Cobblestone Investment Update

December 6, 2018

Are Volatile Markets the New Normal? On Tuesday, December 4, the S&P 500 was down 3.2%. It was one of the worst days of 2018 for US stocks. Some of the more interest rate-sensitive, cyclical areas of the market such as Financials and Industrials were hit the hardest, whereas defensive-oriented sectors such as Utilities typically fared better. This morning, the selloff continued as the market opened lower.

While it is difficult to pinpoint exactly what caused the selloff, potential catalysts underpinning the surge in volatility include the persistence of trade-related concerns, uncertainty regarding the future path of Fed policy, and continued softening in the world's second largest economy of China and its implications on broader global economic growth.

The uptick in equity market volatility can certainly be unsettling. It also underlines the notion we have espoused for some time: investors should not expect the relative market tranquility experienced throughout 2017 to continue. It is true that the fundamental underpinnings of the economy generally appear healthy. Corporate profits remain strong, inflation is relatively contained, and labor market activity continues to strengthen. The open question, however, is whether these positive trends are sustainable.

Underlying data from GDP releases throughout 2018 show that business investment growth has consistently slowed. Specifically, nonresidential business investment grew by 2.5% over the latest quarter, its slowest pace since 2016. Further, net exports decreased by approximately $100 billion, with overall trade activity providing the largest drag on US economic growth in more than three decades.

The US also continues to move later in the cycle, a period typically defined by rising risks. This is occurring at a time when trade tensions are escalating between the US and its trading partners. If these tensions persist, business, investor, and consumer confidence may be negatively affected, posing a material risk to global growth and financial markets. Taken together, the current backdrop supports an increased likelihood of market volatility. Hence, when considering whether volatile markets are the new normal, our answer is yes.

Bottom Line. Although the US cycle continues to mature and investment risks are rising, there remain few observable excesses that suggest a recession or prolonged bear market is imminent. While it may be tempting to make changes to your portfolio following the recent pickup in market volatility, we suggest taking a broader perspective to determine if repositioning is appropriate. We recommend reviewing your long-term objectives, current financial position, and tolerance for risk. Absent any changes in these areas, adjustments to your investment allocation are likely unwarranted. Instead, a more appropriate approach is to be prepared to take advantage of opportunities to purchase compelling investments that sell off indiscriminately as the market pulls back and valuations improve. As seen in the accompanying chart, this occurred globally amid the recent bout of volatility, and the MSCI All-Country World Index Forward P/E remains near the 2016 and 2014 lows—a silver lining for investors, indeed.

As always, please call with questions or concerns. We understand that volatile markets can be unnerving, and we believe conversations with clients can be invaluable in times of uncertainty.

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