A dip on the road to wealth creation

6 February 2018

Today saw a bit of a shake-out in equity markets around the world. Whilst it may feel traumatic and certainly got a lot of headlines (the Dow Jones saw the worst weekly performance since 1998), it was not in many ways surprising.

Regular readers will know that we expected volatility to pick up. This was part of our forecast for 2018. The reason was that central bankers, who had hitherto been smoothing the path for investors with unnatural amounts of liquidity, have been trying to quietly withdraw their support.

Interest rates are rising at a time when the economy needs money for the increased corporate investment activity which is taking place. That means there won't be the constant flow of money into the equity market which has been supporting prices over the last couple of years.

Understanding that volatility is on the way is unfortunately not the same as being able to sell just before the top and then buy at the bottom. We can use sell offs to buy stocks at cheaper prices, but nobody knows whether they are getting to the very bottom.

That said, there are some indicators which are worth looking for.

There can be little question that the potential return from equities greatly exceeds that available from bonds and cash. In an environment in which the global economy is performing well, money needs to be invested somewhere and the equity market is the most attractive home for that money by some margin.

Equities, though, are risky assets in the short term, and after a year in which they performed like low risk assets, there is a real risk that some investors feel overly disconcerted by what we saw during Monday night.

This will be particularly acute for those who joined the party relatively late. There were plenty of these investors around the turn of the year when we saw strong flows into equity markets.

During this period the US Conference Board survey of consumers found that more of the public than ever before expected to see equities rising over the next twelve months. Given that this survey was not even a survey of investors (just consumers) it certainly supports our expectation that some investors who are new to equities are going to panic. However, more seasoned investors, and investment managers such as ourselves, know that what we are seeing is a commonly occurring setback on the march towards wealth creation.

As I said before the year ended "The real challenge for investors after an environment of very low volatility is that they may be unnerved as it 'normalises'. More volatility means more opportunity for active investors with strong nerves." We see the recent sell off as validating rather than challenging that assessment.

Also, to remind readers of an observation we made last summer. Fear of commitment is a real problem for many investors. They delay their investment because they are concerned that it might be the wrong time.

We looked at the impact of investing in different calendar years. The best time to invest in recent years was 2009, just after the financial crisis and giving a return of 110% by the start of 2017. But investing before the crisis in 2006 was not bad either; the road may have been rougher, but investors still doubled their money. The adage goes it's time in the market not timing the market which creates wealth. We're here to make it as comfortable as possible but the market's gains are only there for those who can ride out a few bumps here and there.

Guy Foster, Head of Research

Guy leads Brewin Dolphin's Research team ensuring that a rigorous and exhaustive investment process is employed. He also provides recommendations on tactical investment strategy to Brewin Dolphin's investment managers and strategic recommendations to the group's Asset Allocation Committee. Before joining Brewin Dolphin in 2006, Guy was an Investment Director at Hill Martin (Asset Management). Guy has a Masters in Finance from London Business School. He is also a CFA charterholder, holds the CISI Diploma, and is a member of the Society of Business Economists. Guy frequently discusses financial issues with the written and televised media as well as presenting to the staff and clients of Brewin Dolphin.

The value of investments can fall and you may get back less than you invested

If you invest in currencies other than your own, fluctuations in currency value will mean that the value of your investment will move independently of the underlying asset.