MARKET UPDATE

Your information connection

08.24.15

The Return of Market Volatility

Consider the "Fasten Your Seatbelt" sign officially lit up. It's about to get bumpy. After an extended period of calm, volatility has returned to the equity markets. A weak start to August turned into a much more pronounced decline as the major market averages were off over 5 percent last week and began this week down another 3%.

While the magnitude of these declines have made headlines, the markets have been making a silent retreat since the beginning of August. In fact, both of the major market averages have been negative in 13 of the last 15 trading days. These declines have been echoed overseas by equally large sell offs in the major markets of the world.

With today's declines major indices have entered a formal correction, which is defined as a decline of more than 10 percent. This correction is not entirely unexpected, given that they typically occur every 18 to 24 months and the last one was in 2011.

While these dramatic declines may stir up bad memories of the last round of dramatic sell offs before the recession, it is important that investors understand that the economic circumstances are not the same now as they were then. The 2008 crash was only part of a larger economic calamity, which included the near failure of the banking system, record home foreclosures and massive job losses, conditions we believe do not exist today.

Keep reading to learn more about the causes of this correction and our opinions on its impacts in the short and long-term for investors like you.

What caused last week's decline?

While the popular consensus has China as the primary catalyst, we believe that to be the most convenient answer but not the most complete one. From our perspective, concern about *global* growth is a more accurate description. Despite significant stimulus efforts by the global central banks, global growth has remained below average for the post 2008 recovery. China is the world's second largest economy and a significant market for American products, so it is certainly a real concern. We believe China's latest efforts to counteract slowing growth rates simply brought global growth concerns into focus and, in turn, caused investors to question whether global stock prices were too high. Not surprisingly, companies with the highest valuations were most impacted in Thursday and Friday's market decline.

Most headlines are also listing falling oil prices and concerns that the Fed may raise rates as causes as well. In reality, both of these items are simply symptomatic concerns about slowing global growth.

Is this a buying opportunity?

At LAMCO, we do not believe this decline to be a buying opportunity. While stocks are undoubtedly cheaper than they were a month ago, at this point, we do not believe they are trading at bargain prices. At an estimated Price/Sales ratio of 1.71 on the S&P, this remains one of the more expensive markets since 1990.

This is not to say the market won't recover. In fact, a short-term rally in the not so distant future is a real possibility. However, any rally in prices without an improvement in the underlying fundamentals will only accentuate our concerns about excessive valuations.

Recent market activity has conditioned investors to buy on market dips. With the belief that the US Federal Reserve and the other Central Banks would defend global growth without reservation, investor complacency has become prevalent. In fact, until last week, the main periods of market volatility have typically resulted from fears that the US Federal Reserve was ready to raise rates, effectively announcing last call to an investor base that has already had too much to drink. Unfortunately, complacency turned into panic last week with the CBOE VIX (often referred to as the fear index) rising 46 percent on Friday and nearly 100 percent for the week. In Monday's trading, the VIX briefly reached a level of 46 before settling back to a close of 37.7, over a 140% increase from one month ago.

Is it time to sell?

We also do not believe that this decline represents a reason to sell. Exiting the markets, in whole or in part, requires a conviction in the belief that we are in the early stages of a significant downturn. Despite our concerns about stretched valuations and slowing global growth, we view a significant sustained downturn only as a possibility and not a certainty. We believe that it is more likely that we are looking at a natural and healthy, although uncomfortable, market correction.

With that said, the current environment is extremely dynamic, with fears of deflation and inflation often entering into the same discussion. The range of what could happen in the future is broad.

Positioning a portfolio that contemplates one outcome (a significant bear market), or a narrow set of possible outcomes, requires a level of forecasting precision that simply does not exist. Simply put, it is not possible to consistently predict the unpredictable. That is why LAMCO's client portfolios are positioned to withstand this wide range of possible outcomes, seeking to flourish in some and survive in others. We believe that a diversified approach amongst assets that will behave differently in a wide range of outcomes is the best approach in this environment.

So, what should I do?

At this time, we suggest revisiting the objectives of your portfolio and ensuring you both understand and can tolerate the risk being assumed by your current approach. We would also advocate identifying any cash needs you may have over the next several of years and ensuring those assets would be shielded from market volatility, should it occur. It is important in market environments such as these that any need for your assets can be adequately matched by the availability of those assets.

LAMCO's overall opinion.

We have been and remain cautious. Our caution is derived from the lessons we have been taught by markets past. Those lessons have proven that a successful strategy is not one that correctly predicts short-term market movements, but rather one that, over the long-term, patiently delivers the required amount of return within a tolerance for risk that you can comfortably assume. While the forecasting of significant market turns is alluring, the reality of an incorrect decision can be devastating to your ultimate objectives.

It is in this environment of excessive valuations, unprecedented central bank intervention and uncertain global growth LAMCO remains cautious and vigilant. We are continuing to monitor the situation and will continue to publish updates as necessary.

Taking the next steps with a partner you can trust.

If you do not feel comfortable with your current approach, we recommend speaking with a professional advisor who can assist you in ensuring that your approach is appropriate for your objectives and risk tolerance. With a watchful eye on up-to-the-minute market updates and decades of experience improving the efficiency of our clients' portfolios, LAMCO's advisory services can help you determine the most prudent approach to maintaining your portfolio's effectiveness even through volatile periods.