April 26, 2019

Don’t Fear the Headlines

What a difference four months makes. Today is April 25th, which means it has been exactly four months since Christmas and four months and one day since the “Christmas Eve Massacre” when the S&P 500 SPX fell by 2.7% in a single trading session to cap off the Q4 sell-off which saw the major US indices drop by about 20%. At that point, no one we’re aware of was predicting that the S&P 500 would be within 1% of hitting a new all-time high by the end of April, yet that’s exactly where we find ourselves today.

Of course, the next Big Scary Thing is always just around the corner. And as the fears that were cited as the cause of the Q4 selloff - a global economic slowdown, the Federal Reserve raising rates too aggressively, and an impending U.S.-China trade war - have subsided, they have been replaced with headlines telling us what we should fear next. This is to be expected. The financial news industry will always be constructing billboards with 10-foot-tall, bold-faced type to highlight any potential bump in the road. After all, they earn a living by generating clicks, and an article titled “Everything’s Fine”, doesn’t generate many clicks – “If it bleeds, it leads.” didn’t become a newsroom adage by accident. Now that we are approaching all-time highs for the major US indices, the in vogue concern appears to be that stocks have become overvalued.


Fear that markets are overvalued is holding back investors, says BMO strategist

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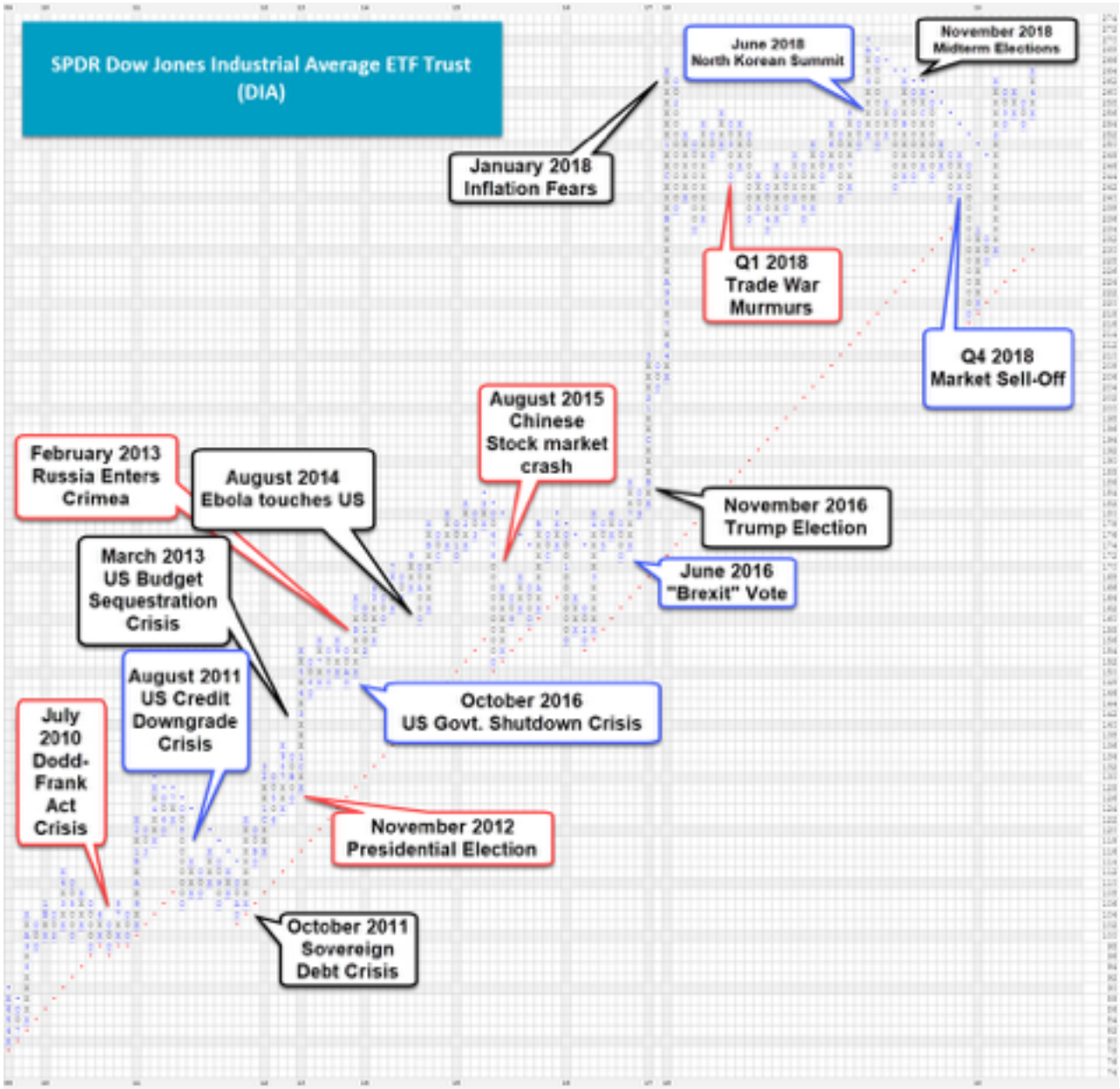
Relax. It’s probably a lizard.

A year from now, some investors may be kicking themselves for not buying into

Image Source: MarketWatch

Perhaps stocks are moving into overvalued territory, perhaps not. The point is we can't try to adjust for every headline or potential bump in the road. There is a commercial for an investment advisory firm that runs on local radio stations here in Richmond, VA which ends "…reminding you that professionally designed portfolios aren't affected by headlines." And, while perhaps it would be more correct to say "…professionally built portfolios aren't affected by headlines over the long-term.", the basic premise is one that we would all do well to keep in mind and to bring up to clients. As surely as you can rely on the sun rising tomorrow, you can rely on the financial media hyping the next Big Scary Thing. You can also rely on the fact that they're often going to be wrong and even in cases where the Big Scary Thing does happen, the consequences are usually not as dire as hypothesized. Take a look at the image below which shows some of the Big Scary Things over the last ten years against the backdrop of the SPDR Dow Jones Industrial Average ETF's DIA $2 per box PnF chart.



As the DIA chart shows, several Big Scary Things during this period had little or no effect on the market - DIA didn't even reverse down during the 2013 budget sequestration crisis and even with all of the anticipation and speculation before the Brexit referendum, DIA recovered within a month after Britain voted to leave the EU. The largest drawdown DIA experienced over this period was during the August 2015 Chinese stock market crash, yet we can see that DIA was within two boxes of its May high by the beginning of November. If you had hibernated in a cave from last September until this week, you would have missed a pretty extreme down-and-up ride, but, if you judged just by the beginning and ending value of your SPY holdings, it would look like you had missed one of the most uneventful six months in the history of domestic equity market.

The point here is not that bad things or bear markets can't happen or that we'd be better off implementing a pure buy-and-hold strategy. The point is that the headlines aren't a good barometer, and having an objective rules-based system can help you avoid falling prey to the noise, while remaining cognizant of what real signals the market, not the media, are giving you. Keep the DIA chart above handy and pull it out the next time a client calls you up because Jim Cramer says the sky is falling. This one simple picture will provide an effective visual to show how overblown most of the so-called crises really are. You can explain that one of the cardinal sins in investing is letting emotions takeover. It's easy to follow the rules you've set yourself when things are going well, but it's when the going gets rough that we need the rules the most.