Newsletter

State of the Economy

April 2018

While 2017 represented a year of tranquility in the stock market; volatility has come roaring back in 2018. The sudden increase in inflation and a potential trade war resulted in two market corrections already this year. A correction occurs when a stock index falls more than 10% from the high point from the prior year. The two quick market drawdowns instilled some fear among investors who were getting used to the steady climb in equity valuations. The stock market generally does not work well with uncertainty. Nevertheless, investors will likely be grappling with uncertainty in the foreseeable future.

The stock market was due for a correction coming off a banner year coupled with the pressure inflation has put on interest rates. The stock market is in year nine of an epic bull run, thanks in part to the help of the Federal Reserve and its decision to hold interest rates at historically low levels. After low rates helped improve the economy, the Fed has subsequently raised rates six times the past couple years to try to prevent the economy from overheating. Surprisingly, the rate increases haven't lead to higher bond yields until now. With the unemployment rate near an all-time low, a sharp increase in wages finally occurred this past January. Wages grew at the fastest pace since 2009, leading to concerns of spurring inflation. The 10-year treasury rate increased close to 3% during this time. The threat of rising interest rates can lead to higher yields for bonds and treasuries, providing investors other options to stocks. This can impact some investors to partially move out of the stock market, resulting in a decrease in prices.

Despite growing investor concern, the Federal Reserve raised rates in March. Led by new chairman Jerome Powell, the Fed unanimously voted to increase its benchmark federal funds rate by a quarter percentage point from 1.5% to 1.75%. An increase in economic activity and the stellar February jobs report helped play a key role in their decision. The Fed is facing a challenging time with the sudden uptick in inflation. Their goal is to avoid raising rates too fast to help keep inflation below their 2% target. However, if they move too slowly the economy could overheat and possibly trigger a recession. Based on their new forecasts, officials predicted faster economic growth, higher inflation, and lower unemployment in the near future. Consequently, the Fed is signaling a faster pace for raising interest rates in the next few years.

The rise in interest rates was not the only factor spooking the stock market over the last three months. The White House also played a large part in the shake-up of the global economy. President Donald Trump followed through with his campaign promise to impose global tariffs due to what he considers unfair trade agreements. So far tariffs will be imposed on imported steel, aluminum, and Chinese imports. However, not everyone has agreed with this decision. Top economic advisor Gary Cohn resigned from his post in early March and China has vowed to fight back with their own tariffs against the U.S. The rest of the world is also providing mixed reviews while Trump administration signals a softening stance toward its allies. Another factor creating uncertainty in the markets involves how the corporate world, particularly technology companies, handles privacy concerns. Facebook came under fire due to mistakes they made with the handling of user data. The growing controversy has shaken social media and the tech world. These major issues brought back fear and insecurity to the state of the market.

As we pay close attention to the various events affecting the stock market going forward, it's important to focus on your own individual situation. The recent pullbacks in the market provided us a sample of what a future recession could look and feel like. We should be asking ourselves what we are willing to lose if the market has a steep drop in prices. We should be evaluating our goals and time horizon for our investments, so we can be prepared to endure through down times.

I am confident two things will always happen when investing in the stock market. The market will witness a significant drop in the future, but it will also rebound and surpass the all-time high in the long run.

Are your investments positioned to stay the course?

Sincerely,

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