# Stay on Track

## Why You Shouldn’t Get Derailed by This Market Environment

Cetera® Investment Management LLC

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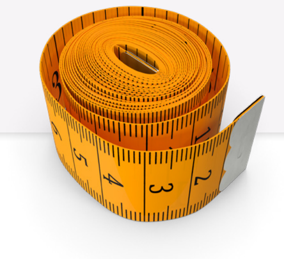
It’s hard to believe, but we are fast approaching the mid-point of the year. The temperature is rising, and you might be feeling the heat when thinking about those ambitious goals you made back in January. If you’re like most, you may have gotten off track a few weeks into 2023. But don’t worry, it’s never too late to get back on track.

For many, improving financial health is a primary goal for the year. And if you need inspiration, this commentary is for you. **While the market landscape over the last year and a half may have caused a lot of jitters, there are many reasons why you shouldn’t let it derail your investment goals.** We will get into that, but first, let’s examine how we got here.

*“Your outcomes are a lagging measure of your habits. Your net worth is a lagging measure of your financial habits.”*[3]

***It can pay to have good financial habits.***

***Literally.***



## Getting Back on Track


**Most New Year’s resolutions are abandoned by January 19.** Lack of willpower, forgetfulness, and laziness are the most common reasons cited.[1]


**The most popular resolutions include eating healthier, exercising more, and getting finances in order.**[1] The first two make sense timing wise since new year’s closes out the winter holidays. With warmer weather and beach season at our doorsteps, it’s a good time to get back on track!

A desire to focus on healthy eating, exercise, and personal finance is generally a good idea. **For a 65-year-old couple, there is a 76% chance that at least one partner lives to 85 and a 50% chance that one partner will live to 90.**[2] Good physical and financial health will improve one’s quality of life in the golden years.

**One of the most effective ways to help reach your goals is by creating new habits.** Building good habits creates consistency, which can lead to improvement. In “Atomic Habits,” author James Clear points out that, “improving by 1 percent each day isn’t particularly notable, but it can be far more meaningful in the long run.”[3] The power of compounding can impact all of your goals, whether they are related to your finance, fitness or diet.

## How We Got Here

The last 18 months have been challenging for investors. Looking back at the start of last year, the S&P 500 hit its only record high of 2022 on the first trading day of the year. In contrast, this happened 70 times in 2021. Momentum was strong and so was market exuberance. Unfortunately, asset prices and sentiment changed quickly. Valuations were frothy for stocks and bonds at the start of 2022, leaving these assets vulnerable to disruption.

Russia invaded Ukraine that February, adding to geopolitical tensions and fueling additional inflationary pressures. Inflation eventually rose to a 41-year high of 9.1% last summer. To combat inflation, the U.S. Federal Reserve (the Fed) increased interest rates at the fastest pace in over 40 years. Corporate earnings slowed quickly, eventually reaching negative growth. Real gross domestic product (GDP) contracted in the first half of 2022 and fears of widespread economic decline rattled investor sentiment. The cumulative effects of these factors pushed stocks and bonds into a bear market.

Both stocks and bonds have rebounded from the lows, but we are by no means out of the woods yet. Even the Fed is concerned that recent issues in the banking sector could lead to a mild recession later this year. That is a lot to unpack, and the heightened fear brought on by these issues can easily derail an investor. We feel that staying invested is prudent, even in this market environment. Two of the most important rules of investing are to stay diversified and stick to target risk guidelines. If you are cautious about this market landscape, we will outline three reasons why it's important to stay invested in the market.

## Too Much Negativity

Heightened pessimism drove expectations for stock markets and the economy lower. The American Association of Individual Investors conducts a weekly poll to gauge market sentiment. From the start of January 2022 through April 2023, there were more bears (negative sentiment) than bulls (positive sentiment) in 66 out of 69 weeks, including one stretch of 44 consecutive weeks of net-bearish sentiment. Similarly, consumer confidence plummeted. At the low last June, consumer sentiment was below the worst levels of the 2008 financial crisis. Consumer confidence has since risen above those lows, but it's still below the pandemic shutdown period. There is a lot of wisdom in the market expression, "beware of the crowd at extremes." These extreme readings can be a contrarian indicator.

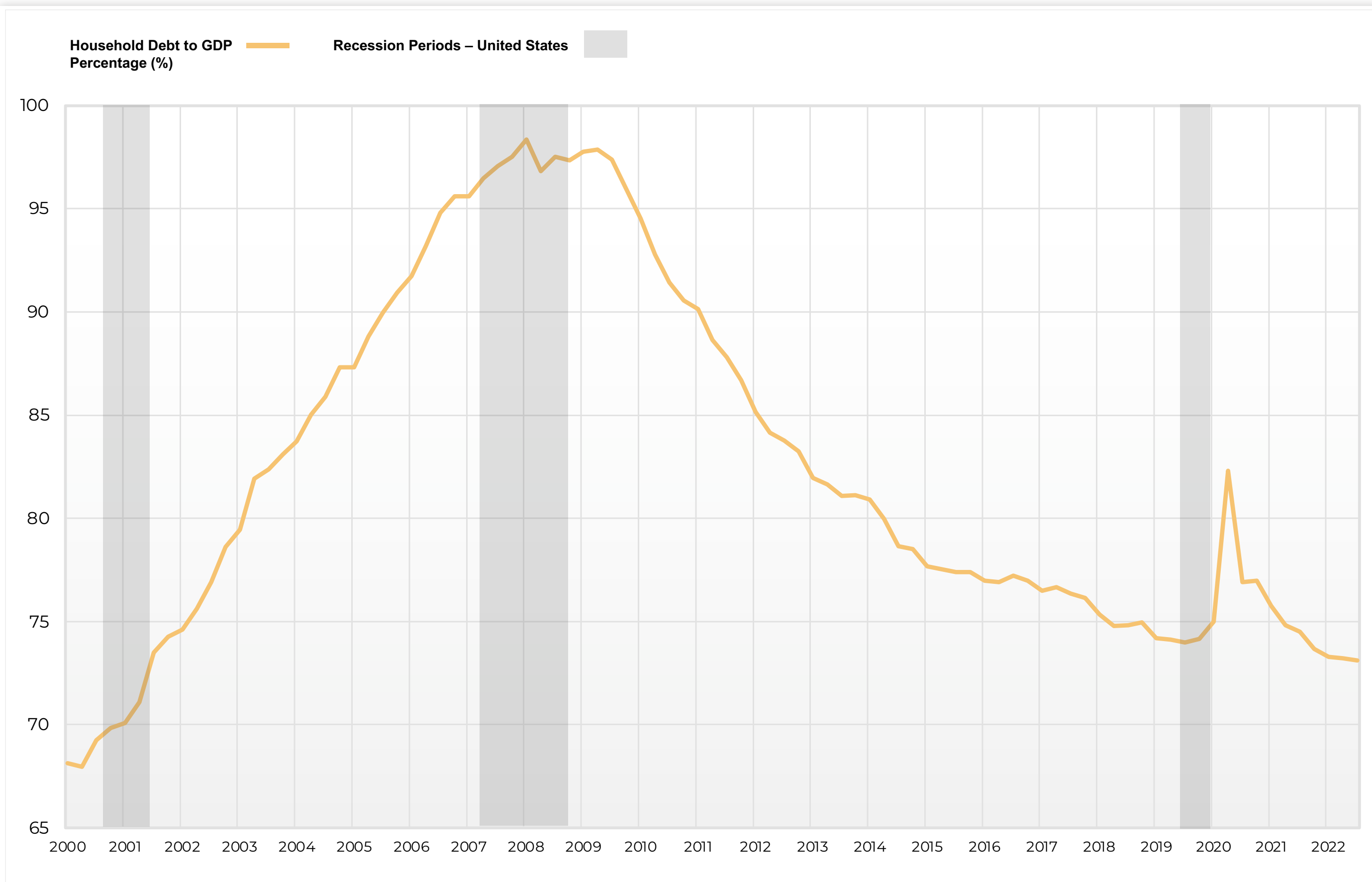
Expectations have gotten outright lousy, creating an easier hurdle to clear for markets and the economy. Even if things are bad, markets can still rise. Markets are also forward looking, and assets are priced based on what's six to nine months down the road. That explains why markets typically bottom before a recession is over, in advance of the actual rebound in the economy.

## We Don't Anticipate a Severe Recession

Inflation rose to the highest level since 1981 last year. The good news is the pace of inflation is slowing and leading indicators are pointing to continued disinflation in the economy. The Fed increased rates at breakneck speed, pushing the Fed funds rate to the highest level in 16 years. The Fed's interest rate policy will likely keep a ceiling on inflationary pressures, though the risk of a recession is also higher, particularly when combined with the fact that tighter lending conditions will result from banking-sector turmoil. That doesn't mean we are assured of a recession in the months ahead. The result could be a slow crawl for the economy.

If we get a recession, we think it will likely be mild, and one can argue that it may have already been fully priced into equity prices based on last year's 25% drawdown for the S&P 500. The contraction was even more severe for small cap stocks, as measured by the 32% drawdown for the Russell 2000 at the index cycle low last summer. Consumer balance sheets are in much better shape than where we were heading into the 2008 financial crisis (Figure 1) and the labor market is still growing at a healthy pace, although job growth is moderating. Job listings remain above pre-pandemic levels and continue to outnumber unemployed job seekers.

**Figure 1:** Household Debt to GDP




Source: Cetera Investment Management, FactSet, Bank for International Settlements, U.S. Bureau of Economic Analysis. Data as of 9/30/2022.

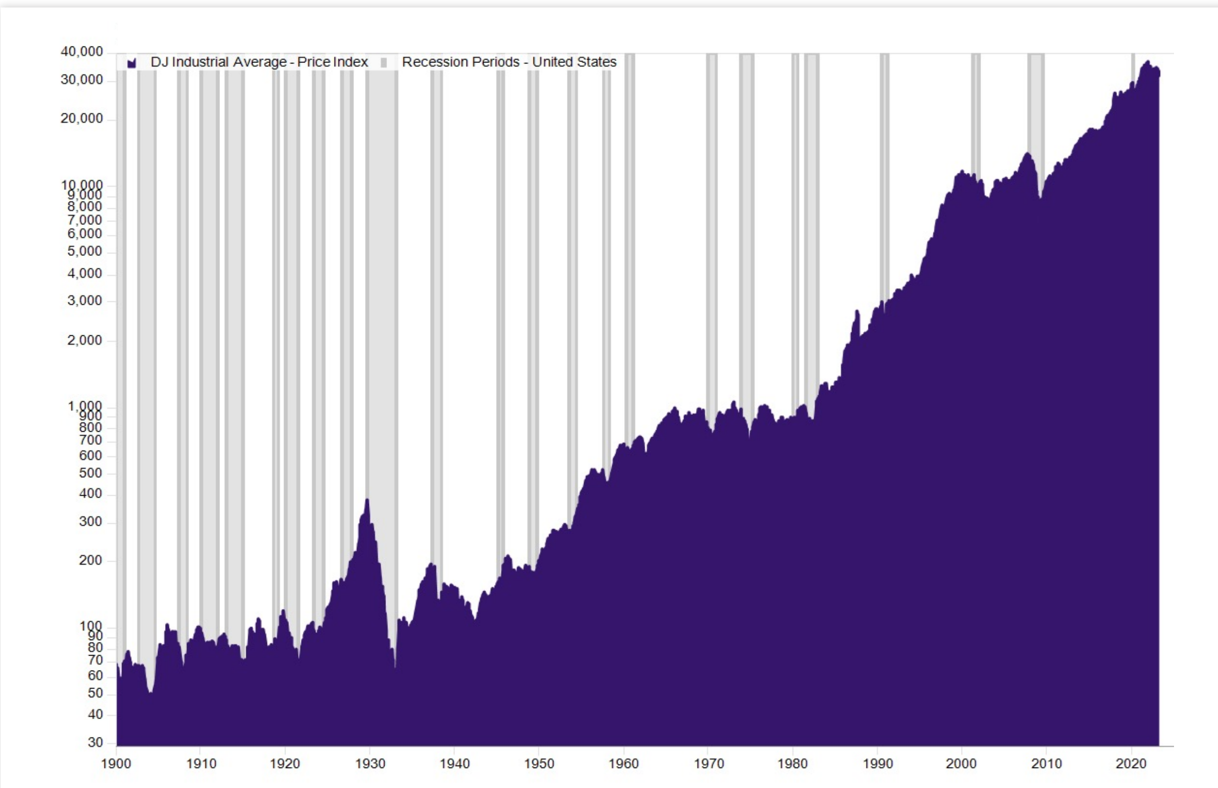
Markets are forward looking and have already been recovering since last year's low. Both the S&P 500 and Bloomberg Aggregate Bond Index are off to a positive start to the year following double-digit declines in 2022. As markets look forward, there is likely one less battle to fight: the Federal Reserve. "Don't fight the Fed" is an old market adage and it proved correct last year, with most major asset classes suffering a loss as the Fed hiked interest rates. Stocks and bonds are pricing in an end to the rate hike cycle, with bond yields easing and stock prices up.

A recession could follow, though the economy may be experiencing a rolling recession, as opposed to a broad-based contraction of the whole economy. Housing, manufacturing and tech were the first dominoes to fall from rising interest rates, but there are signs of an early recovery in these sectors. Commercial real estate, autos and multi-family housing could be next. That said, record construction spending on manufacturing facilities and infrastructure projects could offset weakness in those areas as funds from the 2021 Infrastructure and Jobs Act ($1.2 trillion) and the 2022 CHIPs and Science Act ($280 billion) are dispersed into the economy. The labor market has been resilient thus far, and the housing market doesn't have the same risk profile as 2008. Nobody knows for sure if the worst is behind us. However, the next several months also might not be as bad as many expect.

## Benefits of Long-Term Investing

With a long enough timeframe, there is usually light at the end of the tunnel for investors. Since 1900, there have been 24 recessions, two world wars, two severe global pandemics and countless negative headlines. While certainly not in a straight line, the stock market kept pushing higher through it all.

**Figure 2:** Dow Jones Industrial Average




Source: Cetera Investment Management, FactSet, Dow Jones. Log Scale. Data as of 4/30/2023.

Focusing on negative headlines can push investors to the sidelines. Most of the negativity can be noise and that's why it's wise to focus on "time in the market" as opposed to "timing the market." In other words, you must have a long-term mindset, as trying to time the market can nullify the benefits of time *in* the market. Investors often get most anxious after a big decline in the stock market, after the worst is typically over. But it can be a huge mistake to exit the market after a huge drawdown in asset prices. This can put an investor at the disadvantage of losing out on potential gains during a stock market recovery.

According to research from J.P. Morgan, from 2003 to 2022, seven of the 10 best days for the stock market were within two weeks of the 10 worst days for the market. Missing out on the biggest gains can have a profound impact on long-term returns. The annualized return from 2003 to 2022 was 9.8%, but the return drops to 5.6% annualized if an investor missed out on the 10 best days. With an initial investment of $10,000 at the beginning of that 20-year period, that equates to an ending balance of $64,888 for an investor that stayed in the market, but that figure dropped by more than half to $29,708 if an investor was on the sidelines for the 10 best days (J.P. Morgan).

Having a long-term mindset can serve investors well over the long run because of the power of compounding, which works best when we get out of our own way. One example is Warren Buffett's net worth. Warren Buffett is 92 years old, and his net worth is a staggering $109 billion dollars. At age 52, he had a net worth of $376 million. Nearly all his wealth, or more than 99%, was gained after he turned 50.[4] Mr. Buffett had superior investment acumen, but the impact of compounding and longevity were big drivers of his net worth growing so much after the age of 50.

You don't have to be Warren Buffett to benefit from compounding though. A $10,000 investment that tracked the S&P 500 starting in January 1990 is a good example. With dividend reinvestment, the original $10,000 would have accrued to $53,280 by January 2000. By January 2020, the value would have been $172,730. By the start of this year, the accrued value would have risen to $215,550, or more than 21 times the original value.* All of this happened despite recessions, bear markets, and long stretches of elevated volatility. Time in the market requires patience and avoiding the urge to not time the market.

*Past returns are no guarantee of future results.

## Always Have a Plan

Whether you are trying to stay on track or get back on track, your probability of success will increase if you have a plan. Your financial professional can help. We are near the mid-point of the year, so it makes sense for a mid-year checkup. Your financial health needs a periodic checkup in case any adjustments or fine tuning are needed. Many investors are nervous about markets. Even in bull markets, stocks must climb the wall of worry. Market declines and volatility are a normal part of investing, so it's important to look past the short-term headlines and focus on the long-term. The stock market is resilient over the long run and it's critical to not get derailed by this (or any) market environment. Remember to stay on track to achieve your financial goals. From the Cetera Investment Management team, we hope you have a great summer!

*For more, follow @CeteraIM on Twitter*

[1] https://www.chamberofcommerce.org/top-new-years-resolutions

[2] J.P. Morgan Asset Management 2023 Guide to Retirement, Social Security Administration, American Academy of Actuaries and Society Actuaries, Actuaries Longevity Illustrator.

[3] Clear, J. (2018). Atomic Habits. An Easy & Proven Way to Build Good Habits & Break Bad Ones. New York: Penguin Random House

[4] https://finmasters.com/warren-buffett-net-worth/#gref

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A diversified portfolio does not assure a profit or protect against loss in a declining market

**Glossary**

**The S&P 500** is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

**The Russell 2000 index** is comprised of 2000 small-capitalization companies. It is made up of the bottom two-thirds in company size of the Russell 3000 index.

**The Bloomberg US Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. Eligible bonds must have at least one year until final maturity, but the index holdings have a fluctuating average life of around 8.25 years. This total return index is unhedged and rebalances monthly.

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