Making Sense

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Market Update:

Five Reasons to Stay Invested Despite Volatility

In Brief:

Key Takeaways (Figure 1)

- **Reason 1: Midterm Election & Governmental Disposition**

  12-months post midterm elections: S&P 500 positive returns averaging 15.1%.

- **Reason 2: Forward Returns Post Sentiment Lows**

  S&P 500 averaged 25% returns 12-months post sentiment lows.

- **Reason 3: Forward Returns Post Hiking Cycle**

  6-months following final rate hike historically equity markets recover.

- **Reason 4: Recovery Time Post Drawdown**

  Average peak-to-trough duration: 10 months

  On average, investors regained more than 100% of losses 1 year following the equity market trough.

- **Reason 5: Returns During & After Recession**

  Positive cumulative performance, 1-, 3-, 5- and 10-years following recession

It doesn't take a financial expert to see equity and fixed income markets have experienced a lot of volatility in 2022. While we believe the probability of a US recession over the next twelve months is roughly a coin-flip, continued tightening of financial conditions, weakening economic dataset, and aggressive monetary policy make it a real possibility.

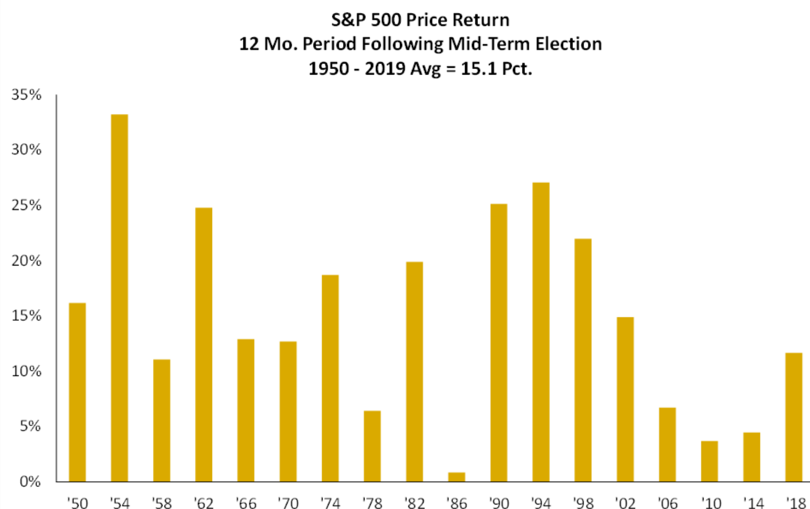
So, what's a long-term investor to do? Where might markets go from here? We believe there are countless reasons to stay invested. Below are five reasons that stand out in today's markets.

1. Midterm Elections & Governmental Disposition[i]

Historically, midterm election years saw heightened volatility and significant market drawdowns, and 2022 has been no exception. The average drawdown for midterm election years is -17%, and the market has already exceeded that number this year. But post midterm elections, markets have seen positive returns. In 100% of observations since 1950, 12 months post midterm elections have seen returns averaging 15.1% for the S&P 500.

The resulting government make-up following midterm elections is also noteworthy. Under the two potential consensus outcomes (1. Democrat-led Senate and President with Republican-led House, and 2. Republican-led Congress and Democrat President), equity returns have been higher compared to other historical governmental combinations since 1872.

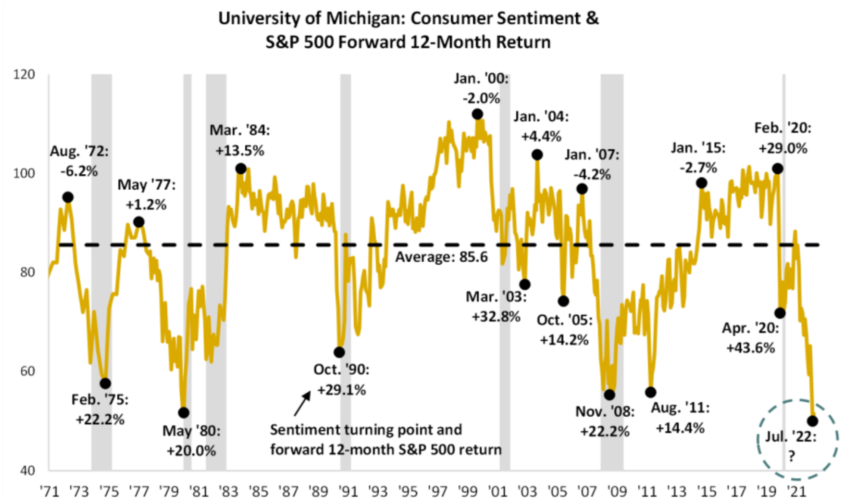
Figure 1: S&P 500 Returns Post Midterm Elections



2. Forward Returns Post Sentiment Lows[ii]

According to the University of Michigan's Consumer Sentiment report, consumer confidence remains near its lowest level since the data began in the 1970s (58.2% in August). When sentiment is low, the gut reaction is to get out of the market. But we've observed that 12 months following sentiment lows, investors saw almost a 25% average return in the S&P 500. Additionally, the smallest 12-month forward return was 14.2%. **It seems counterintuitive, but sentiment lows are a strong indicator for future gains.**

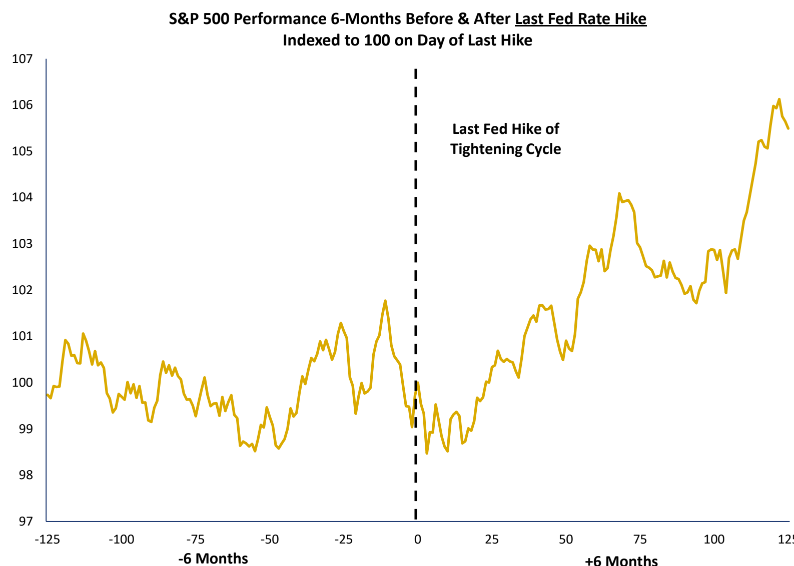
Figure 2: Sentiment Lows Have Historically Seen Higher Forward Returns



3. Forward Returns Post Hiking Cycle[iii]

The Federal Reserve raised rates five times so far this year, including [three consecutive 0.75% hikes as of this week's FOMC meeting]. The Fed may continue raising rates into 2023, but it's interesting that the market often recovers in the six months following the final rate hike.

Figure 3: Continued Volatility Through Final Fed Hike?



4. Recovery Time Post Drawdown[iv]

When you look at all the market drawdowns of 10% or greater following World War II, how long did it take for investors to get 100% of their money back following market bottoms? **In both recessionary and non-recessionary circumstances, the average duration of a drawdown lasted less than 10 months, and, on average, investors regained over 100% of losses 1 year following the trough (Figure 4).**

Figure 4: Market Recovery Time

Major S&P Declines With a Recession - 1950 to Present					
Start Date	End Date	Months Peak to Trough	% Decline	1-year Post Low	% Recovery of Previous High
2/19/2020	3/23/2020	1.1	-33.8%	79.1%	118.6%
10/9/2007	3/9/2009	16.7	-55.2%	72.0%	77.0%
3/24/2000	10/9/2002	30.0	-47.4%	35.5%	71.3%
7/16/1990	10/11/1990	2.8	-19.2%	33.2%	107.6%
11/30/1981	8/12/1982	8.3	-15.6%	65.5%	139.6%
2/13/1980	3/27/1980	1.4	-16.7%	46.1%	121.7%
7/15/1975	9/16/1975	2.0	-13.5%	32.1%	114.2%
11/7/1974	12/6/1974	1.0	-13.2%	39.5%	121.1%
10/12/1973	10/3/1974	11.5	-41.8%	40.9%	82.0%
11/29/1968	5/26/1970	17.6	-32.6%	48.8%	100.3%
8/3/1959	10/25/1960	14.5	-10.1%	34.1%	120.5%
7/15/1957	10/22/1957	3.2	-19.8%	36.8%	109.7%
1/5/1953	9/14/1953	8.2	-12.4%	44.8%	126.9%
	Average	*9.1*	*-25.5%*	*46.8%*	*108.5%*
	Median	*8.2*	*-19.2%*	*40.9%*	*114.2%*

Major S&P Declines Without a Recession - 1950 to Present					
Start Date	End Date	Months Peak to Trough	% Decline	1-year Post Low	% Recovery of Previous High
9/20/2018	12/24/2018	3.1	-19.4%	39.9%	112.8%
5/20/2015	2/11/2016	8.6	-12.6%	28.3%	112.2%
5/2/2011	10/4/2011	5.0	-16.7%	32.0%	110.0%
7/20/1998	10/8/1998	2.6	-18.7%	39.1%	113.2%
8/25/1987	10/20/1987	1.8	-29.4%	21.4%	85.8%
9/21/1976	3/6/1978	17.2	-13.5%	19.0%	102.9%
2/9/1966	10/7/1966	7.8	-15.6%	27.0%	107.3%
12/12/1961	6/26/1962	6.4	-26.9%	38.7%	101.4%
	Average	*6.5*	*-19.1%*	*30.7%*	*105.7%*
	Median	*5.7*	*-17.7%*	*30.2%*	*108.6%*

5. Returns During & After a Recession[v]

As we've stated, we do not believe we're in a recession currently, but we could see one in the next 12 months. Like market sentiment, historically, recessions are a strong indicator for forward returns during the months and years following. Average returns post all 12 recessions demonstrated significantly positive cumulative performance 1-, 3-, 5-, and 10-years with a high frequency of occurrence.

Figure 5: S&P 500 Post Recessions Since World War II

S&P 500 Performance After Recessions (Post-WWII)			Post Recession End (Cumulative Returns)			
	Recession Start	Recession End	1-year	3-years	5-years	10-years
1)	11/30/1948	10/31/1949	35.1%	92.8%	177.8%	510.4%
2)	7/31/1953	5/31/1954	36.1%	83.7%	145.2%	295.5%
3)	8/31/1957	4/30/1958	37.2%	66.4%	89.9%	211.2%
4)	4/30/1960	2/28/1961	13.6%	35.2%	68.4%	112.2%
5)	12/31/1969	11/30/1970	11.3%	20.6%	25.1%	146.6%
6)	11/30/1973	3/31/1975	28.3%	22.1%	55.6%	253.5%
7)	1/31/1980	7/31/1980	13.0%	56.1%	100.5%	344.6%
8)	7/31/1981	11/30/1982	25.6%	66.8%	103.0%	350.2%
9)	7/31/1990	3/31/1991	11.0%	29.8%	98.1%	284.2%
10)	3/31/2001	11/30/2001	-16.5%	8.4%	34.3%	33.2%
11)	12/31/2007	6/30/2009	14.4%	57.7%	136.9%	293.8%
12)	2/29/2020	4/30/2020	46.0%	N/A	N/A	N/A
		Average	*21.3%*	*49.0%*	*94.1%*	*257.8%*
		Median	*19.6%*	*45.6%*	*94.0%*	*268.8%*
		Percent Positive	91.7%	100.0%	100.0%	100.0%

While it may be tempting to get out of markets during times of volatility, remember to keep a historical perspective and focus on the long-term. Reach out to your First Citizens partner with questions and join us for our Making Sense market and economic update on September 28th at 12 pm ET.

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