Volatility has returned – what should you do?

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Following the inflation announcement in the UK, this is another reminder of the economic and political headwinds we currently face.

Inevitably, this has a knock-on effect on portfolio valuations which are down by a year to date. Some of our clients have contacted us for guidance regarding actions they should take and we are sure some of you will be thinking about this without having contacted us.

With this in mind, Simon Hoult, our head of proposition, explores what might need to be done.

What is happening in markets?

As you will have seen, volatility has returned to financial markets with investment portfolios having fallen in value. There haven't been any hiding places, with most asset classes suffering losses this year. Only a few assets are in positive territory, notably energy stocks and gold.

For the first time in over ten years, the UK market (and the FTSE that many refer to as a benchmark for how investments are doing) is doing better relative to other markets and the returns our clients have seen on their portfolios. The UK market contains many energy, utility and commodity stocks that have prospered this year, with minimal exposure to technology and growth stocks which have suffered significantly following the post-pandemic highs reached in November.

What has been the cause?

Inflationary fears, and what this will lead to, sit at the heart of the correction in values.

At the start of the year, there was a general concern that inflation would persist for longer than first thought. Then, the sad events happening in Ukraine caused a spike in oil, gas and soft commodity prices. In addition, the Chinese COVID zero-tolerance policy caused much of their manufacturing to be stopped or disrupted, further impacting supply chains and increasing prices. Inflation is at the highest rate of circa 9% in many years, and experts predict it could stay at these levels until the end of the year, resulting in fears of

recession. Uncertainty like this always causes markets to fall.

What does history tell us?

Financial markets do not track what is happening in the economy simultaneously; they discount the news flow to reflect potential future asset values, usually about 12 months ahead.

So effectively, markets ‘price in’ the current situation, expecting a deterioration or improvement of economic conditions. It is often the case that financial markets lose more value before a downturn or recession than during it. During a recession, most of the bad news is now ‘out’, and financial markets can start to gain value again in anticipation of better economic conditions ahead.

Recoveries can be quick and sharp and missing the ‘best days’ in markets by jumping in and out can negatively impact your investment returns significantly. Research conducted by Schroders against the FTSE 250 over a 30-year period from the start of 1989 to 2019 suggests that returns would be lower by 2% per annum if the best ten days were removed and lower by over 4% per annum if the best 30 days were removed. Quite often, the best returns are achieved immediately after the downturn. This is why ’knee jerk’ reactions mustn’t be taken, as this can lead to prolongued harm in investment values.

What financial planning rules should be followed?

Sometimes, while it seems the hardest to comprehend in times of stress, doing nothing can be the best decision. What I mean by this is that investments should be seen as long-term and it should be expected that there will be periods of volatility during that journey. This is the approach to take for those not drawing from their wealth.

For those drawing from their wealth, if plans have been put in place well, there should be sufficient cash held so that these reserves can be used to supplement income when markets fall hard, thus giving portfolios a better opportunity to recover as fortunes turn around. Whilst we don’t think we are currently at this point, should you wish to discuss your particular circumstances, please do not hesitate to get in touch.

One has to consider the actual impact on lifestyle while such market movements are happening. Will the current falls in your portfolio value impact your lifestyle or what you can reasonably expect to take from your invested assets? Do you have time to ride the storm and wait for the recovery, which often is sharp and quick? It is essential to take a step back, remove your fears and emotions from how you might react to the current situation, and retain a long-term view.

In summary, our key messages are as follows:

There may be more bad news to come, but a lot will already be ‘priced in’ to the market.

Post downturn or recession recoveries are usually strong and quick.

Missing recoveries will be very costly.

The managers of the multi-asset solutions we use will have positioned investments for the current climate.

Be patient and don’t make abrupt decisions without discussing them with your Financial Planner.