Special Update: Recent Market Volatility Perspective 11/16/18

Market declines like the 7% sell-off that the S&P 500 experienced this October or the "correction" (defined as a decline of more than 10%) that took place earlier this year are news worthy and have renewed anxiety among investors. Thoughts of the 2008 market crash that resulted in the "Great Recession" make it difficult to remain calm as investment balances decline. It is imperative to remember that market volatility is a normal occurrence and that changing a long-term investment objective by reacting emotionally can be more detrimental to your financial health than focusing on a long time horizon with a clear head, as many studies have shown.

As we continue moving into the later stages of what is likely to become the longest economic cycle on record this spring, market volatility is not only likely to persist but is expected. As noted in previous communications, the U.S. stock market experiences one 10% decline and three 5% declines on average per year. Recent volatility may feel abnormal or elevated this year coming off one of the least volatile year in decades. So, what is the driving force for the pickup in 2018? Three words… Federal. Reserve. Policy.

The Federal Reserve has a dual mandate of maximum employment and price stability. With unemployment at 3.7% (a 50-year low) and inflation, as measured by the Personal Consumption Expenditure Index or PCE, at 2.0%, spot on the Fed's long-term target, it certainly appears that the Fed is achieving their mandate. With the backdrop of above-trend economic growth, the Fed has taken the opportunity to continue "normalizing" monetary policy. The approach is two-pronged; first by raising the Fed Funds overnight lending rate by 0.25% a total of eight times since December of 2015 and secondly, by slowly decreasing its balance sheet by not reinvesting an increasing amount of principal payments from matured securities in its portfolio. Recent proof of the progress made thus far has resulted in the Fed dropping the language describing its policy as "accommodative" in its October minutes.

It would be difficult to argue that the Fed has not handled this process well thus far. However, the increased volatility is not so much about where we have been, but more so where we are heading in terms of policy moving forward. This is attributable to the history of the Fed increasing rates beyond a desired "soft landing", ultimately leading to recession. As of this writing we do not see an immediate recessionary threat on the horizon but will continue to monitor future moves and the impacts we believe could result in a repricing of risk assets. We need to keep reports of economic softness overseas and headlines of ongoing trade sanctions and tariffs in context. In an increasingly global world such policies have the potential to create additional stressors to financial markets. Experienced investors however view short-term disruption as long-term opportunity.

In closing, the key to any investment discipline is clearly defining your risk tolerance, goals and time horizon and matching an investment strategy with the highest probability of achieving success. Markets will trade on speculation, biases and emotion over the short-term, but we remain confident that over time they reflect the value of the underlying companies they represent. As with every other market pullback our experienced investment team has worked through, we intend to maintain our investment discipline and focus on capitalizing on opportunities that present themselves during turbulent periods.