PRATO CAPITAL

Volatility Returns

February 2022

Since the start of 2022, the news headlines have been dominated by stories of international, domestic, and economic issues. The investor sees the impact of these headlines with the recent volatility of the stock market.

Uncertainty

This year has started off with news headlines of upcoming interest rate hikes, high rates of inflation and potential conflict involving Russia and Ukraine. Often the stock markets react with volatility to the uncertainties of these headlines. And we have seen increased stock market volatility so far this year. In January, the difference between some daily highs and lows have been as high as 5%.

The response of the financial media outlets is to feature analysts, fund managers and commentators willing to make stock market and economic predictions with all this uncertainty, many of whom are making negative, sometimes very dire, forecasts for stocks and investors. One in particular, Jeremy Grantham, has been on many of the financial news outlets predicting the “popping” of the stock market “super bubble.” Mr. Grantham was originally noted for predicting the bear market of 2001 and the housing crisis of 2008. What is left out of many of these conversations is all of the other stock market crashes and declines he has called over the years that didn’t happen. In a November 2010 interview[1], he predicted sharp declines for 2011 and 2012. Since that interview, the S&P 500 has risen 348%. He has also called for stock market declines in 2018, 2020, and 2021. He has called many declines so far, and eventually he may be right. But in the meantime, the S&P 500 has risen 75% since the beginning of 2018, 39% since 2020, and 17.5% since 2021[2]. This is not meant to single out Mr. Grantham for his stock predictions because he is just one of many to do so.

At Prato Capital, we have written many times about just how wrong stock predictions turn out. Many will offer an opinion, but the reality is no one can predict what will happen next week, next month or next year.

1. CNBC interview with Maria Bartiromo, November 11, 2010. https://www.cnbc.com/2010/11/11/full-transcript-jeremy-grantham-interview.html

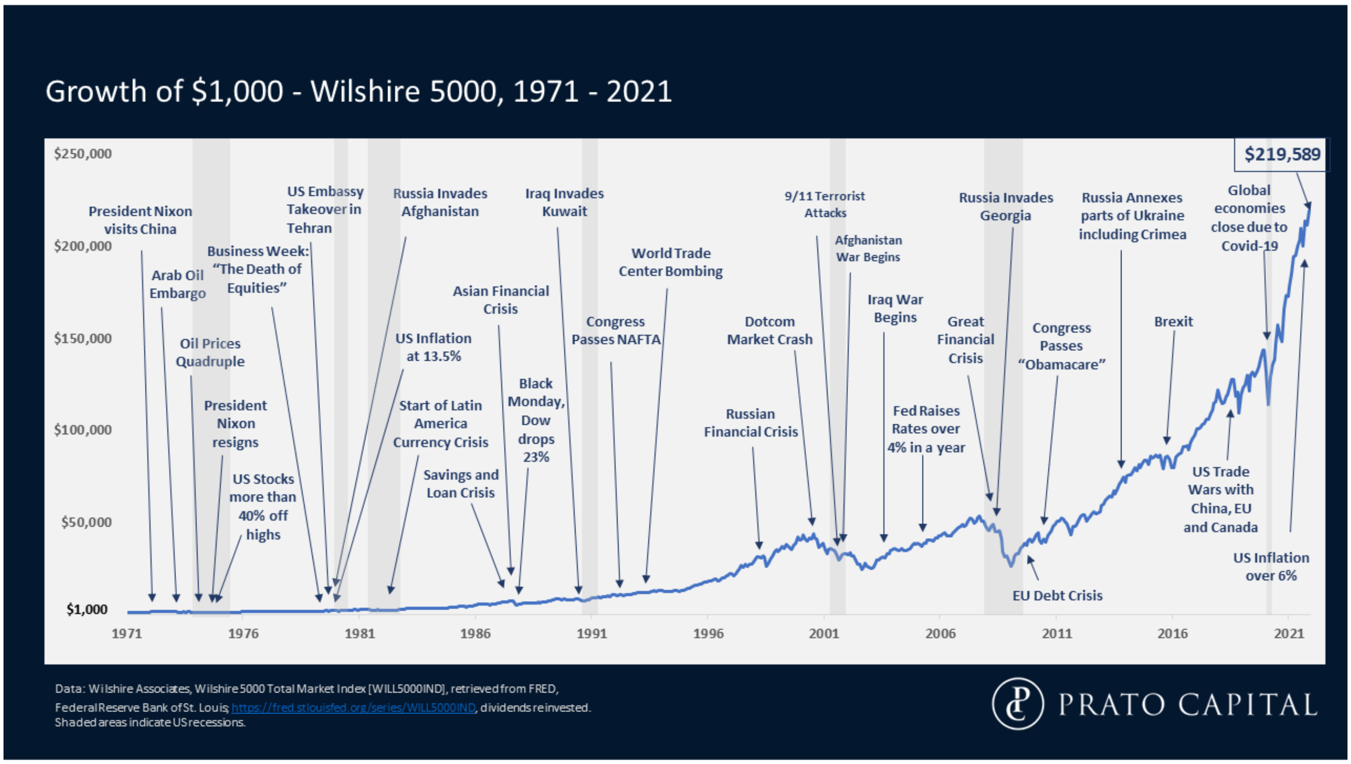
2. S&P 500 data from YCharts, includes reinvestment of dividends.
2010 data from 11/11/2010 to 1/26/2022. Other data from January 1 of 2018, 2020, 2021 to 1/26/2022.

Our last blog, [The Noise of 2021](), discusses many of the headlines from last year and how the media creates anxiety for those that watch. Many of these headlines are very important and newsworthy. But, for any long-term investor with a well thought out investment plan, they would be best served separating the headlines from their investments.

Using history as a guide

At Prato Capital, we like to use history as a guide to bring insight into how markets may react to certain news headlines over the long-term. Since 1971, many major news events have occurred. Chart 1 below shows just some of the events the media has covered over the past 50 years. The chart also shows the value of the Wilshire 5000, a broad based stock market index that includes almost all publicly traded companies in the United States. This chart shows the growth of $1,000 if it was invested in this index[3] since 1971.

Chart 1: Markets Have Rewarded Discipline over 50 Years



The chart above shows how just $1,000 can grow to almost $220,000 when kept invested through many events that were often portrayed as market changing. This is a 6.4% annual gain compounded over 50 years. This includes investing through seven US recessions, indicated by the shaded areas of the chart. The path to growth in the financial markets is not always a straight line and can be stressful at times, but history has shown that staying invested can reward investors over time.

Some investors may not have as long a time period to invest for their financial goals of saving for college or retirement. Chart 2, below shows how $10,000 would have grown in the Wilshire 5000 through many news headlines, economic and political events over the past 15 years. This time period includes the Great Recession and Financial Crisis, the economic shutdown due to the covid-19 pandemic and 2 bear markets.

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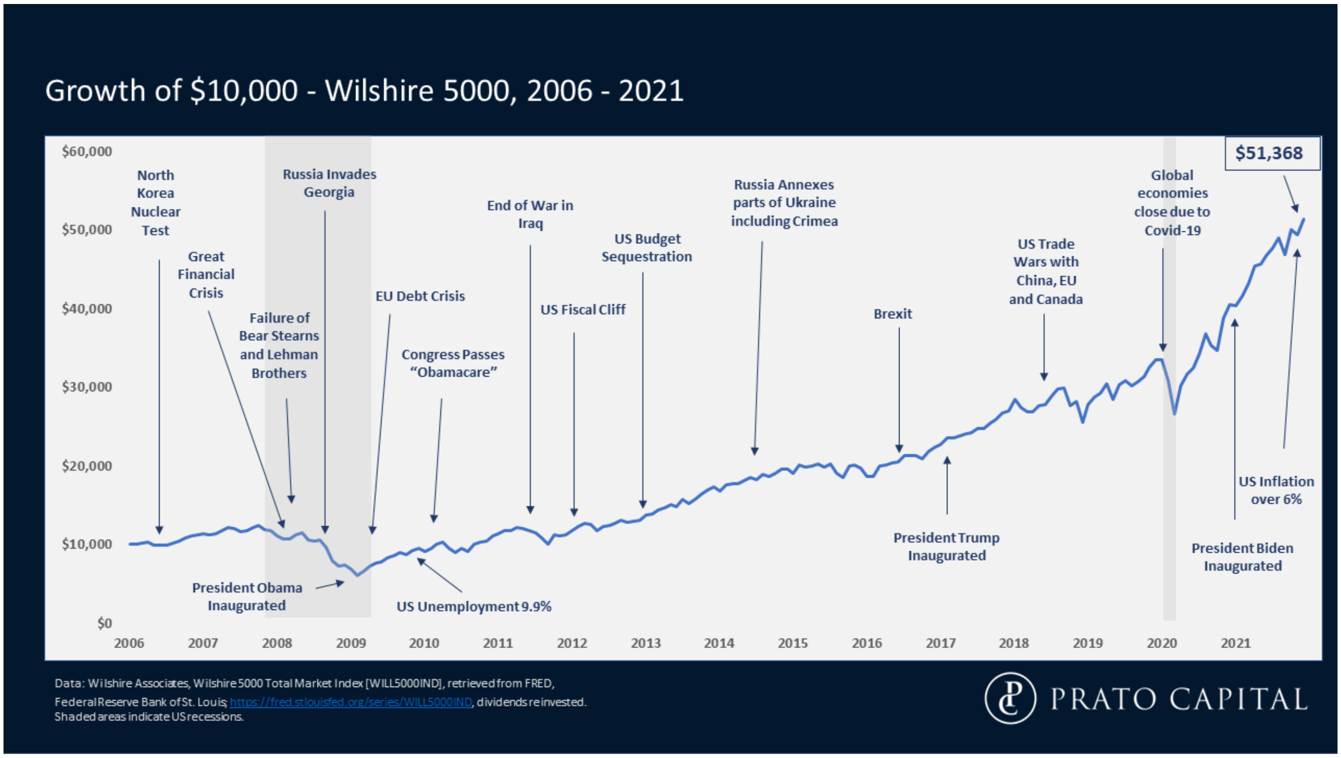
3. This investment is hypothetical since direct investment into the Wilshire 5000 is not possible.

Chart 2: Markets Have Also Rewarded Discipline over 15 Years



Even over a shorter time period, Chart 2 shows how investments can grow. The growth of $10,000 to over $51,000 was an annual return of almost 11.5%.

When using history as a guide, we can see the long-term investor has been rewarded over both a 50 and 15 year time period.

Conclusion

Investors with a proper investment plan know markets will not rise forever. Their plan is built upon this premise and accounts for periods of market declines, gains, and volatility. The right investment plan does not rely on stock market predictions or guesses for growth, it relies on academic research from over 95 years of stock market returns. When we use history as a guide, we see the power of compounding returns over time and how markets have rewarded patient and disciplined investors through recessionary periods, bear markets and major news headlines over the years.

It is not comfortable seeing the effects of volatility changing a portfolio's value every day. But it is critical to find the right balance of risk and growth in any investment plan. This is one of the features we do for our clients at Prato Capital. We help our clients find the investment plan that is right for them.

"The investor's chief problem - even his worst enemy - is likely to be himself." – Benjamin Graham.