MARKET CORRECTION PERSPECTIVES

Corrections in stock markets, after a prolonged period of sustained growth, are commonplace and offer opportunity.

And while generations of investors have attempted to identify signals of impending market sell-offs to get out in front of corrections, most find it impossible given that the catalysts often change.

Our Suggestions:

Recognize that corrections are inevitable and virtually impossible to predict.

Stock valuations are always important, and a deeper look is required for the following reasons:

- Stocks that generally recover first are often those with secular earnings growth, as investors hunt for companies whose growth and demand is less reliant on the broader economy
- Justified valuations are much more complex than a single "multiple" (e.g. P/E). A true present value (NPV) of a security is a function of many variables, including growth and discount rates
- Even when high growth companies become stretched, high-quality companies will reclaim prior levels either by:
    - Growing back into their P/E, or
    - Attracting acquisition interest from larger Public or Private Equity companies (e.g. Microsoft's recent purchase of Activision)

The factors that precipitate or accompany market sell-offs are always unique and cause investors to feel that it is different this time. The reality is that the market inevitably rebounds, often right when participants are in maximum despair and ready to throw in the towel.

For example, 9-11, the Iraq War, Hurricane Katrina, Lehman Brothers & Bear Stearns collapsing, the Arab Spring, U.S. Debt Ceiling Downgrade, Brexit, and Covid-19 were all unique and different. However, the economy and markets recovered as they always have (see attached chart).

It is also worthwhile to put current Financial Market Headline News into perspective. For example, the current group-think is that the Fed will raise interest rates 4-6 times, at 25 basis point clips this year, to curb inflation and aggressively shrink their balance sheet.

And while this is plausible, in our view it is improbable given that we are still in the grips of a Pandemic, with industries and normal life patterns upended and there is no historical precedent of the Fed aggressively reducing their balance sheet and raising interest rates simultaneously.

And, if they do, the economy will either: (1) be resilient and continue to grow (good for stocks), or (2) slow down, which will in turn cause the Fed to stop tightening and/or reduce rates to spur the economy (good for stocks)

This co-dependent relationship between the economy and interest rates is why the Federal Reserve Bank uses the term “Path Dependent” to describe its forecasts. They ultimately will react to the effects that their recent actions have on the economy and financial markets.

Astute investors will look through the current market disruptions and use these pullbacks to buy or add to positions in great companies that have been caught in the backwash of the market sell-off.

In short, we believe that these events provide unique long-term wealth creation opportunities, as many similar periods of financial distress have in the past.

Bradford Stanley, CFA