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Stock Market Volatility Redux

It has been slightly more than six years since the world stock markets experienced significant volatility. As most people are aware, the U.S. and world stock markets have experienced an extended period of exceptional returns with low volatility. Therefore, the current drop in the markets, especially of this magnitude, can be unsettling to many.

The U.S. stock market began its recent descent on January 29 and swings continue today, February 6. The over 2,270 point decline in the Dow Jones Industrial Average from its close on Friday, January, 26 through yesterday's close, represents an 8.5% decline. Stock markets worldwide have also reacted with declines equal to or greater than the decline of the Dow. So what has caused these meaningful market declines over such a short period?

Historical Market Declines

We can point to no significant fundamental reasons causing the severe market volatility observed over the last week. Some attribute the drop in stock prices to a recent increase in interest rates, resulting from continued strong economic growth and possible inflationary pressures. Others believe that it is a short-term phenomenon induced by the collective actions of speculators.

When the stock market began its three-year decline in 2000, most attributed it to an end to the internet and technology bubbles combined with the Enron and WorldCom scandals, and the devastating September 11 terrorist attacks. In 2008 another bubble burst—the housing market—along with the failure of Lehman Brothers, AIG, Washington Mutual, Fannie Mae and others.

Significant market declines are normal and investors should expect periodic market retreats similar to what they are observing now. 2017 was certainly an anomaly. Last year's largest decline for the broad U.S. stock market, at 2.6%, was the smallest decline in history for any given year. Stocks experience an average decline of about 11% from their highest peak to their lowest point during any year. For perspective, such a drop today would translate to a nearly 3,000-point drop in the Dow Jones Industrial Average.

Markets must be managed for the long-term

There are times when a significant market decline gathers momentum as investors observe, and react irrespective of any fundamental knowledge of the economy. We also know that no one can predict exactly when the markets will reverse course. It could be today; it could be next week, next month, a year from now or sometime farther in the future. History has shown that investors who panic by dumping their stock holdings return to the markets too late, and would have been significantly better off had they done nothing. These types of declines can be healthy and they present opportunities for long-term investors.

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Most believe that the U.S. and world economies are on solid footing. The International Monetary Fund recently released its World Economic Outlook increasing its growth forecast for the U.S. and the rest of the world. The U.S. is operating at what many consider “full employment,” with the unemployment rate at a generational low of 4.1%. Consumers surveyed reflect high confidence in their near-term economic future. Business activity reflected in various surveys also points to continued U.S. economic growth. Economic conditions overseas are also strong as European growth is the best in seven years and developing economies have produced solid and sustained growth.

Wespath manages through a long-term, disciplined strategy

So what does all this mean for the investments managed by Wespath? It means that we must maintain our focus. As we have stated when faced with past economic challenges, Wespath has adhered to a consistent, long-term and disciplined strategy for managing a diversified investment program. We continue following this strategy in both up markets and down markets, and it has successfully stood the test of time. We are confident that our approach is prudent and will continue to faithfully serve the retirement needs of our participants.

Our long-term view is an important aspect of our investing strategy. We avoid making hasty investment decisions in response to short-term market volatility. No one—not even the most skilled financial experts—can accurately predict the short-term direction of the U.S. and world stock markets. And past performance is no guarantee of future performance. History has proven—from 2000 to 2003, and again from 2008-2009—that adhering to a disciplined strategy is the best policy—it works.

Wespath understands that market volatility is a source of stress and anxiety for participants and our institutional clients who have seen their account balances decline. These swings can, understandably, cause participants to worry about their retirement security and institutional investors to worry about sources of funds to support their missions. All should take comfort in the fact that Wespath will maintain its disciplined strategy of managing diversified investments.

As always, we will monitor the current episode of market volatility over the coming days and weeks. If warranted, we will also provide additional perspectives about the impact of events on the economy, the possible effect of policy decisions by U.S. and world regulators, and the performance of Wespath’s funds.

Sincerely,

Dave Zellner
Chief Investment Officer