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At the end of last year, the market took a sharp drop. On Christmas Eve, the market was down about 19.9% from its recent high in September, barely escaping bear market territory, which is generally regarded as a decline of 20%. The drop was characterized as a "glitch" by President Trump, which prompted me to write my column, "How the Glitch Stole Christmas" for the Daily Journal of Commerce.

The drop was triggered by two events, the first being the trade war with China. Characterized as "easy to win" by President Trump, the war showed signs of extending and having a negative effect on the global economy. Both Europe and China were showing the effects of slowing, as noted by Christine Lagarde, Chairwoman of the International Monetary Fund. China particularly showed the impact, with its GDP slowing to 6.3% from 6.6%, although still far higher than the EU, the US, and Japan. Still, the longer the trade conflict goes on, the greater the danger of additional global economic contraction. While the U.S. continued to have a generally robust economy, that too showed signs of slowing.

Secondly, the Federal Reserve seemed to be abandoning its support for the U.S economy. With Chairman Powell pursuing an autopilot policy of raising rates, the market lost faith in the Fed as overseer of a strong US and, tangentially, world economy. The market plummeted.

On January 4, 2019, Chairman Powell did an apparent mea culpa. He told the market the Fed was listening and seemed to reverse policy. The market heaved a sigh of relief and powered upward. The global stock market has grown accustomed to Federal Reserve support. Since October 1987, when then Fed Chairman Greenspan blindsided markets with a 50 bp Fed rate increase, causing the market to drop almost 50% in a few days, the Fed has been much more cognizant of its impact. In 1987, after the big drop, the chastened Fed cut interest rates dramatically, and the market has since come to expect such support. Sometimes known as the "Greenspan Put", whenever the market went down, the Fed stepped in to support it. Chairman Powell's comments appeared to reverse that policy and the market threw a tantrum. Powell surrendered and the market recovered.

Trade policy seemed to fluctuate almost daily with frequent announcements about progress and no progress, the market experienced wild swings. But, the message to the market from the Fed was "we've got your back", and the markets surged. Since Chairman Powell's comments on January 4, the market has had a remarkable recovery, increasing more than 10% since then.

Of course the market is about more than just interest rates. Profits are the real driver of markets, and profits are doing OK, hence support for the early 2019 market surge. But, reported profits are already history. As companies look ahead, profits appear harder to achieve; the market seems headed toward a consensus of slower growth. Upcoming earnings reports and outlook will have a lot to do with forward progress in the markets. So far, while not as strong as last year's earnings, the reports seem to be OK.

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However, consumer confidence is dropping, which is a matter of concern, since the consumer represents about 70 percent of the economy. And volatility in stock prices such as we have recently experienced tends to frighten individual investors into pulling out of equities, often at exactly the wrong time, which is not positive for the markets or retirement accounts long-term.

The current government shutdown has had a strong negative effect on individuals' outlook, and should be viewed as a concern for the economy.

The market should operate on the basis of profits, but it has become all too responsive to headline news, and the news has been disturbing. However, the big thinkers are taking notice. And the President is worried about his reelection.

Overall data continues to portray a relatively benign picture which seems inconsistent with the souring business environment and consumer and investment sentiment. While watchful, we are not market timers, so we continue to remain invested.

All the best,

William D. Rutherford
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