# Monthly Market Views

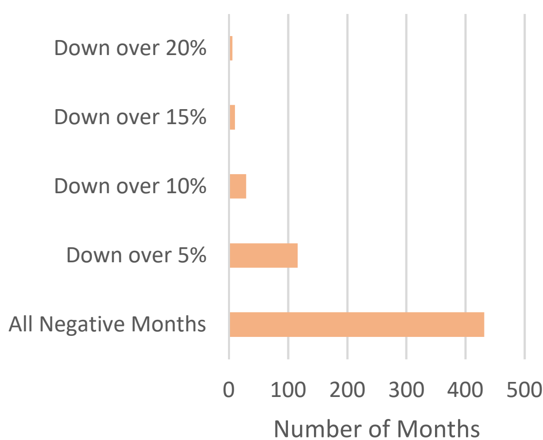
International Private Banking Division

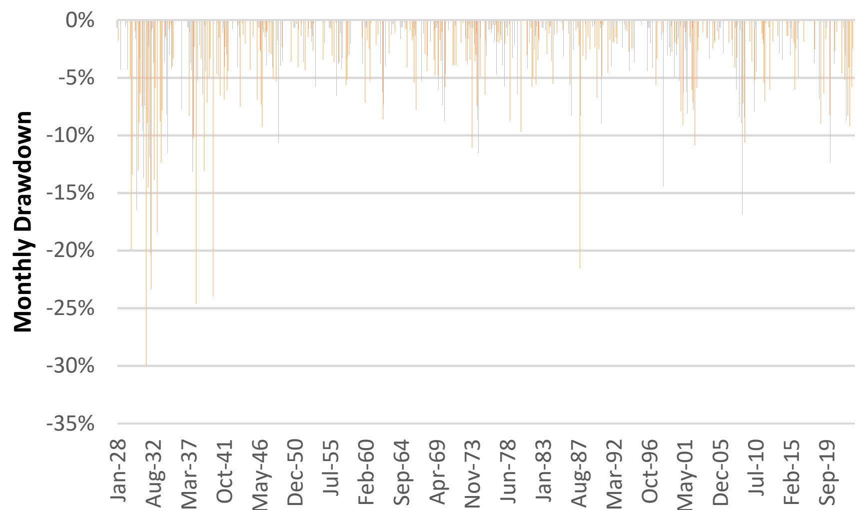
JULY 2023

**The first half of 2023 has been broadly positive for financial markets, but has also brought with it several periods of volatility. How should investors think about the surge of volatility in a historical context?**

As most investors are keenly aware, volatility in equity markets is not an uncommon occurrence. The S&P 500, a primary index of United States listed companies, is no exception. Since its inception in 1927, the S&P500 has had 713 positive month and 432 negative months. Just over one in three months (38%) that the index has been in existence, have been negative. Digging deeper, there have been 116 months (10%) where the index was down at least 5% in a single month, 29 months (3%) where it was down at least 10% in a single month, and even 10 months (1%) where it was down more than 15% (Exhibit 1)[1]. Looking at equity investing from this point of view illustrates its inherent risks.

> Looking at equity investing with a focus on drawdowns can make it seem more like gambling than investing. For long-term investors however, focusing on the equity market's potential for capital compounding can tell a different story.



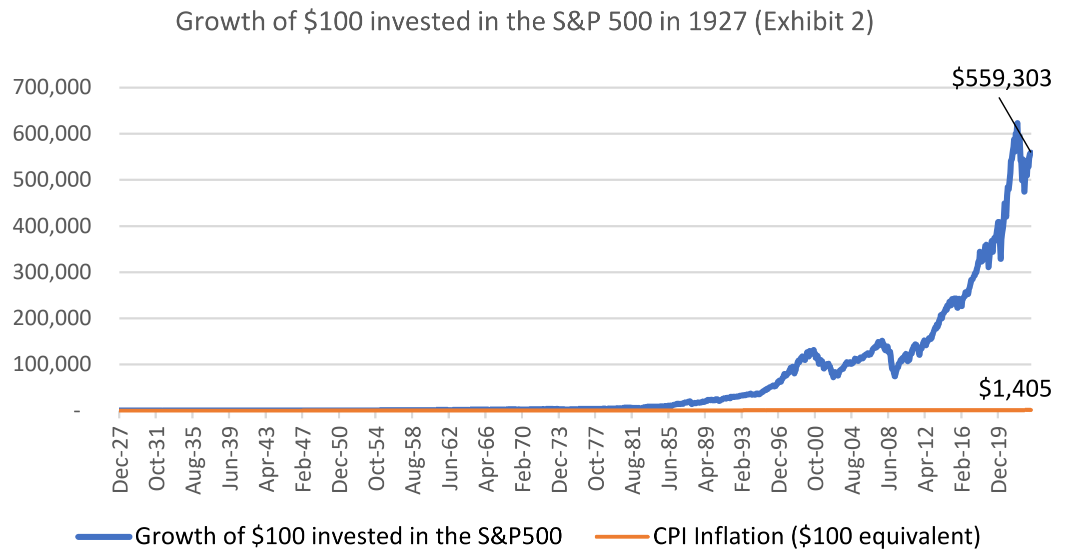




Months like March-April 2023 are a reminder to investors that drawdowns happen. And that their extent and duration are largely unknowable until sometime later. Because drawdowns will continue to be a constant feature of equity investing, maintaining a proper asset allocation will help investors weather the storm. And while it is human nature to over-weigh recent experience (Recency bias) when making investing decisions, longer-term investors would be well served by taking a step back and assessing risk in the context of long-term returns.

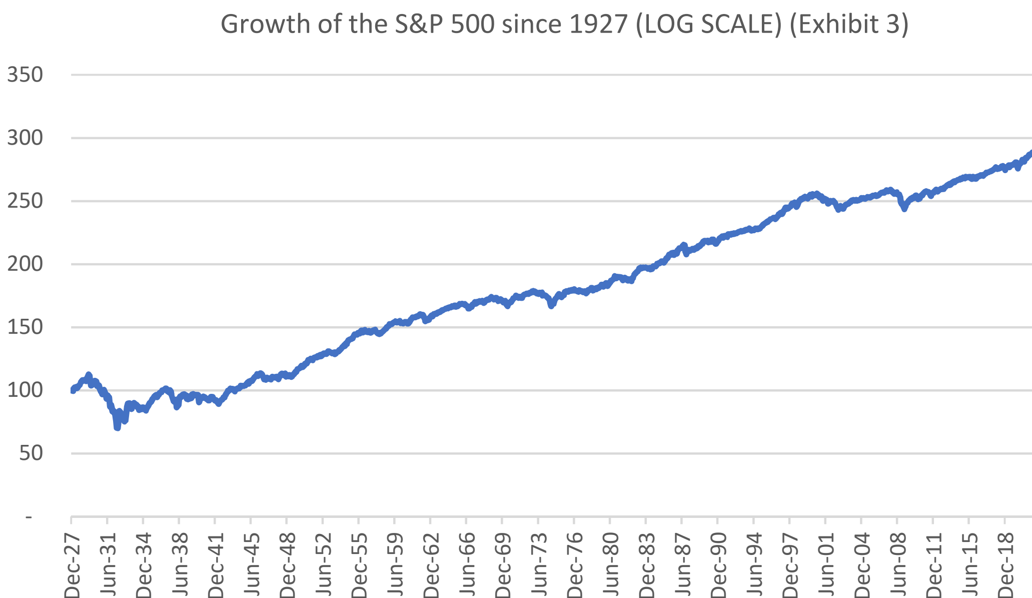
---

[1] Source: Bloomberg (From 12/30/1927 – 6/30/2023)

Since its inception in 1927, the S&P500 has been positive in 713 of 1,145 month (62%). This period includes the great depression, two world wars, the great financial crisis, as well as numerous other volatility inducing events. Through the power of compounding however, this rate of appreciation would have turned $100 invested in 1927 into over $559,000 by June 2023 (Exhibit 2)[2].




As a comparison to the appreciation of investments in the S&P500 (Exhibit 2 – Blue line) we have also graphed the effects of inflation over the same period (Exhibit 2 – Orange line). Inflation between 1927 and 2022 decreased the value of a US dollar by roughly 14 times (Around $1,400 in 2023 has the same buying power as $100 in 1927). This is certainly a significant change in buying power, but relative to the effects of equity market compounding, they are relatively muted.




Another helpful perspective when assessing long-term equity investing, is looking at a log scale of S&P 500 returns (Exhibit 3[3]). Viewing the data this way is helpful in eliminating the exponential nature of compound returns, and instead being able to focus on the relatively steady long-term historical performance. The ability of equities to generate these returns over varying inflation environments, can make them an attractive option for inflation wary investors.

[2] Source: Bloomberg (From 12/30/1927 – 6/30/2023)
[3] Source: Bloomberg (From 12/30/1927 – 6/30/2023)

## While the US economy continues to expand, remains a risk of contraction due to monetary tightening. How should investors think about these factors when assessing their portfolios?

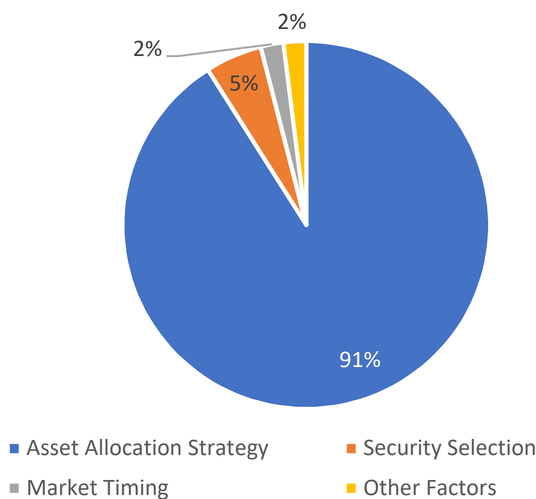
Successful investing is always a difficult endeavor, and one that can be made more difficult by the abundance of financial market noise investors experience on a daily basis. It is commonplace to see financial news headlines decrying "The Dow fell over 300 points and Treasury yields reached their highest levels since March after ADP jobs data raised expectations the Fed would need to keep rates higher for longer."[4]. Headlines like these can cause investors to overweigh the importance of current events beyond their lasting effects on long-term portfolio returns. We believe that in order to succeed as a long-term focused investor, one is better off tuning out the noise and concentrating on what has proven to be most important element in driving portfolio returns; maintaining proper asset allocation.

There have been numerous studies conducted on the factors that influence portfolio performance. For investors with a long-term time horizon, the most important thing to focus on is asset allocation. Historically, timing the market and security selection have only been responsible for 2% and 5%, respectively. Meanwhile, asset allocation has been responsible for roughly 91%[5] of portfolio returns (Exhibit 4).

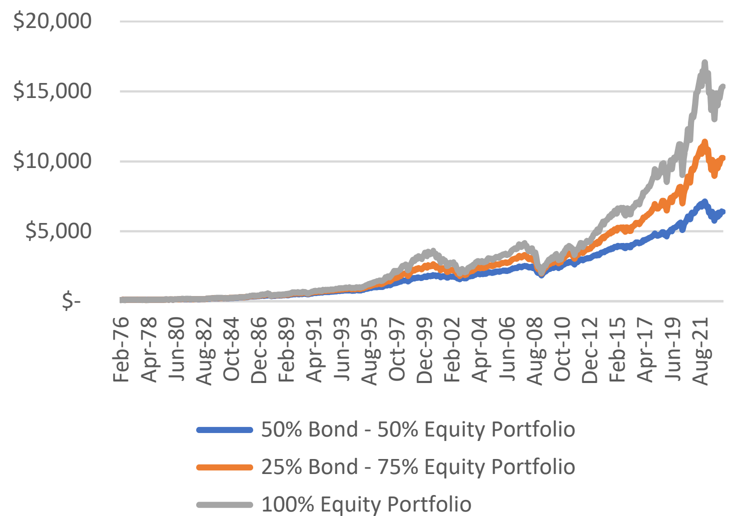
The effects of asset allocation can be seen even more clearly in Exhibit 5 below. Here we compare the returns of three portfolios invested in varying percentages of Equities vs. Bonds[6]. The results seem to speak for themselves, illustrating that larger equity allocations tend to increase portfolio volatility, but also significantly increase returns.

- A 50% Equity/50% Bond portfolio returned an annual rate of 9.3% or 6,608% cumulative over 47 years.
- A 75% Equity/25% Bond portfolio returned an annual rate of 10.4% or 10,750% over 47 years.
- A 100% Equity portfolio returned an annualized rate of 11.4% or 16,352% over 47 years.

Factors Driving Portfolio Performance (Exhibit 4)




Growth of $100 from 1976-2023 (Exhibit 5)




[4] Wall Street Journal website, July 6, 2023

[5] Roger B. Ibbotson. Does Asset Allocation Policy Explain 10, 90 or 100% of Performance? Financial Analyst Journal, Jan/Feb 2000

[6] Equity (S&P 500 Index), Fixed Income (Bloomberg US Aggregate Total Return Value Unhedged USD Index)

Based on the observation that asset allocation is the primary driver of investment returns, we believe that it is prudent for investors to focus their energy on this part of the investment process. As for the underlying equity and bond selection; outsourcing these decisions by allocating to Mutual Funds and ETFs is a great way to participate in market returns while diversifying holdings.

For investors looking for an edge over index-like investing through ETFs, there can be significant value added from employing active management through investments in Mutual Funds. Utilizing an active manager to make investment decisions can put an investor in the best position to stay away from two factors that tend to hamper returns; most investors inability to time the market, as well as to time the decision of when to enter/exit specific investments.

When investing with an active manager, there are several characteristics investors should look for:[7]

**High Active Share**

- There are numerous studies linking high active share to long-term outperformance. Although this is the case, only 30% of US Large Cap Equity funds have an active share of over 80%.

**Low Turnover Portfolio**

- There are several advantages to low turnover, two of the largest are that it reduces trading costs and limits tax implications. Additionally, turnover can adversely affect performance through variations in bid/ask spreads. This is especially relevant for larger funds and less liquid markets.

**A Focus on Risk Adjusted Returns**

- Over the long term (24+ months) a focus on risk adjusted investing has shown positive rolling alpha over a simple market index. For shorter periods (under 12 months) this trend disappears.

**Alignment of Interest**

- This is one of the harder variables to screen for and is generally discovered when conducting a more thorough fund review. However, funds with managerial participation tend to outperform their peers by 1.4% per year.

**A Reasonable Fee Structure**

- This may be the most obvious attribute to look for, as it reduces the drag on returns.

[7] Understanding the case for active management (http://www.dodgeandcox.com/pdf/white_papers/the-case-for-active-management.pdf

**Economic Overview**

| | GDP Forecast (2023) | GDP Forecast (2024) | Inflation Forecast (2023) | Inflation Forecast (2024) | IG Credit Downgrade |
|---|---|---|---|---|---|
| Argentina | -2.5% | -1% | 118% | 99% | N/A |
| Brazil | 2.1% | 2% | 5% | 4% | N/A |
| Chile | -0.1% | 2% | 8% | 4% | Low |
| Mexico | 2.2% | 2% | 6% | 4% | Medium |
| Peru | 1.8% | 3% | 7% | 4% | Low |
| Uruguay | 1.5% | 3% | 7% | 6% | High |
| Israel | 2.9% | 3% | 4% | 3% | Very Low |
| USA | 1.3% | 1% | 4% | 3% | Very Low |

*Data Source: Bloomberg Terminal, as of July 6, 2023*

**Market Overview**

| Equity | | Foreign Exchange | | Fixed Income | |
|---|---|---|---|---|---|
| S&P 500 Index | 15.9% | | | Global High Yield | 5.2% |
| Nasdaq Composite | 31.3% | USD | -0.4% | Global IG Cor: 50% | 2.4% |
| Euro Stoxx 50 Pr | 14.4% | EURUSD | 1.7% | US Corp. High Yield | 5.2% |
| FTSE 100 Index | -0.3% | GBPUSD | 5.4% | Corporate (USD) | 2.6% |
| Nikkei 225 | 27.0% | USDJPY | -9.0% | EM High Yield | 3.8% |
| Hang Seng Index | -3.9% | USDCNY | -4.8% | Investment Grade | 2.8% |
| Brazil Ibovespa Index | 7.0% | USDBRL | 7.4% | Treasuries | 0.3% |
| S&P Merval Tr Ars | 106.6% | USDARS | -32.0% | U.S. Treasury | 1.0% |
| S&P/Bmv Ipc | 12.0% | USDMXN | 13.1% | Sovereign | 4.0% |
| MSCI ACWI | 14.3% | | | Global Aggregate | 1.1% |

*Data Source: Bloomberg Terminal, as of July 6, 2023*

Chief Investment Officer, IPB
Alex Polshikov
+1-212-551-8297
APolshikov@IDBNY.com

**IMPORTANT DISCLOSURES**

This Monthly Market View ("Communication") is produced by Israel Discount Bank of New York ("IDB Bank"). IDB Bank is a registered service mark of Israel Discount Bank of New York.

The opinions are those of the Bank's International Private Banking division and are made as of the date of this commentary, and are subject to change without notice. There is no guarantee these opinions will come to pass. Other Affiliates and Bank divisions may have opinions that are different from and/or inconsistent with the views expressed herein.

This commentary is for our clients' general information. It does not take into account the particular investment objectives, financial situation, or needs of individual clients and does not contain investment recommendations. It is not an offer or solicitation to buy or sell any securities or to adopt any investment strategy. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by the Bank to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. Past performance is no guarantee of future results. Investment involves risks. International investing involves additional risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments.

**Investment Products:**

<table>
<tr><td>Are Not FDIC Insured</td><td>Are Not Bank Deposits</td><td>Are Not Bank Guaranteed</td></tr>
<tr><td colspan="2">Are Not Insured by Any Federal Government Agency</td><td>May Lose Value</td></tr>
</table>