The plunge in shares and flow on to Super
Key things for investors to keep in mind

Antipodean Advisory

June 2022

Key points:

> Share markets have fallen sharply in recent weeks continuing the plunge that started early this year due to worries about inflation, monetary tightening, recession and geopolitical issues including the invasion of Ukraine.

> It's still too early to say markets have bottomed.

> This will weigh on super returns for this financial year.

Introduction

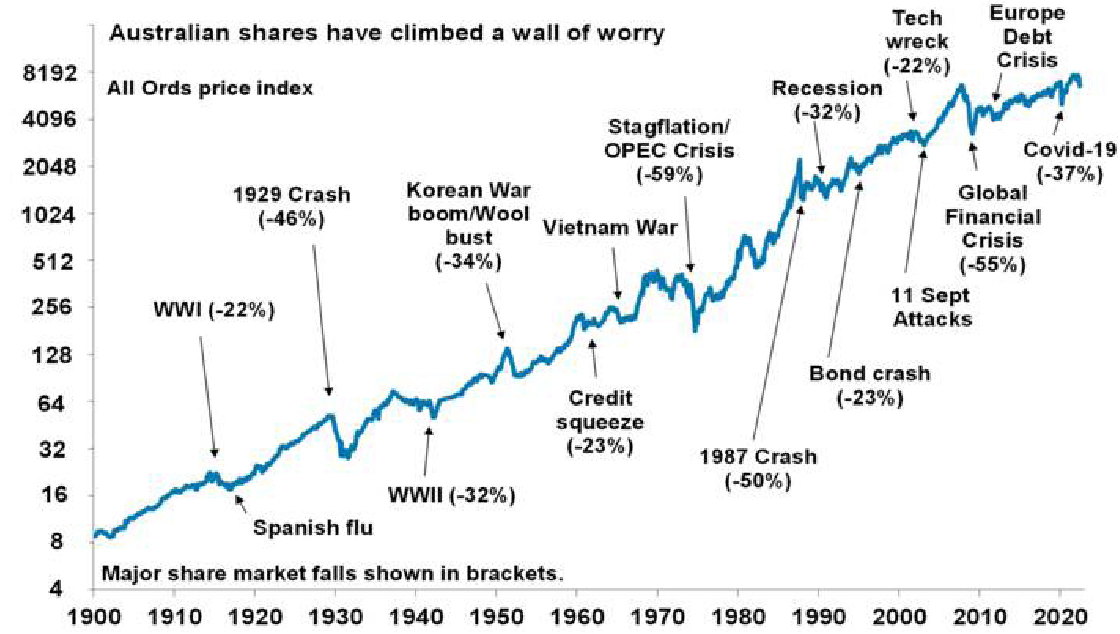
Usually share markets are relatively calm and so don't generate a lot of attention. But periodically they tumble and generate headlines like "billions wiped off share market" and "biggest share plunge since…" Sometimes it ends quickly and the market heads back up again and is forgotten about. But once every so often share markets keep falling for a while. Sometimes the falls are foreseeable (usually after a run of strong gains), but rarely are they forecastable.

From their all-time highs to their lows in the past week US shares have now fallen 24%, global shares have fallen 21%, and Australian shares have fallen 16%.

What's driving the plunge in share markets

The key drivers of the fall in shares remain:

- Shares had very strong gains from their March 2020 lows and speculative froth had become evident in tech stocks, meme stocks and crypto, and this left them vulnerable.
- High and still rising inflation flowing from pandemic distortions made worse by the war in Ukraine and Chinese lockdowns. US inflation rose further in May to 8.6%, its over 8% in Europe and looks to be on its way to 7% or so in Australia (not helped by our own electricity crisis and floods).
- The ongoing upside surprises on inflation have seen central banks become more aggressively focussed on pulling it back down and so stepping up the pace of rate hikes with the US hiking by 0.75% last week; Canada, NZ and the UK all continuing to raise interest rates; the ECB moving towards rate hikes from July; and the RBA hiking rates by 0.5%.
- The increasing aggressiveness of central banks in the face of higher inflation is in turn raising the risk of triggering a recession, which could depress company profits.
- Rising bond yields in response to rising inflation and central bank tightening is adding to the pressure on share markets by making them look relatively less attractive which is driving lower price to earnings multiples.
- The ongoing war in Ukraine along with tensions with China are adding to the risks.
- As always, the most speculative "assets" are getting hit the hardest including the pandemic winners of tech stocks (with Nasdaq having fallen 34%) and crypto currencies (with Bitcoin down 70% from its high last year). Crypto currencies surged with semi religious fervour around the claimed marvels of blockchain, decentralised finance, NFTs, freedom from government, an inflation hedge, etc, only to become a speculative bandwagon fuelled by easy money and low interest rates. Trying to disentangle its true fundamental value from the speculative mania became next to impossible. And now the easy money and low rates are reversing, pulling the rug out from under the mania and driving mishaps along the way (eg, Terra, Celsius Network and Babel Finance). Fortunately, the exposure of major banks and mainstream investors to crypto is still relatively low so this is unlikely to be another GFC moment.



Source: ASX/AMP

Reflecting the sharp falls in share markets and in fixed interest investments (which suffer a capital loss as bond yields rise) balanced growth superannuation funds are down by 5% or so for this financial year to date and are on track for their first financial year loss since 2019-20 (due to the pandemic) and their worst financial year loss since the GFC.

Key things for investors to bear in mind

Sharp market falls are stressful for investors as no one likes to see their investments (including their super) fall in value. But there are some key things investors should keep in mind:

First, while they unfold differently, periodic share market corrections and occasional bear markets (which are usually defined as falls greater than 20%) are a normal part of investing in shares. For example, the last decade regularly saw major pullbacks and rolling 12 month returns from shares have regularly gone through negative periods.

While falls can be painful, they are healthy as they help limit excessive risk taking. Related to this, shares climb a wall of worry over many years with numerous events dragging them down periodically, but with the long-term trend ultimately up and providing higher returns than other more stable assets.

Second, historically, the main driver of whether we see a correction (a fall of say 5% to 15%) or even a mild bear market (with say a 20% or so decline that turns around relatively quickly like we saw in 2015-2016 in Australia – which may be called a "gummy bear market") as opposed to a major ("grizzly") bear market (like that seen in the mid-1970s or the global financial crisis when shares fell by around 55%) is whether we see a recession or not – notably in the US, as the US share market tends to lead most major global markets.

We remain of the view that a global recession can be avoided - if inflation starts to slow later this year or early next (as supply improves) taking pressure off central banks and in Australia as growth initially cools faster than expected (as the plunge in consumer confidence suggest that it will) putting a cap on how much the RBA needs to hike interest rates allowing it to avoid triggering a recession. But with inflation still surprising on the upside and central banks hiking rates aggressively the risks have increased to the point that its now a very close call. Either way it's still too early to say that shares have bottomed.

Of course, short-term forecasting is fraught with difficulty and should not be the basis for a long-term investment strategy, so it's better to stick to long term investment principles.

Third, selling shares or switching to a more conservative superannuation investment strategy whenever shares fall sharply just turns a paper loss into a real loss with no hope of recovering. Even if you get out and miss a further fall, the risk is that you won't feel confident to get back in until long after the market has fully recovered. The best way to guard against deciding to sell on the basis of emotion after falls in markets is to adopt a well thought out, long-term strategy and stick to it.

Fourth, when shares fall, they're cheaper and offer higher long-term return prospects. So, the key is to look for opportunities' pullbacks provide. It's impossible to time the bottom but one way to do it is to "average in" over time. Fortunately, the Australian superannuation system does just that by regularly putting money into shares for workers (via their super) effectively taking advantage of the fact they are cheaper.

Fifth, while share prices have fallen dividends have not and so the dividend yield has increased. Australian shares are offering a very attractive dividend yield compared to bank deposits despite rising deposit rates. Companies don't like to cut their dividends, so the income flow you are receiving from a well-diversified portfolio of shares is likely to remain attractive.

Sixth, shares and other related assets often bottom at the point of maximum bearishness, ie, just when you and everyone else feel most negative towards them. So, the trick is to buck the crowd. "Be fearful when others are greedy. Be greedy when others are fearful," as Warren Buffett said.

Finally, turn down the noise. At times of uncertainty like now, the flow of negative news reaches fever pitch. Talk of billions wiped off share markets and of "crashes" help sell copy and generate clicks. But less newsy are the billions that market rebounds and the rising long-term trend in share prices add to the share market. Moreover, they provide no perspective and only add to the sense of panic.

Further information

For more information please contact Michael Clapham on 1300 101 250 or michael@antipodeanadvisory.com