Despite Short-term Volatility, Long-term Returns are Worth the Wait

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In the past week, media pundits have elaborated on how "new millennial investors" are responsible for the majority of "Robinhood" trades (Robinhood is a new online stock broker, only accessible through a mobile app, that allows the purchase of stocks and ETFs with no commissions or fees on transactions. Robinhood is a completely free trading platform where anyone can buy stocks and ETFs). The sudden surge of these trades has exacerbated recent volatility in equity markets---mostly to the upside for the "Big 5" (otherwise nicknamed FAANG stocks). Over the past two weeks, the NASDAQ was the biggest recipient of this volatility as reflected in the index's price decline of more than 7% putting this index into correction territory. The S&P 500 index, which represents a much broader array of industries and sectors, is only down roughly 3.8% for the past 14 days leaving year-to-date returns at 4.89%. Does this short-term volatility matter in the grand scheme of investing for the long-term? History tells us that such volatility is dissipated over time.

Most professional investors recognize the importance of having a long-term perspective. We do too! As an investment team with over 80 years of combined investment experience and working together since 1991, we know all too well about these temporary declines. Most of our private clients have been with us through both the tech meltdown of 2000-2002 and the financial depression of 2008-2009. During both crises, our disciplined investment process led us to raise 100% cash. This decision was not top down (otherwise known as market timing) but based upon our bottom-up fundamental analysis of individual securities and the lack of investment options to populate our Approved List.

We did not react to the recent stock market plunge as it was sudden and forced upon the markets by the government's decision to shut down the economy. There was no warning as there was in 2000 and 2008 when the deteriorating economic environment occurred over time and was not a sudden event. We would use the analogy of an earthquake versus a hurricane. Prior to the onset of the coronavirus and the subsequent lockdown, the economy was doing exceptionally well. We expected that when the coronavirus was defeated, the U.S. would get back to a normal economy and normal financial markets. Events over the past few months provide some evidence that we are back on the right track. For example, estimates for third quarter gross domestic product (GDP), a broad measure of the growth of the economy, is estimated to be the greatest growth rate on record at somewhere between 25-30%. Further economic growth is likely as more states open in the face of a declining number of coronavirus cases. The equity markets have rebounded but with divergent performance. For example, large capitalization growth stocks have rallied 40% since the low point in March while value stocks have lagged by an appreciable amount. The big market rally could come from the successful discovery of the coronavirus vaccine. The growth theme remains prevalent but, due to the sharp surge in growth stocks, there was likely to be some normal retracement of gains. The retracement came in the last two weeks as we mentioned earlier. Further profit taking is likely during the month of October and into the election. We do not see such short-term volatility as an indicator that financial markets will fall back to where they were in March or anywhere close. Remember that the initial market collapse was engineered by the government and not by a general deterioration of the economy. However, on a day-to-day basis, there might be some wider swings, both up and down between now and yearend.