EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR WEEKLY ECONOMIC UPDATE

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WHAT INVESTORS SHOULD DO AS VOLATILITY INCREASES

Even after increasing interest rates by 0.75%, the United States (US) Federal Reserve (Fed) still believes that it is possible for the central bank to achieve a soft landing in which they can tame inflation without pushing the economy into a recession. Consumers, however, seem to disagree, and this is in line with economic data showing the worst reading of consumer confidence since the 1970s. From the comments made by the Fed Chairman, Jerome Powell, it seems that the Fed believes that a successful policy outcome would be if unemployment increases from 3.6% to 4.1% while inflation returns to 2% over the next two years. Even though investors had not seen such a rapid increase in US interest rates since 1994, they reacted positively to the news, mostly because it shows that the Fed is serious about fighting inflation. Theoretically, lower inflation is necessary in developed economies to have a healthy labour market in terms of real wage gains.

The Fed also signalled that more interest rate increases would be needed in 2022. Last week's 0.75% increase brought the short-term borrowing costs to a target range between 1.50% and 1.75%. The median Fed policymaker expects further increases up to roughly 3.4% by the end of the year. That would suggest another 1.75% in total rate hikes, spread across the remaining four scheduled Fed meetings in 2022. In March, experts believed that it would only be necessary to increase rates to 1.9%. But since then, the Fed has increased their inflation forecast for 2022 from 4.3% to 5.2% and decreased their economic growth forecasts from 2.8% to 1.7%.

Overall, the S&P 500, a stock market index that tracks the performance of 500 large US-listed companies, has seen its second-worst year-to-date performance in its history. Only during the Great Depression of the 1930s has this index seen a larger contraction, 39.2%, compared to this year's 21.6% contraction. Riskier asset classes, like cryptocurrencies, have seen even greater contractions. Since its high in November 2021, around $69 000, the price of Bitcoin has contracted by almost 70%. Overall, the market capitalisation of the cryptocurrency market has fallen from around $2.97 trillion, down to $900 billion. Cryptocurrencies were hit hard this week after US crypto lender, Celsius, froze withdrawals and transfers between accounts. Fears are mounting around the potential for a wider fall out in digital asset markets, which were already shaken by the demise of the TerraUSD and Luna tokens last month.

But what does all this uncertainty mean for investors? Is this the time to panic-sell and put all of your money into cash? Definitely not! Markets reward investors for their time, thus trying to time the markets can cause a lot more harm for investors. The reality is that we are all exposed to market volatility, in some way or another. The best we can do is to plan accordingly, something your financial advisor can assist you with, and to stick the course. As an example, if you are retired, a silo approach will protect your investments because you do not have to sell out of your equity positions. You can continue to draw an income and wait for markets to set new all-time highs. If you are not retired yet, market corrections like these provide a unique buying opportunity where investors can acquire assets at substantially reduced prices. Investors should, therefore, rather attempt to acquire more assets now.