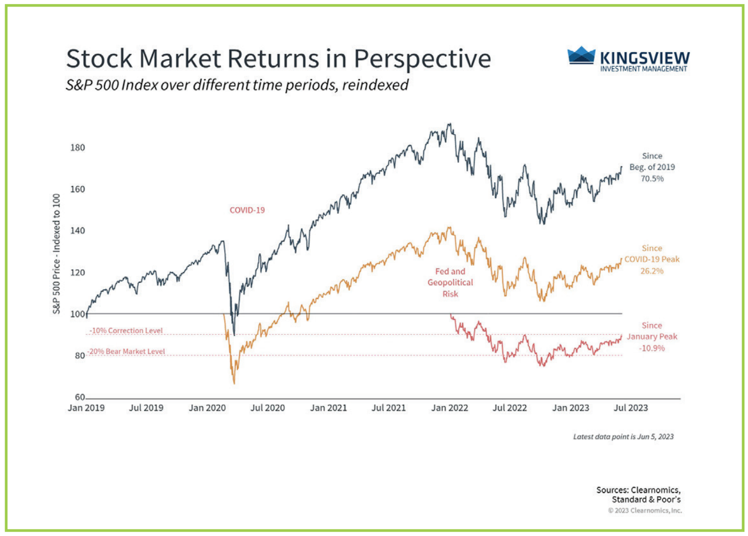
Why Stock Market Returns Are Strong Despite Investor Concerns

Weekly Investor Commentary | June 7, 2023

Investment Committee

Investors have grappled with market and economic challenges this year ranging from Fed uncertainty, stubbornly high inflation, the possibility of a recession, a banking crisis, the debt ceiling, ongoing geopolitical tensions, and more. And yet, the stock market has made significant year-to-date gains with the S&P 500 returning 12.4% with dividends and the Nasdaq 27%. This is further evidence that markets often defy expectations and can rebound when it's least expected, especially when investors are overly focused on short-term events. **What factors are driving these returns and how can investors focus instead on long-run trends?**

MARKETS HAVE MADE CONSIDERABLE GAINS OVER THE PAST FEW YEARS



Investor sentiment tends to swing from one extreme to the other. At the start of the year, many investors and economists were certain there would be a recession within months that would result in higher unemployment and Fed rate cuts. As we approach the second half of the year, no recession has yet materialized, and many economic trends have surprised to the upside. Headline inflation measures have improved although core inflation remains stubborn. Interest rates have stabilized with the 10-year Treasury yield hovering around 3.7%, partly due to a possible Fed pause at an upcoming meeting. These factors have helped tech stocks rebound, especially in areas related to artificial intelligence. This has driven a divergence between sectors this year with Information Technology and Communication Services returning 36% and 34%, respectively, and Energy, the top performer last year, declining 9%.

Despite the strong market gains this year, it's unlikely that investors feel comfortable in the current environment. There is always something new to worry about, a concept often referred to as the "wall of worry." The wall never shrinks - new building blocks are continually added as investor focus and media coverage shift to the next set of worries.

A focus on day-to-day headlines naturally leads investors to have a glass-half-empty view. After all, current events tend to dwell on unexpected negative events, rather than on the steadier, less noticeable progress that drives stock market returns over years and decades. Today, this short-termism reminds investors that major indices are still in the red when compared to last year's all-time highs, and that many thorny market and economic issues are still unresolved.

This is why it's often important to view the market with a broader perspective. The glass-half-full view, which is much more appropriate for long-term investors, is that many of these issues are slowly improving. As a result, the market has risen 21% from last year's market bottom, and 71% since the beginning of 2019, despite all of the intervening events. These are figures that everyday investors would likely be unaware of if they only followed the day-to-day headlines.

Of course, this is not to say that markets only go up or that there is never anything to worry about. Instead, these facts are a reminder for investors to stay disciplined, in both good and bad markets, and to stick with their financial plans. Just as pilots often remind passengers to keep their seatbelts fastened even when the air is calm, periods of positive market performance are the best times for investors to stay balanced and prepare for future uncertainty.

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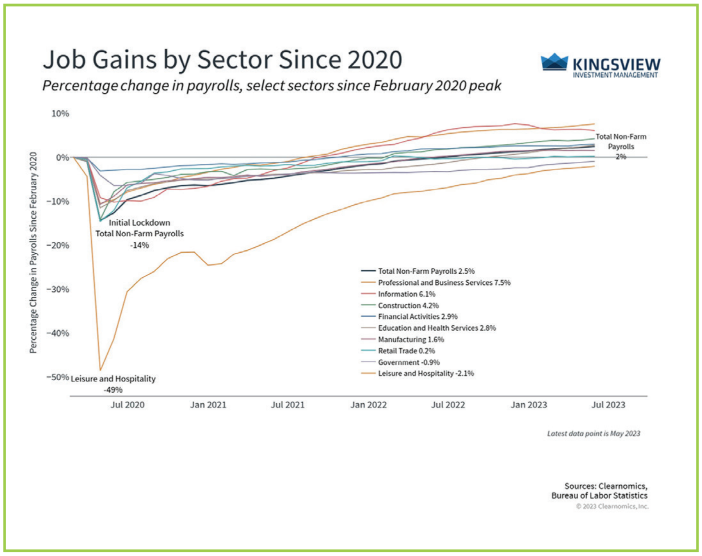
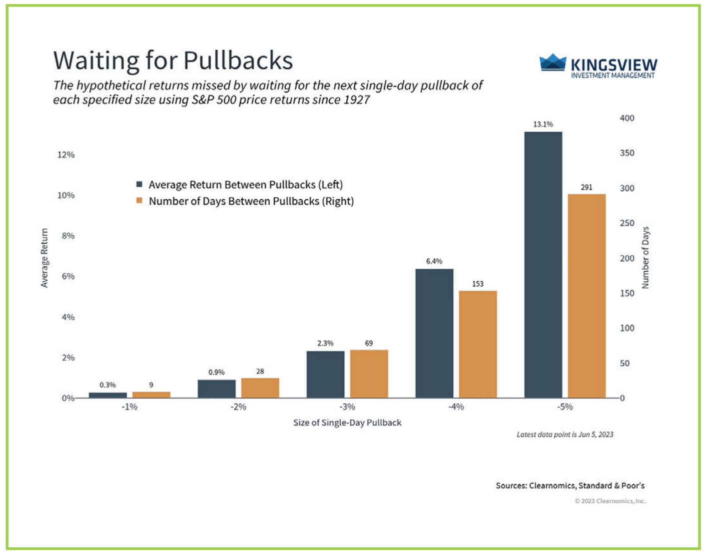
The latest data confirm that the economy is doing better than many feared just a few months ago. Despite what economic theory would predict, Fed rate hikes have had little impact on the labor market so far. The recent jobs report showed that 339,000 new positions were created last month, many more than forecasted. Unemployment did tick up to 3.7%, but it has been fluctuating around these levels since last August. What's more, recent data also show an increase in the number of job openings back above 10 million across the country. Thus, despite recession concerns and shocks such as tech layoffs and the failure of a few mid-sized banks, there are still 1.7 job openings for each unemployed person.

THE ECONOMY CONTINUES TO GROW DESPITE RECESSION FEARS



GETTING INVESTED IS OFTEN BETTER THAN TRYING TO TIME THE MARKET



Other issues that have been on investors' minds have also been resolved, if only temporarily. The latest debt ceiling bill was signed into law after months of posturing and last-minute negotiations. While many of these same issues will re-emerge in the future during budget talks and again after the next presidential election, the worst-case scenario of a government debt default has been averted. Similarly, the banking crisis has stabilized after the failure and acquisition of First Republic Bank over a month ago. While the situation is ongoing, broad financial contagion have not occurred. These events have given investors some much-needed breathing room.

The fact that there are risks for investors to navigate is not only normal, but is always the case. The truth is that there are always reasons to be concerned when it comes to the economy and world events. However, this is also why investors are rewarded in the long run. As the accompanying chart shows, getting or staying invested, rather than trying to wait for the next big pullback, is the best approach. Investors should not let news headlines and constant uncertainty jeopardize their financial plans.

The bottom line? The stock market has performed well this year despite ongoing market and economic challenges. This is further reason for investors to focus on the long run and stick to their financial plans.