Lower asset prices should lead to higher long-term returns

Recent volatility in financial markets has left many investors feeling uneasy. In light of this, Brad Willock, Vice President and Senior Portfolio Manager, U.S. Equities, shares some of his thoughts on the market and discusses how he's responding within his portfolios.

What's happening in the markets?

We are now in a period where COVID-19 is exponentially spreading in the Western world. China has already experienced this phase and has seemingly been able to contain it. This means that we have a playbook on how to combat the spread, which includes social distancing, quarantining, temporarily shutting down public buildings, etc. Today, these practices are being employed around the world, including here in North America.

Unfortunately, the result of these measures is a massive hit to economic activity as businesses are shut down and people stay home. The reason that markets have been so volatile is because there is tremendous uncertainty as to how long this may last and the extent of the economic impact.

What will it take for things to calm down?

Central banks around the world have been doing everything they can to help stabilize the economy. In the U.S., the Federal Reserve has taken several actions which include:

- Cutting interest rates
- Injecting cash into the markets to improve liquidity
- Providing various stimulus packages

These initiatives should be helpful, but the ultimate solution to solving the uncertainty is some sort of remedy for COVID-19. Measures such as social distancing are instrumental for flattening the curve. But beyond that, a vaccine or other medical solution to treat the virus would be extremely helpful. There are a multitude of clinical trials underway and we should get data on several of these over the next few months. Once we start hearing some progress – either on a slowdown in new cases or on a treatment – markets should start to calm down more and more.

How are we positioning our portfolios?

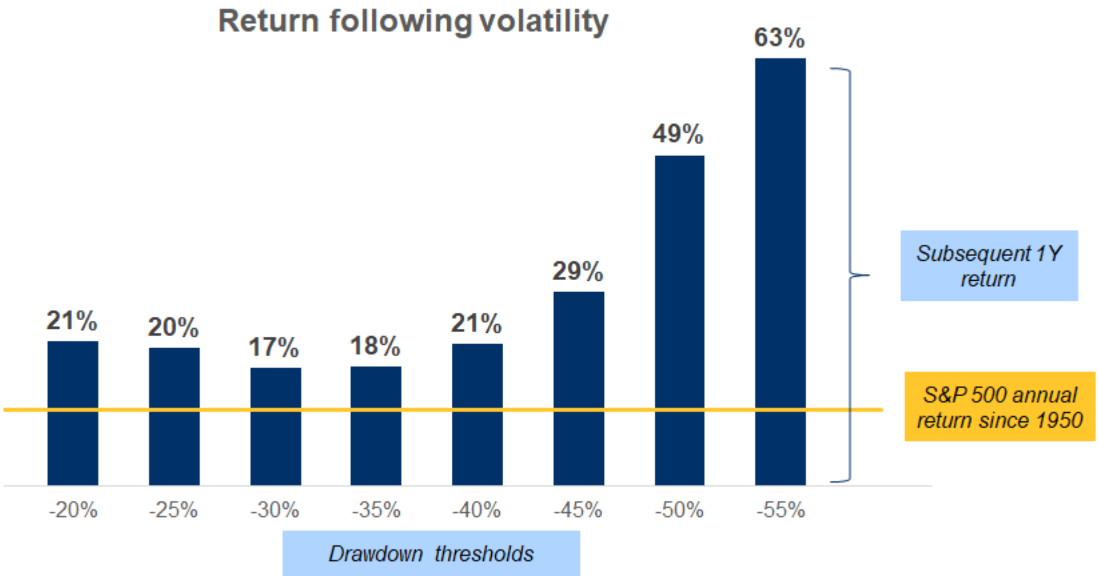
At this point, a recession is a very real possibility given the measures that are needed to contain the spread. However, a recession is already being priced into the stock market. And, even if the spread of the virus does get worse from here, by this time next year it's likely that we'll have some sort of vaccine or treatment.

In our base case scenario we don't believe COVID-19 will be a permanent issue. We are thus viewing this as a great opportunity to concentrate our portfolios into an exceptional list of companies that are trading at a steep discount. We are focused on companies with strong balance sheets that are able to withstand this disruption and come out of it in an even better competitive position.

Lower asset prices should lead to higher long-term returns

While it's possible that prices could go even lower in the near-term, we expect purchases made today – and on any further weakness in the markets – to generate better than average returns over the long term. In general, falling asset prices imply higher future returns.

As of March 23, 2020, the S&P 500 is down roughly 30% year-to-date in U.S. dollar terms. This chart shows how the market has performed following other drawdowns of various magnitudes since 1950.



Source: RBC GAM, Bloomberg. S&P 500 TR (USD). Data reflects time period of January 1, 1950 to February 29, 2020. Subsequent 1Y return reflects the median 1-year return.
An investment cannot be made directly into an index. The graph does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results

Crucial time for investors

Investors tend to make poor decisions under stress which can have harmful impacts on their long-term financial goals. It's important to take a step back during periods like this and avoid making emotional decisions. If history has taught us anything, it's that long-term investors should be looking at the current environment as a great buying opportunity. After all, lower asset prices should lead to higher long-term returns.

Publication date: March 24, 2020