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Volatile September market is true to form

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In my September column, I warned that September (and October) could be down months, with a correction of 5-7 percent possible. I thought that this pullback should be used as a buying opportunity. September and October are frequently volatile. The market lived up to expectations with September seeing wide market swings: Six days had over 100 point changes and one day had more than 200. The volatility index rose from 36 percent. The market in September saw the S&P drop by 1.4 percent.

October is often a scary month, and not just because of Halloween. Since 1929, the S&P has risen or fallen 6 percent or more on 91 occasions. Twenty-five of those changes have occurred in the month of October.

At the beginning of the financial crisis in 2008, the market had five moves of 6 percent or more, with moves up of 10.8 percent and 11.6 percent in a day, and down moves of 9 percent, 7.6 percent and 6.1 percent all in a day. In October 2008, in spite of the volatility, the market ended up 8.6 percent. History suggests that October could be a volatile month.

Many global concerns fed September's pullback. China's growth appeared to slow. The umbrella revolution unfolded in Hong Kong. Europe, with woes exacerbated by Ukraine, slid closer to recession and deflation. Ebola threatened to spread. Only the U.S. economy seemed to expand.

The expansion in the U.S. economy led American investors to fear that the Federal Reserve might raise interest rates sooner rather than later. This fear was a negative for the markets, but positive for the dollar. The dollar has strengthened against major currencies.

Dollar strengthening has in turn worried the markets, as investors thought that U.S. exports would be less competitive, thereby slowing the U.S, economy. The strengthening dollar attracted more investment into the U.S., particularly into fixed income, which of course put downward pressure on interest rates. This downward pressure gave the Federal Reserve more leeway to raise interest rates.

The strengthening dollar meant that oil prices fell, which is a real plus for the economy (and a headache for Mr. Putin). Other commodities fell too, in part because of the slowing Chinese economy. These falling prices led to fear of deflation. So, you see, up is down and down is up. It is enough to give investors headaches.

In general, the strengthening dollar will be a net plus for the U.S. In past periods when the dollar has strengthened, the market has risen. The reason is not a cause and effect, but a coincident indicator. The dollar strengthens because the U.S. economy is stronger relative to other economies. Similarly, interest rate increases are often accompanied by a market rise, because interest rates tend to go up when the economy is stronger and sometimes are thought of as a leading indicator of equity markets. Of course, the talking heads sensationalize these trends to instill fear, because it attracts listeners, stirs up interest, and makes viewers hungry for more. It sells newspapers too.

On the other side of all the negative news is the growth in the U.S. economy – 4.6 percent in the second quarter of this year. Unemployment fell to 5.9 percent, a six-year low. The rate of unemployment was helped, however, by the fact that even fewer people were participating in the labor force. The labor force participation rate fell to 62.7 percent, as more and more people opted out of work and into the transfer payment way of life. Cursory observation shows that there is no shortage of jobs, but rather people who want them or are qualified for them. Eventually the shortage of workers will put upward pressure on wages, which are now growing at about a 3 percent annual rate.

Housing, one of the mainstays of the economy, has been erratic: Existing home sales are down, but new home sales are increasing. One of the drags on home sales has been the inability of people to get a bank loan. Recent government regulations have deterred home loans, and some small banks have exited the market.

Even seemingly qualified borrowers, such as Ben Bernanke, have had difficulty getting a loan. It has been reported that Mr. Bernanke, former Federal Reserve chairman, was turned down for a home equity line of credit. The reasons are unclear, given that he has a million-dollar deal for his book on his time at the Fed, receives speaking fees in the six figure range, and has a good, steady job. However, he did recently change jobs – always a red flag with the robo underwriters today.

In general, I believe that, in spite of our government's impediments, the weakness in the European economy, the threats from Mr. Putin, Hong Kong, Ebola, and ISIS, and the slowing growth (to 6-7 percent) of the Chinese economy, the U.S. is still, relative to others, the best place to invest. With cash returning next to nothing and fixed income under pressure from rising interest rates, equities still appear to be the most attractive asset class.

Wise investors will use this pullback for investment opportunities. Warren Buffett stated recently that times like these are when he likes to invest. The market seemed to hear him with a strong rise just after he made his statement. Noted investor Shelby Davis has said, "You make most of your money in a bear market; you just don't realize it at the time."

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