Date: August 23, 2015

Category: Market Valuation and Direction

Multiple False Starts for the 2015 Markets

"A Year of Volatility"

By: Doug Horn, CFP®

(I would like to provide a word to my friends and clients about the current market activity. There is no need to panic or change long-term investment strategies. There is much happening both in the US and around the globe such as a slowing down in China, falling oil prices, the strength of the US Dollar, continued economic recovery efforts in Europe, persistent struggles of Greece, and lastly the discussion of the Federal Reserve to start raising the Federal Funds rate this coming September. While this may seem overwhelming, there is rarely a day the US economy isn't facing similar issues. Until additional data is released to indicate the contrary, this recent decline in the value of the markets appears to be the long anticipated correction.

You will see headlines using words like 'crushed' and 'plummeted'. For decades advice has been given to avoid reacting to *headlines* when managing investments. This time is no different. While the number of times the market has dropped 400 points or more is few, the markets have **always** recovered to set new highs. This is an opportunity to reposition and take advantage of quality companies now trading at lower values. I hope the following discussion and insights answer questions you may have.)

Beware of headlines touting the Dow's 531 point decline as one of the largest or largest since 2011. That is pure sensationalism by the journalists. Yes the Dow dropped 531 points, but it was only 3.1% of that day's value which has occurred before. In May of 2011, to drop 3.1% only required a decline of 384 points. In 2002, it required a drop of 268 points. As the Dow climbs over the years and reaches higher and higher levels, we will experience large point moves like this one or perhaps larger. But in many cases, they will be small percentage moves. There will come a time soon when the Dow will move up 2,200 points, and it will not even be considered a spectacular year.

A correction has been long overdue, since they can occur annually. Yet, the last correction was in 2011. Below I will go into more detail about corrections and bear markets, but let me first share why I believe this to be a correction and not something far more onerous. All of the US economic statistics are still positive indicating continued growth and not a move into a recession. With continued low interest rates, low unemployment, and positive gross domestic production (GDP), our markets will reflect this and start to gain in value.

For a correction to occur, it is always triggered by an event. In our world economy, there are many events taking place daily; and unfortunately, we can never predict which event will be the trigger. It appears the devaluation of the

Continued Insights

Chinese Yuan and the long anticipated increase of the Federal Funds rate is creating a strong case of heartburn for the markets. During 2015 to date, the investment markets headed into positive territory ten times, only to fall back to the year's beginning value or lower before starting the climb higher once again. A question can be raised, "Has something fundamental changed within the US economy or is this the start of a normal but long delayed correction?" As I stated earlier, there is no data indicating a weakening in the US economy, but we will monitor this closely so proper action can take place if required.

Now let me address the definition of a *correction* and a *bear* market. A correction is a retracement of recent gains resulting in a ten percent (10%) decline from the most recent high. The last high for the Dow Jones 30 Industrials was on May 19, 2015 when it reached 18,312.39. On August 21st, it closed at 16,459.75 which represent a 10.11% decline from the last market high. The long anticipated correction has finally occurred. To have a correction based upon our recent high, a decline of 1,831 points in the Dow was required. Whether it happened now, six months from now, or in a year, it would have occurred. By reaching a 10% decline, that does not automatically indicate the markets are ready to resume their march higher. We may continue to and most likely will see volatility in the markets. We will continue to monitor the markets to determine whether this is just a correction or a fundamental change in economic conditions.

With the last correction in the markets occurring in May of 2011, everyone's opinion meant a correction was due. While a correction may be anticipated, it not wise to sit on the sidelines until it occurs, because the gains achieved prior to the correction may easily outpace the value after the correction. This is certainly true since the last correction.

A bear market is when the index declines twenty percent (20%) from their most recent highs. Our last bear market was in 2008 and early 2009. Bear markets generally follow key economic events, such as a rise in unemployment rates or a slowdown in economic production which can lead to a negative growth rate. The US GDP is currently positive with a 2.99% growth rate for the quarter ending June. To date, there are no changes in the US economic conditions which would indicate we are headed for a bear market.

Regarding the issues facing our economy, I believe uncertainty is the primary concern in my opinion. The Federal Reserve has continually said their rise in interest rates is data driven, and not knowing those parameters raises questions as to whether an increase will or will not occur. Naturally, the follow-up question is whether or not the higher rate will impact our economy negatively. I can only speculate on the Federal Reserve's actions but anticipate the current data will support a minimal increase to the rate. Rate increases have always been interpreted positively, since it indicates a strong economy and thus able to withstand the increase.

Since China took the surprise action of devaluing their currency, this most likely added to the chain of events and the market decline. Like any economy, when it slows there is a ripple effect on those economies selling to it and buying from it. If China's economy is slowing, their citizens will be buying less, and thus business revenue will slow. Please remember, this is not new news. Ever since international trade began, one economy has benefited or suffered based

Continued Insights

upon the strength of their trading partners. China's currency, the Yuan, has also gained against other currencies recently just like the US Dollar. As a result, this requires buyers from other countries to spend more of their own cash to purchase Chinese products. This can result in a slowdown of exports and thus slows down the local economy. By devaluing their currency, they once again made their products less costly to other nations. Due to the large size of China's economy, even small changes can have an impact on world trade. However, this has also created uncertainty around the markets as to whether all the devaluations are over or whether there are more to come.

The Chinese have the reserves necessary and the ability to manage their economy, and I expect they will stimulate their economy. This action will be positive to not only their economy but the rest of the World's as well. Our economies are interconnected, and a tug on a string here often has a reaction somewhere across the oceans.

My conclusion is caution. Nothing has changed to change our long-term growth, and thus it should resume in the markets as well. But expecting a bumpy ride is prudent. We have recently modified some allocation and have been reviewing others to adjust. We will continue this process as we watch the ebb and flow of the market and global changes.