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The Long Awaited Market Correction

The recent sudden and significant drop in global stock markets has many investors on edge. With memories fresh of continuous equity highs, retail "mom & pop" investors as well as professional money managers seemed to be caught off guard by this stock market correction of about 10%. Not us. As written in our Year-End 2017 *Investment Insights*: "… while we are "running with the bulls" for now, we are still somewhat cautious (with lower stock positions than normal) compared to other upbeat money managers … This is in light of high stock valuations and the potential for lower returns going forward, along with rising interest rates and possible declining bond prices."

So what caused equities to rapidly decline? Will stocks continue to drop? What is our strategy going forward?

To discuss why we've experienced the recent market meltdown, it's important to first talk about the market "melt-up" of the past two years. From a purely fundamental perspective, investors experienced the tailwind of a synchronized global economic expansion, "easy" monetary policies by central bankers keeping borrowing rates low, very low market volatility and arguably pro-business policies (such as executive deregulation and tax reform) enacted by the Trump administration. And as the 9-year bull market churned ahead—from a behavioral perspective—retail investors and money managers with high account cash values of late experienced an even greater level of FOMO (Fear of Missing Out), hence an anxious "urge" to invest more cash in a rising stock market with virtually no turbulence, despite ever higher-soaring stock and cryptocurrency prices. (To wit, investors added about $100 billion into equity funds in January as the Dow Jones Industrial Average set new record highs nearly every day. The price of bitcoin had tripled over a month between November and December.)

Now many of these same investors (more accurately—traders) are selling. Why? While there is not total agreement from market experts on all the causes, most agree that: 1) investors were spooked by the sudden rise in Treasury yields, thinking that the bond market was signaling a problem in the economy … mainly rising inflation as news of recent wage growth was higher than expected, 2) with high inflation, the Federal Reserve would be forced to raise the Fed funds rate more rapidly than expected—causing a potential recession by choking off consumer and corporate borrowing, and 3) "forced selling" by large hedge funds, algorithm/robo traders on autopilot, and retail investors—all whom were either caught placing the wrong bets (low volatility, excessive leverage or borrowing on a rising stock market, cryptocurrencies, low bond yields, etc.), or 4) investors just over-allocated to stocks and other "risk" assets in general—all expecting the party to continue another day.

Will global stocks continue to decline?

Since our crystal ball is missing it's impossible to answer this question. Still, as of this publication, with stocks gyrating from positive to negative and back intraday, it seems markets are about to shake out the excess sellers. So we expect a market bottom to happen soon.

Are we in a market meltdown or global financial crisis like in 2000 or 2008?

Not likely. In 2000 equities (especially technology stocks) were extremely overvalued. While today one can argue that, based on solid corporate earnings, stocks are more in the fair to fully-valued range. (Especially given the recent decline in company stock prices.) In 2008 we experienced a financial crisis—a systemic problem involving sky-high housing prices and consumer debit, tied with unregulated poor bank lending procedures, and associated bad brokerage loan securities packaged products that blew up when attempted to be sold. This triggered a full global stock market panic and the Great Recession. In contrast, economist view today's global economy and financial system as sound.

What is our strategy going forward?

Strategic Financial Concepts' strategy is the same as planned and discussed in previous *Investment Insights* publications. In our last newsletter we stated, "History indicates that there's likely to be a pullback in the stock market of over five percent in any given calendar year, which did not happened in 2017. When the market does decline (and it will), we anticipate using our excess portfolio cash to invest mainly in beaten-down stock holdings to increase our equity positions in all model portfolios."

Once we believe markets have settled (perhaps soon), we will make minor simultaneous trades to increase stock positions at lower prices (mainly in best-valued and growing emerging markets) and buy additional fixed income holdings that will potentially prevent bond losses as interest rates rise. Some excess cash and a small portion of "core" bond holdings will be sold for these purchases. More information will be provided when the trades are made.

We appreciate your continued confidence. Your inquiries are welcomed.

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