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insight.

MONTHLY

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Coping with the current market turmoil

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Stock markets have had more to digest in the past six months than for much of the past decade. A pandemic, war in Europe, inflation and rising interest rates have left investors' nerves frayed. Every time markets have processed one problem, a new one has emerged. Given that there appears no immediate end to the difficulties facing the global economy, how should you respond as an investor?

Short of a miracle in the next few months, 2022 will go down as a year most investors would rather forget. The FTSE All Share is down around 10%[1] for the year to date and there has been a lot of unsettling volatility over that time. At the same time, there have been relatively few places to hide. Many of the winning sectors of the past few years – particularly technology – have been very weak, as have previously 'safe haven' assets such as UK government bonds. Energy, mining and infrastructure companies have been the rare exceptions.

While much of the market volatility has been driven by global problems, like the supply chain disruption caused by the continued fallout of the Covid pandemic and the war in Ukraine, the UK has also been affected by other issues. Chancellor Kwarteng's mini-budget seriously unsettled the UK government bond (gilt) market.

By seeking to marry additional spending with tax cuts, without providing the usual forecast information of how this would be funded, the market anticipated higher borrowing by the UK government and pushed up gilt yields and saw sterling fall to an all-time low against the dollar[2]. This, in turn, pushed up mortgage rates, which are priced from the gilt market, and the speed of the rises also destabilised defined benefit pension funds, which use gilts as an important part of financing their current and future retirement income payments.

The Bank of England acted quickly to restore stability and the Chancellor rowed back on some of his more controversial plans, but the equilibrium appears fragile. At the same time, concern about increasing inflation and the likelihood of further interest rate rises remains, adding to the overall economic uncertainty.

Why it's important to stay invested

Given this gloomy backdrop, the temptation is to sell out of stock markets or at least stop putting any more money in. However, there are several reasons why staying invested during periods of market volatility is important for your long-term finances.

The biggest problem with selling in times of turmoil is timing the market. Most investors don't think about selling out until after markets have fallen a long way, which means they are likely to be selling when sentiment is weakest, crystallising their losses.

In addition, generally private investors don't have a good track record of reinvesting when markets are still low. Stock markets tend to turn a long time before the environment appears to be improving, which makes it difficult to identify the best time to reinvest. During the pandemic, for example, the S&P 500[3] started to change direction in March 2020, eight months before a vaccine had been found. By the time the vaccine offered a way out of lockdowns, markets were higher than they had been in early 2020.

Missing a few key days in markets can be very important. These often come after significant falls. Research from JP Morgan Asset Management showed that someone investing $10,000 in the S&P 500 on 1 Jan 2002 would have a balance of $61,685 if they'd ignored markets and stayed invested. If they'd missed the 10 best days, their investment would be just $28,260[4]. A similar pattern is seen across all markets.

Why you should keep investing

Of course, if your household finances are really under strain then you may need to reconsider your savings plans, but, if you're still building your wealth, there are sound reasons to keep investing through a downturn in markets. It means you will be investing at a lower price point. This helps you achieve a lower average buying point over time, which should improve your returns.

Also, gaps in your regular savings can put a real dent in your long-term savings. Research from life insurer Aegon[5] shows that stopping contributions for just one year at age 25 will save around £622. However, it could put a £7,300 hole in your pension fund at retirement because you miss out on the effects of compounding. A five-year break could knock £42,100 off your pot[6]. It is important not to take any decisions today that will hurt your long-term financial security.

It is worth remembering that when you contribute to a pension, you gain valuable top-ups from the government and, for those in a workplace scheme, your employer. This is essentially 'free' money. For those in England, Wales and Northern Ireland, the government will add 20%, 40% or 45% to your pension contributions in the form of tax relief, while in Scotland it's 21%, 41% and 46%. If you are invested in your employer's pension scheme, they will also add in a minimum of 3% of your salary. If you pause your contributions, you may save a little at the time, but you miss out on a lot which will boost your future pension pot.

Next Steps

Market volatility can be unsettling, especially at the levels we've seen recently, but it is part and parcel of stock market investing. It's worth remembering that stock markets have been shown to outpace cash over time, providing investors with higher returns and better protection against inflation. While the FTSE All Share is down 10% this year, over the last ten years, it has increased by 90%[7].

This recent bout of weakness should not have fundamentally altered your ability to achieve your longer-term financial goals, even if it feels uncomfortable while it is happening. Companies have not lost their power to generate revenues and grow over time and a well-diversified portfolio will take advantage of this fact. But if you are at all concerned about the current market turmoil, or would like to review your investments, you don't need to wait for your annual review. Please contact your adviser, who will be happy to help.

[1]https://www.londonstockexchange.com/indices/ftse-all-share accessed 06/10/22

[2]https://www.cnbc.com/2022/09/26/bank-of-england-monitoring-markets-very-closely-after-pound-falls.html

[3]https://www.marketwatch.com/investing/index/spx

[4]https://www.cnbc.com/2022/03/09/you-may-miss-the-markets-best-days-if-you-sell-amid-high-volatility.html

[5]https://www.aegon.co.uk/news/the_impact_of_pausingyourpensioncontributions.html

[6]https://www.actuarialpost.co.uk/article/think-again-about-taking-a-break-from-pension-contributions-15862.htm

[7]https://www.londonstockexchange.com/indices/ftse-all-share accessed 06/10/22

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