"Why can the markets fall quickly and rebound slowly?"

By Tommy Williams, CFP®

How can the stock market fall when the economy is doing well? The answer is that one reflects the past and the other anticipates the future. The recent advance estimate from the *Bureau of Economic Analysis* showed the U.S. economy grew 3.5 percent during the third quarter of 2018. Harriet Torry of *The Wall Street Journal* reported:

"The economy powered ahead in the third quarter, driven by robust consumer and government spending, though Friday's report included warning signs that the business sector faces turbulence that could hold back the expansion in the months ahead."

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Third quarter's economic growth was slower than economic growth during the second quarter and stronger than economic growth during the first quarter of 2018.

Economists refer to economic growth as a 'lagging indicator.' It is a measure that may help confirm longer-term trends, but offers little information about the future.

In contrast, the stock market is a 'leading indicator.' It reflects what investors think may happen over the next few weeks or months. The volatility we've seen during the past two weeks suggests investors are uncertain about what may be ahead. Many factors are contributing to uncertainty. For instance, investors are concerned:

- **The U.S. economy may grow more slowly.** Economic growth slowed during the third quarter and investors are uncertain whether the trend will continue through the remainder of 2018 and into 2019.

- **Negative earnings guidance from companies.** Corporate earnings growth was robust during the third quarter. Through Friday, almost one-half of companies in the Standard and Poor's 500 Index had reported earnings and their blended earnings growth rate was 22.5 percent, according to *FactSet*. However, despite strong earnings growth, many companies' shares lost value. One reason is a fair number of companies have issued negative guidance indicating earnings may be weaker in the future.

- **Trade tensions could slow global growth.** While trade disputes with Mexico and Canada have been resolved, trade issues between the United States and China remain. Al Root of *Barron's* reported:

"Now, on third-quarter calls, companies have begun to spell out tariff impacts in greater detail. Calculating the ultimate impact of tariffs isn't easy or precise. A fair calculation would include not only costs but also changes in demand and the possibility of supply-chain disruptions. The result could be significant. The International Monetary Fund lowered its global growth expectations when it released its recent outlook because of, in part, ‘escalating trade tensions.’

- **Federal Reserve rate hikes could slow economic growth too quickly.** The Fed has begun raising the Fed funds rates, encouraging interest rates higher, in an effort to keep inflation in check. Some are concerned the Fed may raise rates too quickly or too high and choke economic growth.

You have heard me say, “Markets hate uncertainty.” Recent volatility seems to be the result of uncertainty and it is possible that this condition will persist for some time. Another interesting factor (experts tend to agree upon) that impacts volatility to the downside is the trades executed by traders using technical analysis. They tend to watch trends using an algorithmic process which can be calculated instantly. This can create a “snowballing” effect as one sell trade triggers the next, which triggers the next, etc., etc. On the other hand those adhering to fundamental analysis look at actual valuation metrics (like price to earnings, etc.) and it takes more time to do the math and arrive at a buy or sell decision. Therefore the market can fall quickly fueled by the technical guys, yet recover slowly fueled by the fundamental guys. The good news is that the fundamentals are largely favorable now. It is one of those times when a competent trusted advisor can be very valuable!

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Tommy Williams is a CERTIFIED FINANCIAL PLANNER™ Professional with Williams Financial Advisors, LLC.

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