Market Volatility & Corrections

In a precautionary measure, the U.S. Federal Reserve cut rates by 0.25% on Wednesday, July 31. In the days that followed, the U.S. announced plans to impose a 10% tariff on the remaining $300B of Chinese imports that thus far have been left unscathed (goods that include smart-phones, laptops and clothing). This move marked a clear escalation which pushed China's retaliation in the form of allowing its currency to free float for a day and halting all soybean imports from the U.S. The equity markets in turn, reacted strongly to the downside. Trade and currency wars can be a dangerous game, and predicting the outcome is not a reasonable expectation. Maintaining a diversified approach with a disciplined strategy remains our best advice.

Perception is relative.

Over the past 5-7 years, the U.S. stock market has experienced relatively few corrections and low volatility. In this context, volatility spikes and associated market declines feel scary and unusual.

Volatility is normal.

However, market volatility and short-term declines are a regular part of the investment landscape. In fact, it is unnatural for markets to advance without pause or correction. History offers us many lessons of serious consequences when things stayed too hot for too long without adequate periods of cooling or catching a breather. We are now in a period of adjustment during which the market will seek to assess the very real uncertainties and risks that have the potential to negatively impact the U.S. economy which otherwise appears to stand on a relatively sound foundation. This process will take time to play out and is likely to be accompanied by additional volatility.

Don't fear a 'correction' per se.

While we haven't yet hit correction territory – defined as declines greater than 10% but less than 20% from a previous high – U.S. stock market corrections have occurred on average once per year since 1928. Having a correction, or even two, in a year is more common than not having one. Typically, the market recovers within 8 months.

Stay invested, even if it gets ugly.

Less than 20% of corrections turn into bear markets – defined as a decline of more than 20% from a previous high – but some do. This is when it can get really scary, but also when staying out of the market can be most detrimental. Why? In part, because the best market days typically occur within two weeks of the worst ones. For instance, despite two bear markets from 1998 to 2017, the S&P 500 still returned 7.20% per year to investors who stayed the course over the entire 20-year period. Had the investors missed only the 10 best trading days, they would have seen returns dwindle to 3.53% per year. Miss the 20 best days and the returns would have dropped to 1.15% per year.

What is HoyleCohen doing?

We know we can't predict the future and we don't try to "time the market." However, on a regular basis we do revisit our investment thesis to determine if our long-term assessment has materially changed based on new developments. We recently posted a piece from Capital Group entitled "A Guide To Recessions" which touches on the key factors that can indicate a downturn. These factors are not yet indicating imminent recession.

While corrections may be a good time to do a reality check on your risk tolerance, our objective is to help provide context and to prevent fear from unduly influencing the course that may be best for you over the long-term. If you would like to discuss further, please don't hesitate to contact your Advisor.

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