After a rattling start to 2022 – what's ahead?

Managing Your Money

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Have you ever driven from Ontario into Quebec and without noticing the signs you know without a doubt that you've entered Quebec? It goes from a smooth comfortable ride to a rattling from head-to-toe. This is how the markets have transitioned from a smooth 2021 to a bumpy start in 2022.

There are many things contributing to the recent volatility in the stock markets. Inflation, anticipated interest rate hikes, supply chain issues, geopolitical fears, not to mention a global pandemic heading into its third year! Equity markets are 35% higher than before the pandemic, hitting historical highs. There are trillions of dollars in government stimulus in the system which may soon come to an end. Should we be expecting the stock markets to change direction?

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Corrections and bear markets don't follow a predetermined pattern. Markets can turn for any number of reasons. Usually, it's after the fact that a consensus is formed by the financial community as to the likely narrative that caused the markets to turn. This rear-view mirror approach really doesn't help investors, but it's more realistic than crystal ball predictions.

It's not volatility that's the problem when it comes to investing. It's the people who react to volatility based on their emotions – namely fear and greed. Volatility is normal, and healthy in the stock market. One of the issues is that we haven't seen much volatility over the past decade (March 2020 excluded). Investors have become accustomed to a fairly smooth, upwards climb, watching their portfolios mostly grow month after month. So, enter 2022 volatility and it's throwing some investors in for a loop, asking themselves "what's going on!?"

Having been in this industry for all the crashes, corrections, and recessions that happened after 1987's Black Monday, I've experienced this firsthand many times. Depending on your goals as an investor, my advice varies. If you're a short-term trader, these are exciting times. If you're an investor adding money to your portfolio on a regular basis, then this volatility can work in your favor. If you're a long-term investor with a well-structured portfolio, then this volatility should be inconsequential to you. If you're a retiree, and are withdrawing income from your portfolio, then it is essential to have a strategic income plan in place.

Keeping your emotions in check during volatility is probably the single most important thing you can do to avoid disastrous mistakes. If you're selling an investment, ask yourself "Am I selling for good fundamental reasons, or am I scared of losing more money?" (fear). If you're buying, ask yourself "Am I buying because the numbers behind this investment make good sense, or because I think I can make fast money on this investment?" (greed). You don't necessarily need an investment advisor to do well, when it's smooth sailing. But when things turn, it can be very helpful having someone to guide you through the bumps.

Portfolio wise, keep things in check. Make sure you're "properly" diversified. Most people don't think to question their portfolio during good times. I'm always surprised at the number of people who contact me for a 2nd opinion on their portfolio (which they think is well diversified), only to find out that it's not properly diversified at all.

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Be aware of the risks. As we are likely heading for a rate-rising cycle, keep an eye on your fixed income duration. Some of the more popular stocks with extreme valuations faltered in 2021. So, if you've already done well, keep the green in check and take some money off the table. While 'growth' focused investments have dominated this decade, it may be time to start reconsidering 'value' as a more defensive approach. I see many portfolios with a "home-bias", meaning heavy in Canadian equity. Don't neglect other markets. And lastly, if we've learned anything from the "smart money", the institutional investors who manage the largest pension funds in the world, consider including alternative investments into your portfolio. They tend to be noncorrelated to the rollercoaster ride of the public markets, and generally reduce overall risk and increase returns if chosen properly. With all that said, hang on tight, and fasten your seat belt, 2022 might be a bumpy ride.

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