Manulife Investment Management

Investment Note

27 Mar 2020

In times of extreme volatility and wild market swings, it can be very easy to give in to our emotional instincts and head for the exits. However, Nathan W. Thooft, CFA, head of our asset allocation team, urges patience and long-term thinking. Staying calm is the most sensible decision that investors can make right now.

Making sense of the market drawdown: what history has shown us

Key takeaways

- Markets are reacting to uncertainty and fear. This is likely to continue in the short term until there's more evidence of containment of COVID-19.
- Prior to this event-driven correction, market fundamentals were supportive of risk assets. As certainty eventually returns to the market, we believe a material re-risking will take place and that investors are best served by maintaining a medium- to long-term investment horizon.
- We've been through corrections before, and we believe experience and expertise are critical to navigating through volatile markets.

Markets may be dominated by uncertainty, but experience counts

Without a doubt, the news cycle and what we're experiencing in the markets have investors on edge, with major market indexes globally now in bear territory.[1] This period of volatility and uncertainty is likely to continue until the COVID-19 outbreak is contained—particularly in the United States and Europe—and when we see a more coordinated policy response from governments and central banks worldwide. At this point, we're now operating with the view that the world economy is in a recession, one that we expect to be short lived but significant in magnitude. Given how quickly markets reacted and began to price in a recession, we feel that they can rebound just as quickly once there's better visibility. In our view, the foundation for the turnaround is beginning to take shape, with valuations improving, interest rates at low levels, government stimulus efforts under way, inventory levels in need of a rebuild, and the potential for pent-up consumer demand.

Perspective is important. Seasoned investors who have experienced other sharp market sell-offs will probably remember that it's often wise not to react drastically to dramatic movements in the market. Instead, investors should rely on the tools that they have at their disposal to ensure they're positioned for the next phase of the market environment. Paraphrasing our Chief Investment Officer of Fixed Income John F. Addeo, CFA: We aren't epidemiologists, doctors, or politicians—we are investors. Our job is to use available information and synthesize it into actionable items and take the most appropriate course of action.

Diversification has typically been able to help mitigate the worst impact of market drawdowns.[2] Defensive assets such as low beta equity strategies, real estate, infrastructure, and liquid alternatives often come into their own in times of market stress. It also goes without saying that when uncertainty spikes, high-quality assets—in particular, those with a safe-haven status, such as gold, select currencies, and US Treasuries—exhibit strong protection characteristics. These assets can offer ballast and help to mitigate volatility.

[1] Bloomberg, March 12, 2020

[2] Diversification or asset allocation does not guarantee a profit or eliminate the risk of a loss.

What history has taught us

At this stage, we expect a market rebound when more certainty returns. We don't have a crystal ball on when this might occur, but we believe that we're closer to the end of the correction than the beginning. Crucially, historical market performance of equities after steep market sell-offs of this magnitude certainly suggests that a rebound will take place. Historical data also shows that *when* stock markets come back, the rebounds are typically sharp, sustained, and can happen very quickly. What history has taught us is that despite our emotional responses, it makes sense to stay invested, particularly for those with a longer investment horizon.

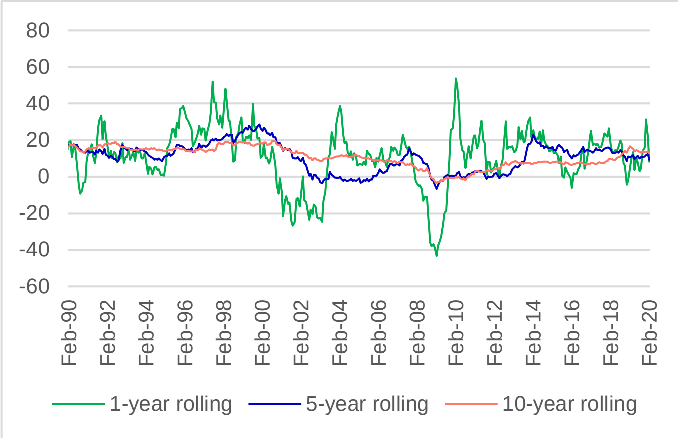
Chart 1: S&P 500 Index ten worst days

Date	One-day drawdown	Return after 1year	Return after 3 years	Return after 5 years	Return after 10 years
15 Oct 2008	-9.0%	24.0%	41.4%	109.0%	275.4%
1 Dec 2008	-8.9%	39.3%	62.9%	146.3%	315.0%
29 Sep 2008	-8.9%	-1.5%	12.2%	69.9%	226.4%
9 Oct 2008	-7.6%	20.9%	40.5%	103.5%	292.2%
27 Oct 1997	-6.9%	23.4%	62.0%	8.7%	102.5%
31 Aug 1998	-6.8%	39.8%	22.5%	13.0%	60.1%
20 Nov 2008	-6.7%	48.8%	68.7%	164.3%	334.5%
8 Aug 2011	-6.6%	28.1%	82.2%	117.0%	N/A
13 Oct 1989	-6.1%	-5.8%	35.6%	63.8%	396.3%
19 Nov 2008	-6.1%	39.2%	58.0%	147.5%	312.8%

Manulife Investment Management, Refinitiv, as of 12 March 2020. Data shown is for the S&P 500 Index, which includes price increases and dividend payments. Past performance does not guarantee future results.

History also teaches us that staying invested over the long term can smooth out the volatility of returns.

Chart 2: Volatility of rolling returns within the S&P 500 index (January 2000–February 2020)



Source: Manulife Investment Management, Morningstar Direct, as of 12 March 2020. Past performance does not guarantee future results.

And finally…

With each passing day during this period of market uncertainty, we think it's important to monitor market developments and debate the most sensible way to position portfolios. While it may not be easy, it makes the most sense for us to check our emotions at the front door and focus on long-term goals. Turmoil can often lead to opportunity. But above all, be well and stay healthy.

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Manulife Investment Management

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