How Do You Handle a Bear? Patience and Diversification

March 2020

- The global stock-market plunge that began in earnest during February has been primarily defined in broad headline-grabbing terms, ignoring underlying details about how different parts of the market have behaved.
- Sector-specific analysis shows that different segments of the market have been contending with a variety of pressures that extend beyond COVID-19 containment.
- We believe it is deeply inadvisable to sell now. Market participants who have remained invested and have already borne much of the decline should be in an advantageous position when the rebound arrives.

Swift selloffs have a way of letting fear obscure reality. The global stock-market plunge that began in mid-February has been primarily defined in broad headline-grabbing terms, tying financial-market conditions to the COVID-19 outbreak—and ignoring underlying details about how different parts of the market have behaved.

We can explore this more nuanced story by looking at sector-level performance of the global stock market. While impossible to conclude with any degree of certainty if or how much further stocks will fall, a sector-specific analysis shows that different segments of the market have been contending with a variety of pressures that extend beyond COVID-19 containment.

Defensives Have Fallen By Less

Despite the recent all-encompassing declines, traditional defensive sectors (consumer staples, health care, telecommunication services and utilities) held up better, as expected. Exhibit 1 shows each sector's decline from its 2020 high price through 16 March, as well as the date of its peak.

Notably, information technology has suffered only a middling decline despite being the highest-flying sector in the year-to-date prior to the downturn.

The Rest of the Pack Has Fallen By More

Cyclical sectors (consumer discretionary, materials and industrials) have fallen more sharply than their defensive peers. The materials sector, in particular, has failed to attain a new high in 2020.

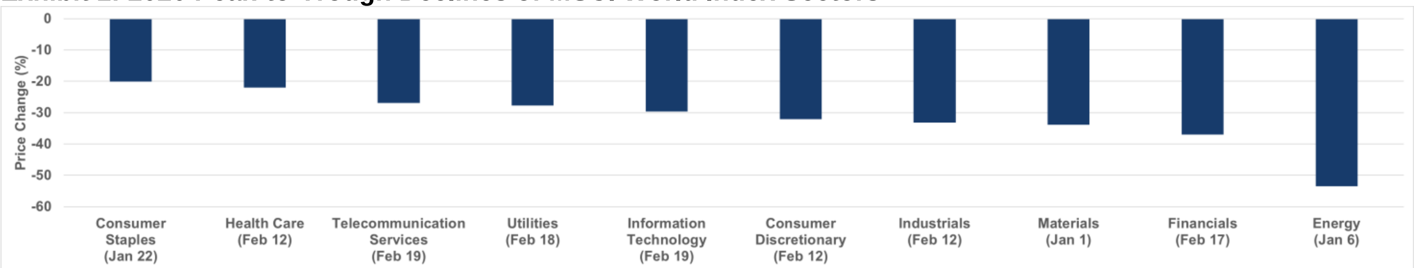
Financials—while not a traditional cyclical sector—have performed quite poorly. Higher interest rates are generally considered advantageous for financial companies, which can increase their net-interest margins. Interest rates have been falling around the globe for most of the year-to-date, and plummeted to historic lows as the stock-market selloff accelerated, putting a great deal of pressure on financials.

The Energy Sector

Investor concerns about the growing economic fallout were compounded by the breakdown of OPEC+ (that is, the Organization of the Petroleum Exporting Countries, or OPEC—led by Saudi Arabia—plus Russia) during the first week of March. The expanded cartel, which succeeded in stabilising oil prices after their declines from mid-2014 through early 2016, has essentially dictated conditions on the supply side of the market (along with non-aligned US producers) for the last five years. Apparently, Russia did not acquiesce to Saudi Arabia's plans for a shared production cut intended to stabilise prices in the face of declining demand, so Saudi Arabia responded by increasing production.

While the move may seem counterintuitive—and resulted in the largest one-day oil-price crash since 1991 (in both West-Texas Intermediate and Brent prices)—the goal appeared centred on driving high-cost producers out of commission. In fact, as a whole, the energy sector never fully recovered from the energy price collapse that began in 2014: the MSCI World energy sector's all-time high was attained in June 2014, and it has declined by about 70% through 16 March 2020.

Exhibit 1: 2020 Peak-to-Trough Declines of MSCI World Index Sectors



Measured from each sector's respective high price in 2020, as noted in parentheses, through 16 March. Source: Bloomberg

SEI's View

We recognise the fear-inducing impact that steep, sustained stock-market selloffs can have on investor temperament. A deeper look at conditions in different corners of the market can help provide a reminder that the headlines often miss the full story. With this in mind, we can see cause for optimism in some areas of the stock market along with a combination of explanations for the volatile conditions in other areas.

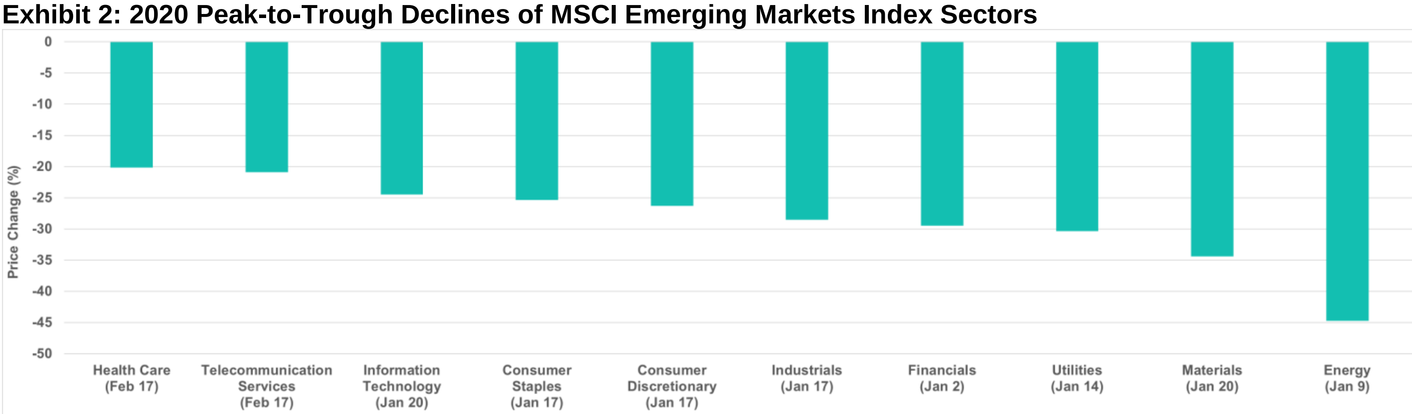
There's no getting around the tough conditions of the past few weeks as performance patterns have been similar in developed and emerging markets. Exhibit 2 shows emerging-market sector declines, which generally started earlier (besides health care and telecommunication services) as China's frontline battle against the COVID-19 outbreak had an outsized impact on emerging-market performance.

The divergent performance across sectors around the globe encapsulates the importance of taking a diversified approach to investing. An investment portfolio concentrated in the worst-performing sectors would have fared much worse than a more broadly allocated alternative.

Looking ahead, there are two ways to respond to this state of affairs: stick to your long-term plan or sell.

We believe it's deeply inadvisable to sell for a couple reasons. First, it's entirely possible that stocks are closer to the bottom than the top. If you've remained invested up to this point, then you have already borne much of the decline. Second, if you decide to sell, when will you re-invest? If you can't provide a realistic answer to that question, then it's probably better to remain patient with your long-term plan in anticipation of the eventual recovery. It's better to sit tight with the vast majority of your portfolio than to sell at low prices today and buy back in at higher prices later.

Exhibit 2: 2020 Peak-to-Trough Declines of MSCI Emerging Markets Index Sectors



Measured from each sector's respective high price in 2020, as noted in parentheses, through 16 March. Source: Bloomberg

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