SSI Investment Management

Recent Market Turmoil – Now What?

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Given the recent market pullback, we thought you would be interested in SSI's take on recent events, along with our updated outlook.

Investment Environment

The third quarter was a very strong period for the stock market, with the S&P 500 up 7.7%. This brought the third quarter year-to-date return to 10.6%. As we have seen in the past, it is not unusual for stocks to pause or even pullback after a period with extremely strong returns. However, the downdraft beginning in the fourth quarter was quite dramatic, as the S&P 500 fell more than 6%, while the Russell 2000 and NASDAQ declined nearly 9%. The speed and magnitude of this decline has raised concerns about a potential end to the long Bull Market, which has been in place since early 2009.

From a fundamental perspective, two of the key drivers of the stock market remain favorable:

I. The domestic economy is thriving with historically low unemployment, strong business and consumer confidence, and GDP growth over 3%. As a result, the United States continues to attract capital from around the globe.

II. Corporate America is producing high single digit revenue growth and earnings growth over 20%. Next year, earnings could also grow by double digits, even as we lap the benefits of the 2018 tax cuts.

The third key driver of the stock market has been low interest rates. As the economy has continued to strengthen, the Fed has raised rates from near 0 to over 2%, and the yield on the 10 year US Treasury has risen to over 3%. While these rates are still low by historical standards, concerns have risen that they are approaching a point where they could negatively impact the stock market. Up until this point, the move in rates has been consistent with the strength in the economy, and we don't expect the Fed to be overly aggressive and raise interest rates to a level which leads to a protracted market downturn.

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In addition to concerns surrounding the Fed and rising rates, several other factors have contributed to the recent market sell off:

I. Growing trade tensions with China and the potential impact on the global economy.
II. Several emerging markets are struggling, and there are some signs of weakness in global markets.
III. The European Union is experiencing slow economic growth, and is under pressure from ongoing Brexit negotiations and a new anti-austerity government in Italy.
IV. Political uncertainty as the November elections approach.
V. Corporate buybacks, which have been a significant contributor to the Bull Market, are not able to provide their usual support to the markets due to the "blackout" period prior to the upcoming earnings season.

At this juncture, we are monitoring all these factors, but don't expect any of them to derail the bull market. We do, however, expect higher equity volatility to continue. Volatility more in line with historical norms means more frequent pullbacks, and even corrections, than we have seen in recent years. However, without a significant deterioration in the prospects for the economy and corporate earnings, we would expect signs of stability in the equity markets relatively soon. If this does not materialize and other key drivers turn negative, we are prepared to take defensive steps in client portfolios.

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