Thursday 29 February 2024

focus

Peak to peak: Record highs are business as usual for markets

The last few years have been a real rollercoaster ride for investors. After the COVID crash in early 2020 — the fastest bear market (defined as a -20% decline) in history — markets bounced back rapidly only to get hit by another bear market in 2022. However, since the October 2022 low, markets have improved, and particularly so in the latter months of 2023 and early 2024. **This month the MSCI All Country World Index (ACWI) hit a new record high. Some investors are now asking "have markets now run too hard, should I be taking money off the table?" Our response is not dissimilar to when shares were in the doldrums – timing markets consistently well is (at best) exceptionally hard, you're better to stick to your long-term plan and not chop and change too much in response to market conditions.** Markets have hit all-time highs many times before, and investors "selling at the top" are just as likely to miss out on future gains as they are to avoid a significant fall.

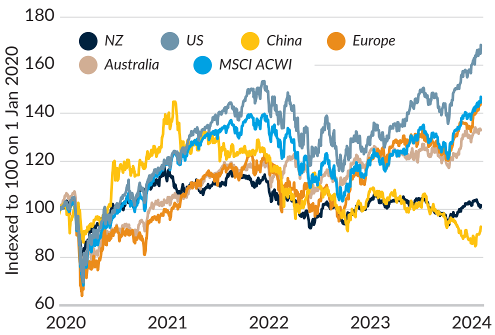
FORSYTH BARR

Investing isn't supposed to be easy

> *"It's not supposed to be easy. Anyone who finds it easy is stupid."*
>
> ***Charlie Munger, investing great, 1924–2023***

The psychology of investing is challenging. When bad news dominates headlines and prices are falling, many shy away from markets: "things could get worse!" But equally, once markets improve some worry "I've missed the rally!" or "aren't shares now due for a pullback?" Unfortunately, there are many ways that the market can tempt you into behaviours that will ultimately be detrimental to your long-term returns.

MARKETS HAVE BEEN ON A ROLLERCOASTER RIDE



Source: Refinitiv, Forsyth Barr analysis

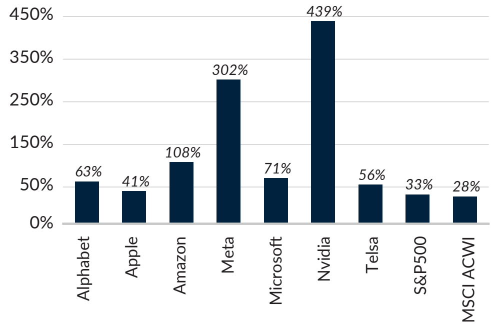
A new record high, but not everything and everywhere

When people say "the market has hit a record high" what they are referring to is a particular share market index. An index measures the performance of a specific basket of stocks, often related to a country or geographical region, or a certain sector, e.g. technology.

In most indices the basket of stocks is not evenly spread. Typically, shares are weighted by their market capitalisation, i.e. the largest companies make up the biggest chunks of the index. What this means is that the largest stocks have a disproportionate impact on the performance of an index or "market".

The recent rally in markets has been led by the so-called "Magnificent Seven" — seven US technology-related behemoths: Apple, Amazon, Alphabet (the company formerly known as Google), Meta (formerly Facebook), Microsoft, Nvidia, and Tesla. These giant companies dominate the US market comprising around 30% of the S&P500 — the main US stock market index of its 500 largest companies. In turn, the US dominates global markets making up nearly two-thirds of the MSCI ACWI. It's been the stellar performance of these leading US stocks, helped by strong earnings growth and the boom and hype around artificial intelligence (AI), which has propelled the US market to its most recent record highs.

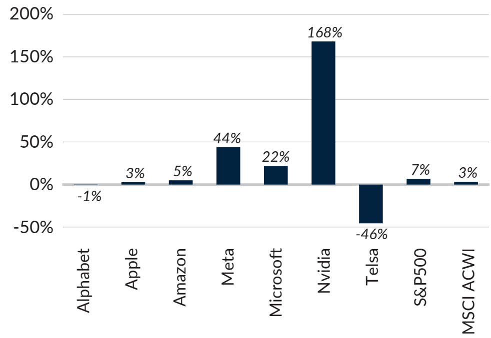
RETURNS SINCE 1 JANUARY 2023



Source: Refinitiv, Forsyth Barr analysis

As an aside, a big part of recent returns has been the bounce back after markets got thumped in 2022. For some of these companies, returns since the beginning of 2022 haven't been anywhere near as flash. Nvidia especially, Meta, and Microsoft have delivered strong returns, but the rest have been ho-hum.

RETURNS SINCE 1 JANUARY 2022



Source: Refinitiv, Forsyth Barr analysis

What is important to understand, however, is that while that the MSCI ACWI and S&P500 indices have hit all-time highs, many individual stocks and markets remain well below their record levels. As an example, still within the US, the Russell 2000 index which is made up of small and medium sized companies is still -18% below its all-time high, while here in New Zealand the S&P/NZX 50 remains -14% off its January 2021 peak.

...investing when markets are near a high is not rare, it's the norm....

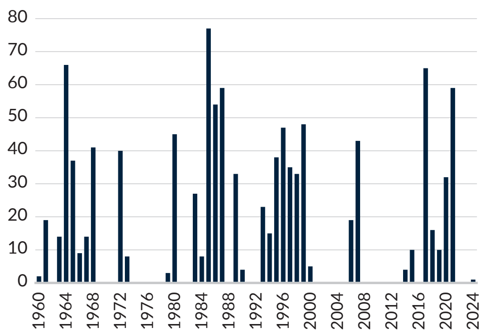
Most investors will own a portfolio that is more diversified than having 30% concentrated in US technology-related stocks. The good news is that the majority of investors will have had some exposure to one or more of the Magnificent Seven, which will have benefited their portfolio in recent time. The other good news is that, outside of this small group of stocks, there are plenty of investment opportunities which remain well below their all-time highs.

Commentators love an all-time high, but in reality they're pretty normal

Another consideration is that, while the media likes to trumpet a new record high like it's a special and rare event, it's not as meaningful as you may think.

A key reason we invest in shares is that we expect them to become more valuable over time as the economy and corporate profits grow. There are periods when the economy does slow, but over time innovation, productivity improvements, and population growth push economic activity higher. It should come as no real surprise that when this eventuates new market highs are recorded. Since 1960 there's been around 1100 new record highs, on average 17 per year.

NUMBER OF NEW RECORD MARKET HIGHS



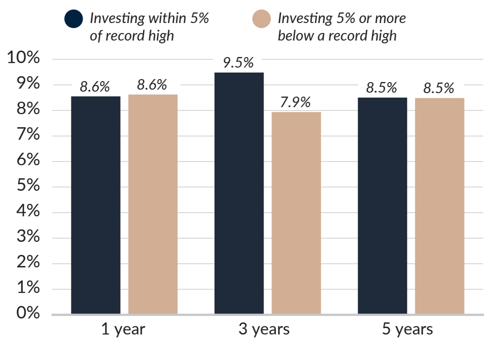
Numbers based off MSCI ACWI Index from 1988, MSCI World 1970–1987, S&P500 1964–1970, Dow Jones Industrial Average 1960–1963
Source: Refinitiv, Forsyth Barr analysis

Also noteworthy, is that over this period the market has traded within 10% of its latest record high 60% of the time, whereas it's only traded at 20% or more *below* its last high 19% of the time (both excluding dividends received). In other words, **investing when markets are near a high is not rare, it's the norm**.

...The global economy has remained far more robust than the vast majority expected...

Given that markets make new highs fairly regularly it should also come as no surprise that even when investing at record highs returns are, more often than not, positive. Over the past 50 years, if you'd invested when markets were within 5% of an all-time high, the MSCI ACWI returns over the subsequent one, three, and five year periods were on average 8.6%, 9.5%, and 8.5% per annum respectively. That's extremely similar to the 8.6%, 7.9%, and 8.5% average returns for periods when the market was 5% or more below an all-time high over the same time period.

ANNUAL RETURNS OVER THE PAST 50 YEARS



Source: Refinitiv, Forsyth Barr analysis

Highs and lows are part of the investing journey

As all investors will know, the last few years have been full of highs and lows ... often in quick succession! Even over the past six months or so, many investors were feeling okay in August, pretty glum by October, but happier again come the new year. Unfortunately, as we've discussed many times before, this rollercoaster ride is an unavoidable part of investing and the price we pay for earning higher returns over the long-term compared to more stable investments like term deposits.

We look forward to the rest of 2024 with a mix of optimism and trepidation.

On the positive side, the global economy has remained far more robust than the vast majority expected. Inflation is falling and it's more than likely the next move in interest rates will be down. New ground-breaking technologies continue to surface — AI and GLP-1 weight-loss drugs moved markets in 2023 — which represent potential human and economic progress in the years and decades ahead.

...positive returns can be achieved even when markets have touched new all-time highs...

On the flipside, geopolitical risks simmer away in the background. Later this year the US election will, no doubt, highlight the fractious state of the world's largest economy, and, if Trump is elected, bring a heightened state of domestic and international uncertainty. China's economy continues to struggle after the bursting of its property bubble, while there remains a risk the global economy slows more sharply than expected as we advance through the year.

Against this complex backdrop attempting to pick the best time to enter or exit the market is almost impossible to get consistently right. Fortunately, as history has shown, positive returns can be achieved even when markets have touched new all-time highs. And given that markets, on average go up over time, the cost of waiting for a pullback can be high.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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