

Which-Way Next?

COMMENTARY
December 2021

Fresh variation in the COVID-19 virus spooked investors over the Thanksgiving holiday. Fears of the virus rather quickly gave way to fears of missing out on further market gains, then turned about again. The u-turns brought these tenets to mind:

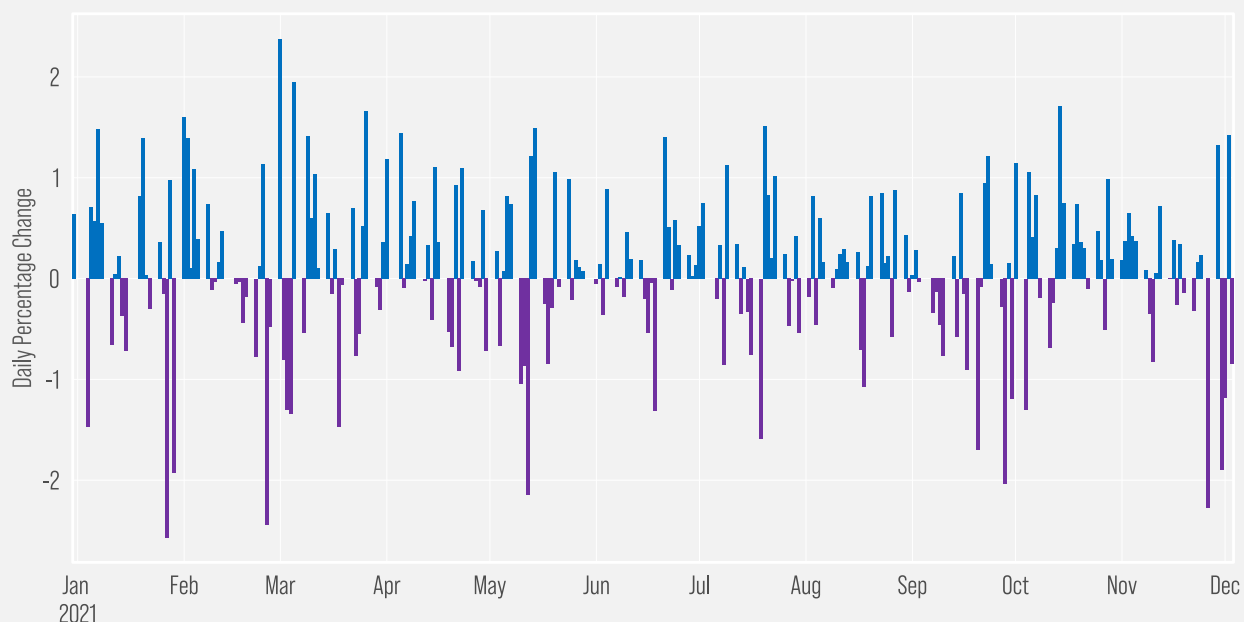
- Even if not presently expressed, investment risk is always present. That is, if for no other reason than we don't know what the future may hold, investing is risky. Still, markets may be surprised when potential risks are realized
- Markets can express unknown risks differently than known risks. And attitudes regarding known risks can shift over time, sometimes quite quickly
- Markets often see quick shifts in fear and greed that can leave long-term thinking at odds with short-term movements
- We think investors are best advised to develop and adhere to long-term plans that take market risk as a given and accommodate exposure near to a comfortable limit

Knees Are Jerking

The new “Omicron” variant of the COVID-19 virus wreaked havoc on risky asset markets the day after Thanksgiving, as investor fear rose on expectations of another Delta variant-like surge in cases, deaths and shutdowns. With those forces on balance likely having negative implications for global growth, the large-cap S&P 500 Index sank 2.27%, while the small-cap S&P 600 Index plunged 3.72%. Domestic stocks followed markets around the globe, which collectively sank 2.3%. Hard to tell if it helped or hurt matters that the U.S. equity market was open only for a half day on account of the Thanksgiving holiday the day prior. Either way, after a weekend of punditry spanning the range of ominous to dismissive, U.S. equities regained a substantial portion of Friday’s losses. But more speculation with regard to Omicron’s potency and a shift in commentary from the Federal Reserve pushed stocks lower yet again. The next day brought another reversal. Should we be expecting a bouncy December?

Figure 1: S&P 500 Index Daily Returns

The last week brought heightened volatility, but the back-forth moves were not out of the ordinary for 2021



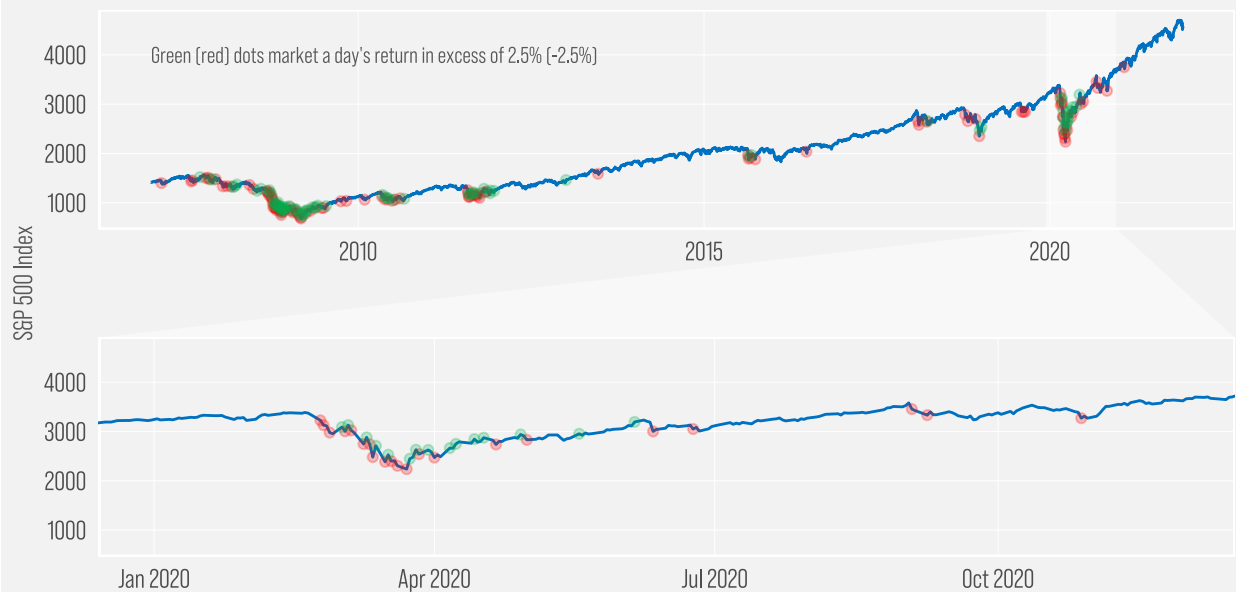
From 12.31.20 to 12.03.21. Price returns, excluding the effects of dividends. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

Knowing is Half the Battle

What’s often interesting (if you care to look at it that way) is how the market expresses unknown risks, versus known ones. And how attitudes shift with regard to known risks over time. When investors achieved seemingly global awareness of the existence of the Omicron variant, they took flight from risk assets in favor of bonds. Some might see this reaction as odd, as the potential for such variation in the virus is not news. Still, news of an actual variant came across as a surprise. Market volatility was no doubt further pushed by the hordes of armchair epidemiologists offering takes as different as hot dogs and apple pie. So, we weren’t too surprised when markets bounced on November 29, nor when they fell anew on the 30th, despite having precious little additional detail regarding the novel variant than they did on Thanksgiving. As we show in Figure 2 (more emphatically using a higher bar of 2.5% for a single day plus-or-minus change in the index), large swings in the market tend to cluster.

Figure 2: S&P 500 Index and Big Up/Down Days

Big up and down days tend to occur near each other. Already well into the drawdown, we generally find it best to stay true to longer-term investment plans, as timing reentry into the market can prove the more challenging decision



From 01.03.07 to 12.03.21. Price returns, excluding the effects of dividends. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

Mid-Day Reversal a Rehearsal?

A good bit more interesting from the “I wonder what’s next?” angle was the December 1st trading day. Up almost 1.9% a bit before east coast lunchtime, the S&P 500 proceeded to stall then plummet through the close to end the day down almost 1.2%. We were reminded by a story on the Bloomberg that such reversals have been pretty rare. And those days have tended to come about during times, nor surprisingly, of market tumult. It would be easy to extrapolate the day’s data and suggest we may be in for a December to remember. Whether it’s a repeat of 2018 (down 9.0%) or 2010 (up 6.7%) we shall see.

In advance of the eventual tally, there’s actually little reason, we think, to be too sanguine about market prospects through year end and into 2022, even as there are fair rationales to remain optimistic. The confluence of stresses this week set the stage for 2022. First, the Federal Reserve faces an increasingly challenging task of balancing monetary support of full employment with price stability amidst more persistent-than-expected inflation. Fed choices are further tested by the potential for fresh waves of coronavirus variants that may threaten to derail growth and dampen

employment by limiting both the availability of and the interest in job openings. And we must remember that even if Omicron doesn't turn out to be all that worse (in all the ways that the virus can be) than Delta or its predecessors, there's still the possibility (some will say likelihood) that a worse mutation may emerge at some point.

That is, the risk will remain there, even if investors occasionally seem to have forgotten that fact. And therein lies the moral of the commentary. The past few years have proved monumentally positive for long-term-focused investors. And we continue to believe that equity markets will reward patient investors over time. But we must remember that, in exchange such reward, we must be ready to accept short- and medium-term setbacks along the way.

Notes from our December 2017 commentary come to mind:

Folks believing markets are richly valued and due for a dump may be proved prescient. And folks singing a chorus of "we've only just begun" could see yet another year of bumper returns. ... The current year, of course, is not yet over, so there's still time for tunes to change. We should trust that while thoughtful, reasonable opinions regarding the range of potential drivers for market performance abound, many are possible and none is assured. And so, we turn again to the primary question we should ask ourselves when it comes to establishing a level of exposure to market risk: how much can we stomach?

As always, we think a trusted financial advisor can be of great help in answering that question. Please be sure to reach out to your advisor where you wish to discuss your exposure to investment risk. And please let your advisor know if any details regarding your financial situation have changed.

Happy New Year!

As we close out another year, all of us at SRCM wish to thank you all for your continued trust in our work and your patience in our efforts to seek more positive outcomes in your investments. Well-wishes to all for a festive and healthy finish to 2021 and a grand launch into 2022.

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