Market comment 2022-02-18

The market is in a nervous correction mode. The correction really started mid-November with a second wave started beginning of January.

The VIX index that measure the perceived risk in the market has increased from its low 16 during 2021 to around 26 since mid-November indicating that fear is beginning to build up which will induce a lot of irrational behaviour.

The reason for the start of the correction mode is hard to pinpoint. There is however a pamphlet of factors fuelling the uncertainty.

- There is an inflation nervousness and expectation of reduced central bank support (Quantitative Easing).
- Concern that, mainly, the Federal Reserve intends to rise the interest rates too quickly.
- Expected change in interest rates is slowly getting to levels where fixed income is beginning to be considered an alternative to equity.
- The reporting season.
- Currently however, the hostile build-up of Russian troops around the borders of Ukraine are dictating the amount of fear that spur mainly speculators to buy or sell. A statement from Biden that attack is imminent cause the markets to fall while a possible meeting between US and Russian politicians cause markets to rise.

From March 23, 2020, which marked the end of the Covid draw down, markets have recovered quite substantially up until mid-November 2021. The main reason though is probably that the short-term and speculative side of the market are trading with a negative sentiment providing big discounts for quality companies. However, these 10 – 20% drawdowns happen every third year or so and recovers on average in about 110 days, that has at least been the case the last 80 years.

Market Shocks

Market shock events have historically not affected the stock markets as severe as one might think. Drawdowns are lesser than expected and recovery is rather swift. Even the Pearl Harbor attack in 1941, an enormous shock during an ongoing world war, was recovered in less than a year.

Table: Shock events market recovery:

		S&P 500		Calendar days to	
Market shock event	**Event date**	**One-day**	**Total drawdown**	**Bottom**	**Recovery**
Saudi Aramco Drone Strike	2019-09-14	-0.30%	-4.00%	19	41
North Korea Missile Crisis	2017-07-28	-0.10%	-1.50%	14	36
U.S. terrorist attacks	2001-09-11	-4.90%	-11.60%	11	31
Iraq's invation of Kuwait	1990-08-02	-1.10%	16.90%	71	189
Yom Kippur War	1973-06-10	0.30%	-0.60%	5	6
Six-day war	1967-05-06	-1.50%	-1.50%	1	2
Cuban Missile crisis	1962-10-16	-0.30%	-6.60%	8	18
N Korea invades S Korea	1950-06-25	-5.40%	-12.90%	23	82
Pearl harbour Attack	1941-12-07	-3.80%	-19.80%	143	307
Source: LPL Research, S&P Dow Jones Indices, CFRA					

Take the Irak's invasion of Kuwait as an example; The bulk of the recovery or about 90% of the recovery actually happened during 23 trading days (from January 14 to February 13) of the 82 days. If you weren't invested during these days, you more or less missed the entire recovery - recoveries are normally extremely fast once they start.

In these types of situations, companies that have had an above the market return for their equity during some times are quite often exposed to profit taking and therefore larger than average drawdown. However, if these companies are high quality and are effectively managed, they tend to recover at speed.

For any long-term investor these situations are investment opportunities.

Remember that just because a lot of investors get scared that does not mean that the quality of companies is decreasing – it's just a psychosocial state of mind.

2022-02-18

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