Why Investors Shouldn't Overreact to Recent Headlines

We're only a few weeks into the new year and global headlines have already begun to rattle markets. As of Monday's open, U.S. markets had pulled back about 2.5% from recent peaks while interest rates had declined by about one-third of a percent from the start of the year. While recent news on the spread of coronavirus in China and abroad has created an environment of uncertainty, it's more important than ever for investors to maintain a long-term perspective. After all, while this public health issue can be scary, it is but one of the many storylines that matter to investors right now.

For long-term investors, there are two important ways to analyze any worrisome headline. First, it's necessary to consider the longer-term economic impact of recent events. While the outbreak of coronavirus could reduce economic activity for a short time, especially in China, history suggests that not only is this very difficult to measure, but that the market impact can be limited if the outbreak is ultimately contained.

For instance, the SARS epidemic of the early 2000's is estimated to have reduced economic activity in range of tens of billions of U.S. dollars, and possibly reduced Chinese GDP by up to 1%. While these are not small numbers, today they are in the context of the U.S. economy generating over $20 *trillion* per year and the Chinese economy growing by over 6% per year.

From a market perspective, the SARS episode occurred in the wake of the dot-com crash which had a much larger impact on markets. The same is true of more recent Ebola outbreaks which, fortunately, were also contained and thus had minimal effects on investment returns.

A similar argument could be made for geopolitical risks as well. Recent tensions with Iran resulted in only a brief period of market turbulence. Whether headlines involve Iran, North Korean missile tests, Russia's annexation of Crimea or other geopolitical events, there will always be global events at play.

Thus, the second, broader way to view these headlines is to realize that there will always be concerns that drive market uncertainty. Whether these are related to public health

crises, geopolitical tensions, trade wars, central bank policies or other concerns, investors will always find reasons to view the glass as half empty. Yet, over the long run, continuing economic growth can drive investment returns despite these headlines. Even though there have been too many negative headlines to count over the past decade, the U.S. stock market has risen almost 400% since 2009.

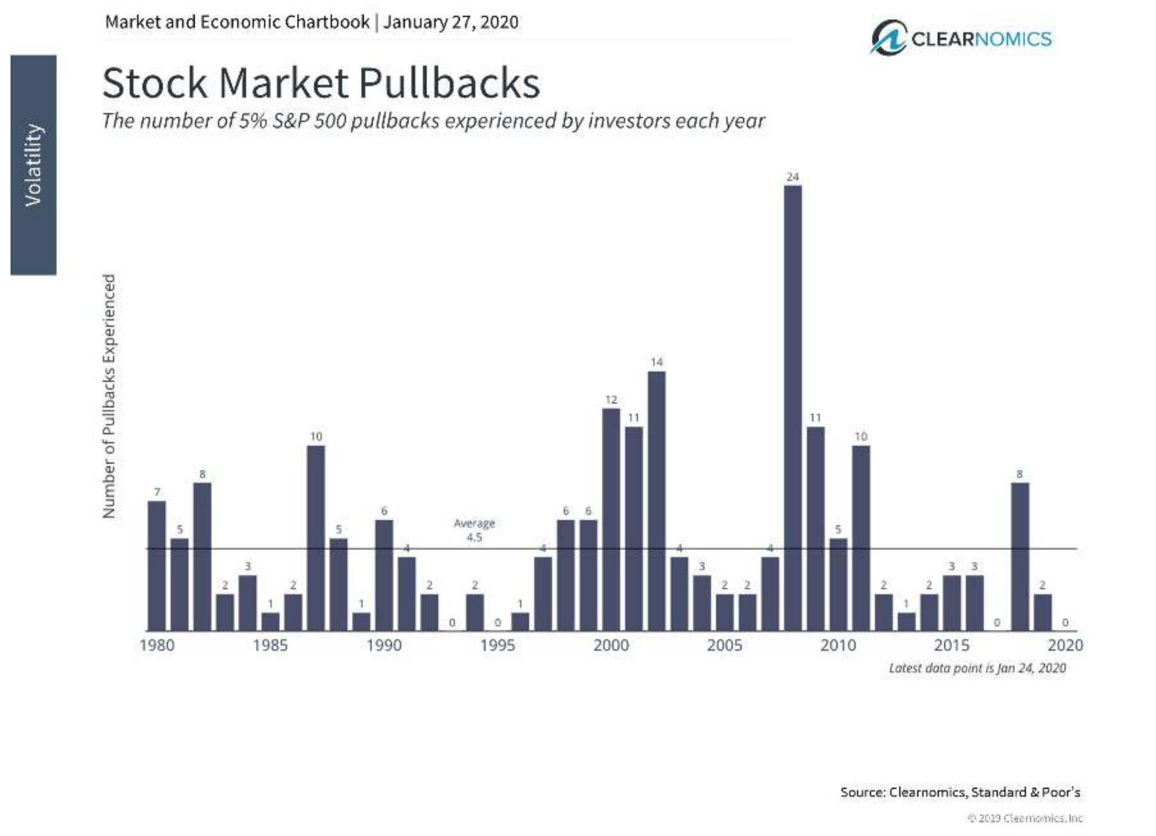
Thus, what should not affect the decision-making of long-term investors is how the market is currently reacting to a news story. Of course, this is not to say that markets only move up. In fact, after the strong returns of 2019, market valuations are near their highest point this cycle, and volatility at the start of this year was extremely low.

However, history tells us that those investors who can be disciplined and see past short-term volatility are often rewarded. Attempting to jump in and out of markets often does more harm than good. Instead, staying invested, especially in diversified portfolios, can help investors navigate any bumps along the way.

Below are three charts that put the recent market reaction in perspective:

1. It’s normal for markets to experience several market pullbacks each year

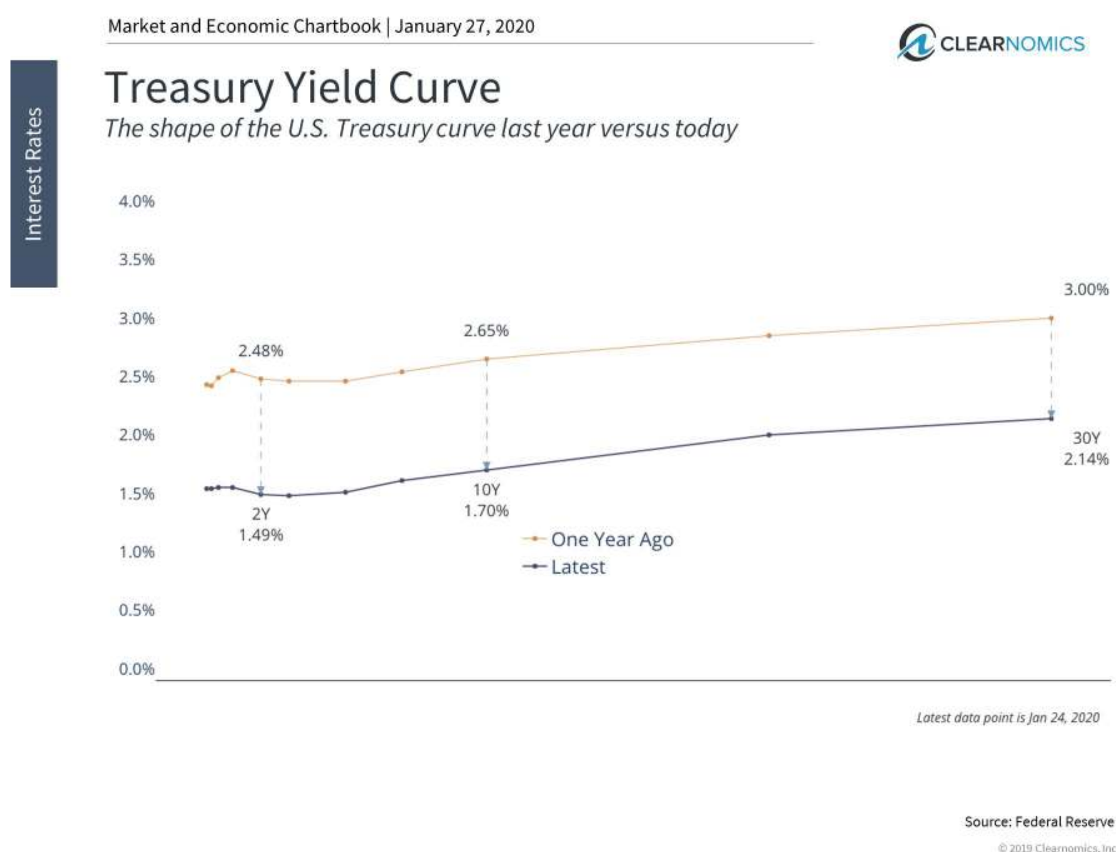
Total Returns and Pullbacks
Find this chart under "Volatility and Staying Invested"



Not only is it normal for stock markets to be volatile, but it's one reason that investors are rewarded for staying patient over the long run. The average year experiences several pullbacks of 5% or worse. Even a terrific market year like 2019 experienced two of these pullbacks. At the moment, recent market volatility is still quite low from a historical standpoint.

2. Interest rates have fallen further this year

Treasury Yield Curve
Find this chart under "Interest Rates"



Interest rates have fallen this year. In fact, the 10-year Treasury yield is now below its levels prior to the 2016 presidential election. While this is a negative economic signal, it also means that rising fixed income prices have helped to stabilize investor portfolios.

The fact that yields have been low for over a decade has made it difficult for investors to generate portfolio income. However, the bright side is that lower interest rates are generally positive for consumers and borrowers. For instance, the 30-year mortgage rate is averaging about 3.6% nationwide. This has helped to support the housing market and has made it worthwhile for many homeowners to refinance.

3. The typical market correction recovers within months

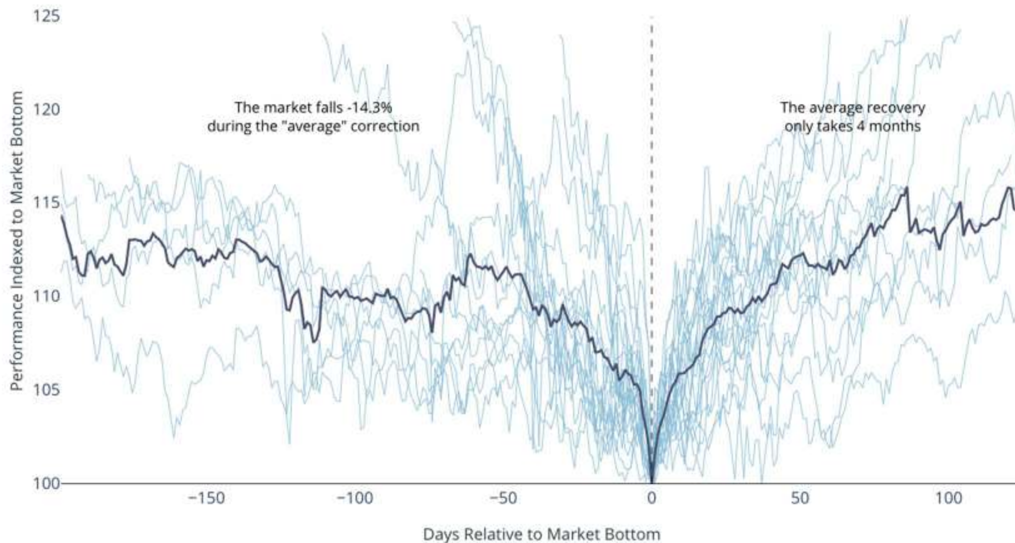
Market Corrections and Recoveries
Find this chart under "Volatility and Staying Invested"

Market and Economic Chartbook | January 27, 2020

U.S. Stock Market

Market Corrections and Recoveries

S&P 500 total returns since World War II. Market corrections are peak-to-trough declines of 10% to 20%. The bold line is an average across all corrections.



Source: Clearnomics, Standard & Poor's
© 2019 Clearnomics, Inc.

Stock market pullbacks can feel scary for many investors. Market corrections - i.e. pullbacks greater than 10% - can occur quite often. Yet, markets also tend to rebound quickly if the economy is still healthy. On average, markets are able to recover from these corrections within 4 months. Coincidentally, this is exactly what happened after the market correction of late-2018.

The bottom line? It's more important than ever for investors to stay disciplined and not over-react to recent headlines.