Ropes Wealth Addresses the 2022 Market Meltdown

Stock market action this week and for all of 2022 has been difficult to say the least. As of this writing, the S&P 500 has fallen -13.8%, and the growth-oriented investments as represented by the NASDAQ have declined -23%. Some of the world's largest, most respected, and well-known companies like Microsoft, Apple, Amazon, Netflix, and Alphabet (formerly Google) have experienced price declines of more than -40%, with Netflix alone down almost -70%. Traditional areas of relative safety have also had a challenging 2022. The Bloomberg Aggregate Bond Index, the standard index measuring fixed income performance of U.S. corporate, treasury, and mortgage-backed bonds, has returned a negative -10% to start the year through April. The magnitude and speed of the decline in bond prices has few precedents in history.

There have been limited places to hide for investors and talk of recession surrounds us. The aftereffects of the pandemic and policies implemented to mitigate COVID's impact are having a significant and lasting effect on the economy. Consumers flush with savings that was built up from two years of lockdowns and restrained activity, fiscal stimulus checks, and low financing rates have pent-up demand for travel, dining out, concerts and events, and a general desire to spend money. This enormous demand has outmatched a global supply chain in disarray due to COVID-induced shutdowns and labor constraints. The result has been high and persistent inflation, the likes of which we haven't seen in 40 years. In reaction, the U.S. Federal Reserve has started raising interest rates more aggressively than they have in decades to counteract rising prices. This has had an immediate impact on economically sensitive mortgage rates and lofty stock market valuations and threatens the trajectory of growth and recovery which we all hoped for after a long COVID slog. To make matters worse, the devastating situation unfolding in Ukraine has put ever more pressure on food and energy prices, impacting household budgets. All this while COVID variants remain a wild card, as the pandemic continues to cripple activity, particularly in Asia where a “zero tolerance” policy has shut down activity in major cities in China.

Of course, issues are never as one-sided as they seem and there are still some positives near-term. Compared with the 2008 financial crisis, the recovery from the COVID-19 crash has been an extraordinary success. It took more than a decade after the onset of the previous recession for the unemployment rate to fall back to 4%, and unemployment today is 3.6%. Most of the jobs created after the 2008 crisis paid poverty wages, and the country never recovered all of the lost manufacturing jobs. Today, manufacturing jobs have nearly returned to their pre-pandemic levels amid a burst of onshoring activity across different industries. Household wealth is at a record $150 trillion, driven by appreciation in housing, savings, and higher incomes. Corporations are likewise full of cash and have modest debt burdens. And thus far they have been able to take advantage of rising prices, successfully passing them on to consumers, with earnings for S&P 500 companies running +9.6% ahead of 2021 levels.

Data tracking the financial health of the corporate and consumer sectors implies there are no significant imbalances in the economy that have typically been present in recessions of the past. While interest rates are rising, they are doing so off historical lows and are on their path to return to levels still consistent with economic expansion.

Monetary policymakers have a difficult path ahead to try to stem inflation without pushing the economy towards recession. The environment is equally difficult for investors to navigate with both bond and stock prices in decline, which is eroding confidence in the future. Managing portfolios and emotions through these challenges will be important in the year to come.

There are changes we can make and are making to help position portfolios. First and foremost, it is important to put this recent decline into a longer-term perspective. As challenging as the last 4 months have been, the S&P is only back to levels first reached a year ago. That may be of little consolation to many, but even after recent declines, the index has still compounded at +13.6% over the last 5 years and +14.5% per year over the last 10 years.

We believe it is important not to overreact, but that does not mean we are sitting idly by. We are redoubling our efforts to review existing holdings to ensure their prospects are as sound today under these changed economic and market conditions as when we made the original investment. We have and will continue to use volatility and weakness to add new positions and increase positions in market segments we think have been unfairly punished.

Away from equities, the weakness in the fixed income market is creating opportunities. As always, we are keeping our portfolio of bonds relatively short in duration (i.e. near-dated maturities). This reduces interest rate risk should rates continue to rise. However, short-term government bonds are starting to provide more attractive income than they have in years. Twelve-month Treasury notes are currently yielding over 2%, and two-year paper is yielding 2.8%. Risk-averse investors haven't seen interest rates this high since 2018, and before that one had to go back to before the great financial crisis to generate commensurate interest income for that level of risk. The volatility in fixed income is also creating other opportunities to improve returns and add after-tax income within bond allocations, including the use of municipal and corporate bonds that have materially repriced in recent months.

Market volatility is not easy to stomach, but it is important to remember it is a normal part of the experience of investing. While COVID, inflation, and Russia invading Ukraine are 2022's specific-fact pattern, the market's reaction today is not outside of volatility experiences we have seen in the past, and from which we have recovered. For long-term investors, equity market weakness provides attractive prices to purchase stakes in strong businesses that should reward investors in the future. During times when equity prices move significantly (up or down) it is appropriate to explore the balance between riskier and less risky assets in your portfolio and the level of volatility you are comfortable with in the pursuit of your financial objectives. Ensuring enough liquidity cushion for your short-term needs can provide reassurance to help maintain long-term thinking. Your Ropes Wealth Advisors team is working to carefully navigate through this period on your behalf and is ever focused on making sound decisions and maintaining a steady hand.

Your Ropes Wealth Team

Thank you for your interest in our investment commentary. If you would like to speak personally with a member of our team at any time, please click here.

The information set forth in this communication is presented by Ropes Wealth Advisors LLC ("Ropes Wealth") a wholly owned subsidiary of Ropes & Gray LLP. The contents are for informational and educational purposes only and are not intended as investment, legal or tax advice. Please consult with your investment, legal or tax advisor concerning any specific questions you may have. Ropes Wealth cautions the reader that past results are not indicative of future performance. The historical return of markets generally and of individual assets classes or individual securities may not be an accurate predictor of future returns of those makers, asset classes or individual securities. Ropes Wealth does not guarantee the accuracy and completeness of any sourced data in this communication.

Ropes Wealth Advisors LLC
800 Boylston Street Boston, MA 02199-3600