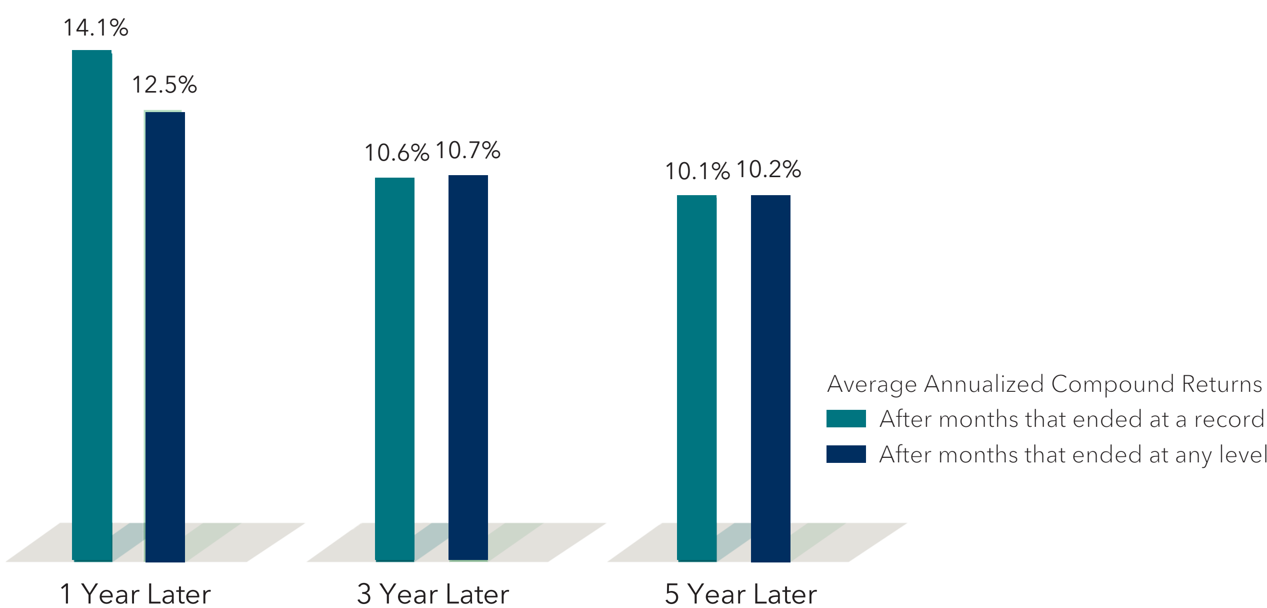
Markets and Volatility

In our January Oakwood Insights, we stated that we expected the markets to be volatile in the first half of 2022. With the global tensions over the Russian invasion of Ukraine, and the certainty of rising short-term interest rates as the U.S. Federal Reserve (Fed) seeks to lower the level of inflation, we have definitely seen market volatility in this new year.

The mood of the markets today contrasts sharply with the previous 20 months, when stocks staged a dramatic recovery from the shutdowns caused by Covid-19, and reached new highs as the pandemic continued. Remember the headlines touting that the S&P 500 Index closed at a market high 70 times during 2021?

Many investors may think a market high is a signal that stocks are overvalued or have reached a ceiling. However, they may be surprised to find that the average returns one-, three- and five- years after a new month-end market high are similar to the average returns over any one-, three- or five-year period, as shown in the chart below.

S&P 500 Index Returns, 1926-2021



Past performance is no guarantee of future results. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

In US dollars. For illustrative purposes only. New market highs are defined as months ending with the market above all previous levels for the sample period. Annualized compound returns are computed for the relevant time periods subsequent to new market highs and averaged across all new market highs observations. There were 1,151 observation months in the sample. January 1926–December 1989: S&P 500 Index, Stocks, Bonds, Bills and Inflation Yearbook™, Ibbotson Associates, Chicago. January 1990–December 2021: S&P 500 Index (Total Return), S&P data © 2022 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Source: Dimensional Fund Advisors

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In looking at all monthly closing levels between 1926 and 2021 for the S&P 500 Index, 30% of the monthly observations were new highs.

After those highs, the average annualized compound returns ranged from over 14% one year later to more than 10% over the next five years. Those results were close to average returns over any given period of the same length.

Reaching a new high does not mean the market will retreat. Stocks are priced to deliver a positive expected return for investors, so reaching record highs regularly is the outcome one would expect.

In addition, during this volatile time in the market, we want to emphasize the importance of maintaining a long-term perspective and avoiding an overreaction to short-term volatility.

Since 1926, the U.S. stock market has rewarded investors with an average annual return of about 10%. Yet it is important to remember that returns in any given year may be sky-high, extremely poor, or somewhere in between.

Annual returns came within two percentage points of the market's long-term average of 10% in just 7 of the past 96 years. Yearly returns have ranged as high as up 54% and as low as down 43%. And since 1926, annual returns have been positive 71 times and negative 25 times.

Understanding the range of potential outcomes can help you stick with a plan and ride out the inevitable ups and downs.

Contact us with any questions or comments

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