The Elusive Correction

by Kamyar Kashfi CFS

As of today, August 21st, the S&P 500 is touching an all time high of 1993.53. The S&P 500 has experienced nearly 3 years of uninterrupted gains without a significant pullback.[1] Along the way the market has climbed many walls of worry including Fed tightening, European crisis, gridlock in Washington and countless conflicts abroad. U.S. equities, and bonds, are clearly garnering a lion's share of investment dollars because of the relative safety of our markets. This does not mean, however, that we will not eventually experience a dip in prices. The big question is "when?" not "if" this will occur. While the market has enjoyed a steady climb as of late and the path of least resistance seems to be higher, we know from experience that corrections can come suddenly and markets tend to go down faster than they go up. The trend is your friend until it ends.

The U.S. economy has been referred to as a Plow Horse Economy in recent years. The economy is fundamentally improving along with unemployment at a tepid but steady pace. It is not running away like a race horse but it is slow and steady like a plow horse.[2] Slow growth is welcome relative to the volatility overseas. In this global economy that we live in, however, the risk of contagion is real and nobody can go it alone forever. A dip in the market will happen but we don't know when or why. Index returns are luring individual investors who have been on the sidelines for much of this unprecedented bull run back into the market.[3] Bond funds are experiencing outflows and stock funds are gaining momentum.[4] Investor appetite is increasing at a time when stocks are hitting highs. Fundamentals may warrant higher prices as earnings improve but I cannot remember a market peak that did not coincide with relatively strong fundamentals.

I am not trying to argue that the market is about to crash. In fact, if you read my previous newsletters you will see that I have been positive on the market even when many others were not. I have argued that investors should ignore the noise and focus on the underlying strengths and improvement in the market and economy.[5] I would argue the same today. I would also argue that investors should take measured steps to protect themselves. These steps include being diversified, employing a method of periodic review and rebalancing, and embracing some fixed returns for a part of their portfolio regardless of how unappealing the yields may seem. Low yields can be quite attractive relative to big losses. Some structured products today even allow for high yields with some degree of principle protection just in case markets decline. The option of earning 9% or 10% yields in addition to potentially having access to all of your principle even after a 20% decline in the market may be worthwhile to review the associated risks and investigate whether they may be appropriate for your goals.[6]

The market looks strong today, as it always does when it is at a new high. Here in California, we are experiencing the worst drought on record but it doesn't mean we shouldn't plan ahead for a rainy day. Call or email me so we can review your account and any new offerings.

1. http://www.bloomberg.com/quote/SPX:IND
2. http://www.ftportfolios.com/retail/blogs/economics/index.aspx
3. http://www.bloomberg.com/news/2014-08-01/money-flowing-amid-selloff-with-s-p-500-etf-getting-7-6-billion.html
4. http://www.forbes.com/sites/spleverage/2014/08/07/us-high-yield-bond-funds-see-shocking-record-7-1b-cash-outflow/
5. http://www.stockcross.com/home/resources/resources/newsletter
6. http://www.stockcross.com/home/investments/investments/daily-offerings?pmId=11

Broker Spotlight

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