Financially Speaking

Uncertainty Can Cause Short Term Financial Market Volatility

"*May you live in interesting times*."

Ancient Chinese Quote

Scholars have long debated whether the ancient Chinese meant the saying above as a blessing or a curse. I'll let you decide but I think there can be no doubt that we are currently living in interesting times.

At the start of the year I spent a lot of time talking with my clients about how I expected three important issues, that all happened to start with the letter "I", to cause increasing volatility in the financial markets due to the uncertainty around them. Those areas of uncertainty – interest rates, inflation, and infections – remain, and each impacts the other.

We briefly started to see optimistic signs related to each of them a couple of months ago. Following the Omicron surge Covid infections fell dramatically across much of the world, allowing many restrictions to be lifted and more and more people to travel and work again. As supply chains were able to reset, we started to see indications that inflation, which has been running higher all around the world than we have seen for some time, had peaked and prices were leveling off. And the Federal Reserve finally started raising interest rates, giving a fairly clear indication of their intentions to continue doing so and what the pace of their plans were.

And then came a fourth "I" – invasion. Russia's invasion of Ukraine is horrific for purely humanitarian reasons, the cost of which can't be calculated in dollars. It also adds to global uncertainty and, even though Russia's economy is tiny relative to ours, it does have an outsize impact on energy prices which can impact US inflation numbers but frankly has a much more significant impact on Europe.

When you couple those concerns with the huge problem that China is now having dealing with the Omicron Covid variant, you might expect that the financial markets would be down significantly during the first three months of the year. In fact, while virtually every asset class did decline, those declines for most investment types were limited to mid-single digits, which is quite pedestrian in terms of market pull backs. This is because the underlying economy remains quite strong, as a number of indicators continued to show throughout the quarter, and corporate profits have generally continued to be solid.

Interestingly, the broad bond market actually declined by slightly more than the broad stock market, with the Bloomberg US Aggregate Bond Index falling 5.93% while the MSCI World Index of stocks fell 5.15% for the quarter. Not surprisingly though, some of the growth stocks that had often performed really well in recent years, represented by the Russell 1000 Growth index, and the heavily technology stock focused Nasdaq Composite declined more than the broader markets, dipping 9.04% and 8.9% respectively.

Volatility has continued in April but the story has remained similar with both stocks and bonds broadly dipping as investors struggle with what to expect going forward and how to price in future interest rate and inflation movements.

Market volatility doesn't mean people shouldn't be invested, as volatility can mean movements both up and down and volatile markets can still produce solid returns for patient investors. Instead, it reaffirms the importance of diversification and can prove the value of a regular strategy of rebalancing. It can also be an excellent time to be systematically adding to investments, such as through contributions to employer retirement plans or automatic investment plans.

It's unclear who first said it, but this too shall pass. The uncertainty of today will eventually give way to more clarity and with it the ability for investors to better determine what asset values should be. When that happens the investors that stayed patient and stuck to their investment plan are likely to be rewarded for having done so.

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