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Why You Shouldn't Panic About Higher Rates and a Falling Market

Presented by Frederick Dunbar

As we encounter another downswing in the ongoing bear market, it's only natural to be concerned and ask questions. Here's where we are at the moment: using the S&P 500 as a measure, the markets are down 22 percent from the peak at the end of last year, and just under 14 percent from the end of the most recent rally in August. This year, there have been four drops and three rallies. We're down quite a bit, and that doesn't feel good. The question to ask is: what should we do about it? To figure that out, we need to look at two things.

Bear Markets in History

First, have we seen this before? In the broader sense, yes. We've seen this many times. Bear markets, generally defined as declines of more than 20 percent, are typical enough that they were given this name. Looking back to 1980, there has been a decline of 20 percent or more about every five years. That statistic changes to every two to three years when talking about 15 percent declines. Significant drops are a regular and recurring feature of the stock market, and it has always bounced back. This one is no different. We can reasonably expect the markets to bounce back at some point.

Why the Decline?

The second thing to ask, now that we know history is on our side, is: why is this happening? The primary reason is because the Federal Reserve (Fed) is raising interest rates in order to combat inflation. Generally, when the Fed is raising rates, the market will have a tough time. This is what's meant by the old Wall Street saying, "Don't fight the Fed." So, just as the existence of the phrase "bear market" speaks to how normal that phenomenon is, the reason for the drop is also normal enough to have its own catchphrase. These are both things we've seen before.

Looking Ahead

When we look at the primary cause of the pullback—inflation and the consequent Fed tightening of interest rates—we see reasons for both caution and hope. The Fed has committed to raising rates until inflation is brought under control, which is what sparked the current renewed downturn. This is a reason for caution. We can expect continued market turbulence for some time. When inflation eventually pulls back, however, that will open the door to sustained growth and market gains, as we've seen many times in the past. The Fed is performing metaphorical surgery on the economy right now. In the short run, it's painful; but in the long run, it's a healing process. This healing will set the stage for a healthier economy and markets just as we've seen historically.

A Positive Spin

Even in the short term, despite the pain, it's not all bad news. There are some positive side effects. Higher rates offer an opportunity for savers, who can finally get a decent, low-risk return. For those who are still putting money aside, a bear market offers a chance to buy stocks on sale, potentially leading to better future returns when the market recovers. Lastly, as always, a bear market gives you a reason to take a good, hard look at your portfolio, and find out if you're really comfortable with the risks you're taking.

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The Bottom Line

This is where we stand. The Fed is in the middle of a painful policy change and, while the headlines and current numbers are certainly scary, that change will lead to a healthier economy and stronger future growth. A bear market offers plenty of reasons to worry, but that has always been the case. Looking at history, bear markets have always come back to future gains. And, while markets are down at the moment, we're also seeing new opportunities appear. If you look at the bigger picture, and the longer term, we as investors are still in a position to work towards meeting our goals over time.

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