10300 SW Greenburg Rd.
Suite 115
Portland, OR 97223

Client Newsletter – 3rd Quarter

Market suffers steep drop and then bounces

What was that all about?

We all know about volatility. The market is volatile; it has been especially volatile in recent years. Yet, we also know that over time the market gains more than it loses, so we expect volatility, we should stay invested. To do otherwise is to bet against the market, which, again, over time, is not wise.

So let's look at what happened and why. On Wednesday of last week, the market declined 832 points (as measured by the Dow) or about 3%, the Nasdaq dropped 4%. This was followed by a drop of 546 points before finally recovering part of the loss.

Why did the market drop? In a word (actually two words) interest rates. They went up. It was not just the trajectory. We have been expecting interest rates to rise for some time. It was the speed by which the rates increased. In four days long term rates went up 17 basis points (a basis point is one hundredth of 1 percent). Investors and the markets get excited about sudden moves like that. Also, recently, the Federal Reserve changed the language in their after meeting message to remove the word "accommodative". That may not seem to be a big deal, but to the markets, it was a big deal. The Fed has been accommodative to the market for years, but now they say they won't be accommodative. What does that bring? Uncertainty! What does the market and investors not like? All together now: UNCERTAINTY! We have discussed this before.

To make matters worse, the Federal Reserve chairman then said that the central bank, was a "long way" from getting rates to neutral, suggesting more aggressive rate hikes were coming. The markets told Chairman Powell to take a hike and went on a tantrum.

Powell's remarks sent bond yields higher with the benchmark ten year Treasury note yield reaching levels not seen in years, the highest level since 2011. The rise in yields made equity valuations less attractive, because large investors use U.S, government bond yields in their financial models to value stock investments.

Tariffs are another matter of concern. The U.S. has embarked on a trade war. The International Monetary Fund says that the trade conflicts are slowing global economic growth. To be sure, growth is still robust, but it is slowing, according to the IMF. Especially hard hit is China. China is the second largest economy in the world, and it is not good for China or the world for their economy to falter. Besides, China says they will retaliate. (Cue the word: uncertainty!)

Well, if the economy is strong, but slowing, do you quit the game? As long as the economy is growing we still have to take our “at bats”. No quitting allowed.
An additional cause for the decline, we are in a “blackout period” during which companies do not buy back shares of their companies. This period begins two weeks prior to quarter end through two weeks after earnings release. Share buybacks have been a big support to the markets this year. This blackout period was a negative for the market when the market could have used some support. The blackout period will end soon.

So, put into the context of long term investing, this decline was just more volatility, which provides opportunity.

All the best,

William D. Rutherford
Rutherford Investment Management