

Equity Investment Performance over Full Market Cycle

July 2020

The investment objective for long term assets was reduced over 2 years ago to an annualized return target of at least 6.5%, over a market cycle (generally 7-10 years). The reason for the reduction in expectation was due to rising prices relative to underlying economics. In addition, the most recent market cycle was much longer than normal, which by itself is not a reason to anticipate a recession.

And then Covid-19 arrived which provides (at least) two reminders;

1. Investment risk is not limited to only risks experienced in the past.
2. The collective emotions of the market can quickly turn from greed to fear to greed very quickly.

In 4 short months, the S&P 500 declined 34% in five weeks and then advanced 44% in 10 weeks. But, the proper assessment of performance is not based on short-term results but results preferably over a full market cycle. And Covid-19 did officially mark the end of the last market cycle.

Broadly defined, a full market cycle is a period that contains a wide variety of market environments. The basic stages of a market cycle are:

- Bear Market: sustained period of negative returns of at least 20%.
- Recovery: the time period from market bottom until recovery to their previous peak.
- Bull Market: a sustained period of positive market returns

Since 1900, full market cycles have ranged from 5 to 20 years. The following summarizes equity performance over the last two market cycles. (Reminder: interest rates declined from 5% to <1%)

	<u>Housing Boom</u> <u>Jan 2000-Oct 2007</u>	<u>Post Great Recession</u> <u>Oct 2007 – Dec 2019</u>	<u>Cumulative</u> <u>Last 20 Yrs</u>
• S&P 500	2.2%	8.6%	6.1%
○ Growth Style	-1.6%	10.4%	5.6%
○ Value Style	7.9%	6.5%	7.0%
• S&P 400	10.5%	8.8%	9.5%
• S&P 600	11.3%	8.8%	9.8%
• Global ex US (USD %)	7.1%	1.8%	3.8%
○ Currency Impact	<u>2.7%</u>	<u>-1.5%</u>	<u>0.1%</u>
• Global ex US (local %)	4.4%	3.3%	3.7%

Since the last market cycle ended at 12.5 years, the assessment of performance late in the cycle resulted in distorted sense of reality including;

- Since the past 10 years performance was 13 - 14%, one should expect continued future performance to be similar since 10 years is 'long-term'
- Since all indices have performed similarly in the past 10 years, the indices will perform similarly in all market cycles

The results of the last 2 market cycles provides better context regarding reality.

The current cycle is underway. The decline of 34% from Feb 19 – March 23 represents the quickest bear market on record. And the subsequent rise of 44% over the next weeks represents the quickest recovery. But perhaps the market remains in the middle of a longer bear market.

During the Great Recession, equity markets declined 50% in price from Oct 2007 – March 2009 but also experienced a 25% gain from Nov 2008 – Jan 2009 that proved to be temporary. Covid-19 continues and the strength, timing and duration of economic recovery remains unknown. The best course of action is to remain cautiously positioned while keeping a long-term orientation.

Regarding equity investment performance, the expectation remains at approximately 6.5% over a full market cycle, which remains far superior to long-term bond yields.