Quarterly Update

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April 5, 2018

The stock market, as measured by the S&P 500, recorded its first negative quarter since 2015. In fact, the S&P 500 has only registered two down quarters in the last four years, this being one of them[i]. In the last four years we've had a multitude of headlines that might scare investors out of the market, but it wouldn't have been a prudent move.

Today, we are faced with similarly scary headlines that might scare you out of the market. While we are suggesting caution, we are not suggesting abandoning long-term goals because of recent market action and volatility.

Let's look at what caused the first quarter to be choppy:
Heated rhetoric around tariffs and trade wars spooked investors and caused the markets to decline. The first salvo of the trade war came when President Trump put into place tariffs on foreign steel and aluminum. We believe this to be a bad move economically. According to the Council on Foreign Relations and The Aluminum Association, there are approximately 140,000 people employed in the steel industry and 161,000 people employed in the aluminum industry respectively. That's a lot of American workers, but it pales in comparison to the 17 million (according to the Bureau of Economic Analysis) employed in industries that rely on steel and aluminum. That makes the number of people the tariff negatively affects is 56 times greater than the number of people it supposedly helps. That doesn't even take into account retaliatory tariffs.

The President also instituted an additional $60 billion in tariffs on Chinese goods on March 22. This provoked China into enacting their own reciprocal tariffs on

U.S goods. The silver lining to this round is while $60 billion is a large absolute number, it only represents 12% of the total annual imports from China[ii]. So, the impact should be somewhat nominal. The greater risk lies in the escalation of these tit-for-tat tariffs to the point of restricting or reducing global trade. We believe the markets are selling off on the idea we are only getting started with the trade war.

Another reason for the market decline is technical in nature. While first quarter earnings we're very good, the market had risen more than it likely should have. As a Chartered Market Technician (CMT®), a discipline that studies supply and demand and its impact on prices, I analyze the global marketplace to see how supply and demand are playing out. In short, when demand exceeds supply prices rise, and when supply exceeds demand prices fall.

In January, there was a boost in demand for stocks thanks in-part to a strong 2017 and expectations for a good 2018, so prices rose. Too much arguably, as the S&P 500 rose by 5.73%, making it the third best month in the last 51 months. It was followed, however, by two of the worst months in the last four years that not only wiped out the gains in January, it turned the quarter negative[iii].

Although this market volatility can be uncomfortable, it is important to remember it is well within the norms of typical stock market behavior. Remembering this should hopefully provide some calm during stormy markets.

Going back to 1980, the average decline during the year in the S&P 500 is -13.8%. In 29 of those 38 years the market had positive returns by year-end[iv]. As of this writing, the market is down approximately -8% from its 2018 high for comparison.

Furthermore, below is a history of market losses going back 116 years from 1900-2016 and their average frequency to illustrate how market volatility is normal[v]:

- -5% or more – about 3 times a year
- -10% or more – about once a year
- -15% or more – about once every 2 years
- -20% or more – about once every 3 ½ years

The market and economy could and should continue to grow from here on the back of strong corporate earnings, low unemployment, and low inflation among other positive things. Moreover, despite the fact the Federal Reserve raised interest rates again in their March meeting, interest rates aren't flashing danger yet.

Every recession and resulting market decline since 1976 has been preceded by an inverted yield curve[vi]. An inverted yield curve simply means a 2-year U.S. Treasury note will pay you more than a 10-year U.S. Treasury bond, thus indicating fear and doubt in the marketplace. As of this writing, the 2-year Treasury is paying 2.28% and the 10-year Treasury is paying 2.79%[vii], meaning the yield curve is not inverted and thus not signaling danger, for now.

In conclusion, while we are optimistic about the economy and markets, we are cautiously optimistic. While the rhetoric around the trade war is heated indeed, it is not materially at a point yet of causing real and lasting damage to the U.S. economy. Remember, market volatility is normal and it is important to keep a long-term perspective on your financial lives.

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[i] Source: Morningstar

[ii] Source: Transamerica Asset Management Inc.

[iii] Source: Morningstar

[iv] Source: J.P. Morgan Asset Management

[v] Source: Capital Research and Management Company

[vi] Source: Federal Reserve Bank of St. Louis

[vii] Source: U.S. Department of the Treasury