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Holding Stocks Through Potential Economic Weakness

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There will always be periods of volatility in the markets, which currently are beset by nerves driven by constant discussions about potential trade tariffs, higher interest rates, and uncertainty over future economic growth.

With the recent increase in volatility, probably the worst thing you can do is watch the market closely. Your money is made by investing in and owning good companies for the long term. Giving in to fear is not a sound strategy and, in our opinion, has much to do with the average investor earning returns much lower than the long-term returns generated by the market.

Long-Term Returns Include Periods of Economic Weakness

What drives market returns over time is the average increase in earnings per share of about 6.8 percent per year and a dividend yield of approximately 2 percent. What this means is long-term returns are attractive, even after including the periods of economic weakness.

You don't have to predict when the good times will roll but you have to stay the course and avoid emotional mistakes. You should certainly worry about what you own, since some companies can be put out of business by economic downturns or higher interest rates and may have to restructure troubled balance sheets causing investment losses.

Despite that caveat, it's difficult to see healthy long-term appreciation in your capital by making short-term decisions.

Value of Short-Term Forecasting

Paul Samuelson, one of the great economists of the 20th century, put the reliability of forecasting recessions this way: “the stock market has correctly predicted nine of the last five recessions.” The best thing to do is keep a level head and focus on what a portfolio of quality companies will be worth three years from now. Unless there’s a significant change in the long-term trend, which seems highly unlikely, that will allow you to capture the long- term returns which short term attempts to time the market usually prevent you from capturing.

Since changes in mass psychology and how the financial community as a whole decide to appraise the outlook for businesses in general or a particular stock can have overriding importance in the short term and can vary almost unpredictably, successful attempts to time the market or forecast recessions is next to impossible to achieve and puts the likely long-term capital appreciation from owning good companies at risk.

Current Situation

Forecasts aren’t always accurate but based on consensus earnings forecasts the market currently trades below 15 times next year’s earnings, which is somewhat below the 20-year average. Interest rates are substantially below historical levels, so “the market” based on history is undervalued relative to current interest rates.

If you’re a long-term investor in a company whose management is disciplined about sound growth you should not worry too much about recessions (which we are not predicting), since they give these types of companies a higher probability to gain market share from a weaker competitor than a strong economy. At a recent investor conference, Jamie Dimon said that, at JPMorgan, rather than fear a recession, they see recessions as an opportunity.

Don’t let nervous investors bother you too much. Downturns are part of the process of getting good long-term returns if you own suitable companies, while succumbing to fear or trying to time the market, in our experience, is part of the process of getting subpar returns.

Please feel free to contact us at info@southatlanticcap.com.

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