Calling someone who trades actively in the market an investor is like calling someone who repeatedly engages in one-night stands a romantic." - Warren Buffett -

February 9, 2018

What a ride! Global equity markets closed down in "correction territory" (down 10% from recent high) yesterday with crazy intra-day swings. CNBC reported that nearly 20% of companies in the S&P 500 are actually in "bear market territory" (down 20%). While walking to work yesterday I considered my own feelings about the recent stock market declines. I decided that it really didn't matter to me what traders were doing every day because I don't plan to tap my own investments for several years--and even then just a small portion each year. I just don't worry about my own money--but I do focus on how to help clients navigate turbulent times without the benefit of that magic crystal ball we all yearn for.

When thinking about the past few days, remember that we had gone 80 weeks without even a 5% pullback, when we normally see this kind of drop every 10 weeks. And the last 10% correction happened two years ago in February 2016. Investors enjoyed very calm waters in 2017 as stock markets around the globe steadily marched upward with very little volatility. That just isn't the norm--but more normal volatility can feel scary after such a smooth ride. We've been talking about the likelihood of increased volatility and a correction at some point for more than a year, and with global equities up over 20% in 2017 a 10% pullback just shouldn't seem like that big of a surprise. We know this kind of downturn can be scary--and no one knows if there's still more pain to come before markets find a bottom. As we shared with clients during the 2007-09 financial crisis, past downturns were also scary with different severity and length, but markets rebounded for patient investors.

We've been busy talking with our trusted partners and reviewing research from a whole host of sources to think about all of this, and again have concluded to stick with our globally-diversified strategies. Frankly, while markets have been volatile, there is good evidence that not much has changed in underlying economic conditions. In her very recent 2018 Market Outlook, Schwab's Chief Investment Strategist Liz Ann Sonders provided some very interesting information. Here is a short summary of some of her thoughts:

- All 45 major economies tracked by OECD are expected to see economic growth--about 1/3 are expected to see accelerating growth. None are expected to see contraction.
- The current US economic recovery is the 2nd longest, but weakest recovery since WWII.
- Leading economic indicators (LEI and CESI that we follow) are positive and showing no real stress.
- We now have the lowest corporate tax rates since 1939 and fewer regulations, both of which are good news for businesses.
- Wage growth is a mixed picture but low unemployment and more job postings may lead to rising labor costs.
- "Underlying" inflation is well above the Fed's target and ticking upward, so expect more Fed rate hikes going forward. But keep in mind 10-year Treasuries at 2.88% are still well below the 4% norm.
- Valuation is a terrible market timing tool with no correlation between valuation and S&P 500 performance over the next 12 months.
- Low volatility years tend not to repeat. There have been 10 years with a maximum drawdown of 6% or less since WWII and average returns were 25%. The following year, maximum drawdowns averaged 12% with average returns of 5%.
- Periods of high investor optimism (like we saw in 2017) tend to be followed by lower returns--while periods of extreme investor pessimism tended to be followed by good returns.

So, while not all-rosy, overall economic conditions around the globe look good, and we advise long-term investors to ride-out market ups and downs in a well-diversified portfolio that is prudently aligned with your financial goals and risk-profile. Because while the past may not predict the future, history shows this is a reasonable way to deal with volatility. Please let us know if you have any questions or concerns. We are here for you.

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