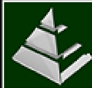


FINANCIAL Insights

March

Stock market corrections

“Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria,” as renowned investor Sir John Templeton once said. Unlike Templeton, however, you do not need to be a Rhodes Scholar or the namesake of a philanthropic organization to know that markets are inherently volatile and prone to cycles of gains and losses.

Though past performance does not guarantee future results, markets have traditionally been cyclical. Some financial professionals viewed the performance of major market indices over the past year or so as the “euphoria” stage described by Templeton; in the 2017 calendar year, the Dow Jones Industrial Average (DJIA) increased in value by more than 25 percent.

In late January, however, investors were reminded of market volatility when stock valuations dropped significantly in a short amount of time. Though the specter of past recessions and depressions looms over these drops, let us examine what a “market correction” is and what it might mean to investors.

What is a market correction?

A correction is when a market index experiences a drop of at least 10 percent in a relatively short amount of time — often without strong underlying data correlations. Typically, a correction is viewed as an adjustment in value from a high-point in an investing landscape that is overly exuberant, not necessarily an all-out crash due to a failing economy.

The most recent correction began in late January. The DJIA had just reached its all-time high when it hit over 26,600. After this, however, the index shed a bit over 10 percent of its value over the next few weeks, falling below 24,000.

Are market corrections bad?

Whether a stock market correction is “bad” or not is a complex topic to address. For most clients, investing in securities is typically part of a long-term strategy when seeking to achieve their financial goals. If an investor keeps long-term goals in mind, short-term fluctuations may not bother them nor coerce them to alter their investing strategy.

Closely watching the balance of an investment portfolio, especially in the middle of a correction or general market downturn, can evoke an emotional reaction in investors. If investors take a more active approach in their investment strategy, a panicked sell-off will result in a loss of capital. In these cases, market corrections can be viewed as “bad,” as they will negatively impact the value of their net worth and the integrity of their long-term investing strategy.

On the opposite end of the spectrum, however, some investors view market corrections as a fire sale for stocks, enabling them to buy at lowered prices. If the stocks regain their previous value in relatively short order, investors may view market corrections as a positive.

Looking ahead, what do market corrections tend to indicate?

Like most aspects of investing, it is usually impossible to forecast what a short-term correction means. In the past, however, according to Peter Oppenheimer of Goldman Sachs, "the average bull market 'correction' is 13 percent over four months and takes just four (additional) months to recover.”

While the past may not always indicate the future, it is important to remember how the market has previously reacted to corrections. The past year or so has been incredibly prosperous for investors, and if the current downward trend is short-lived, investors and financial professionals across the world will still fondly remember this run.

The market at a glance

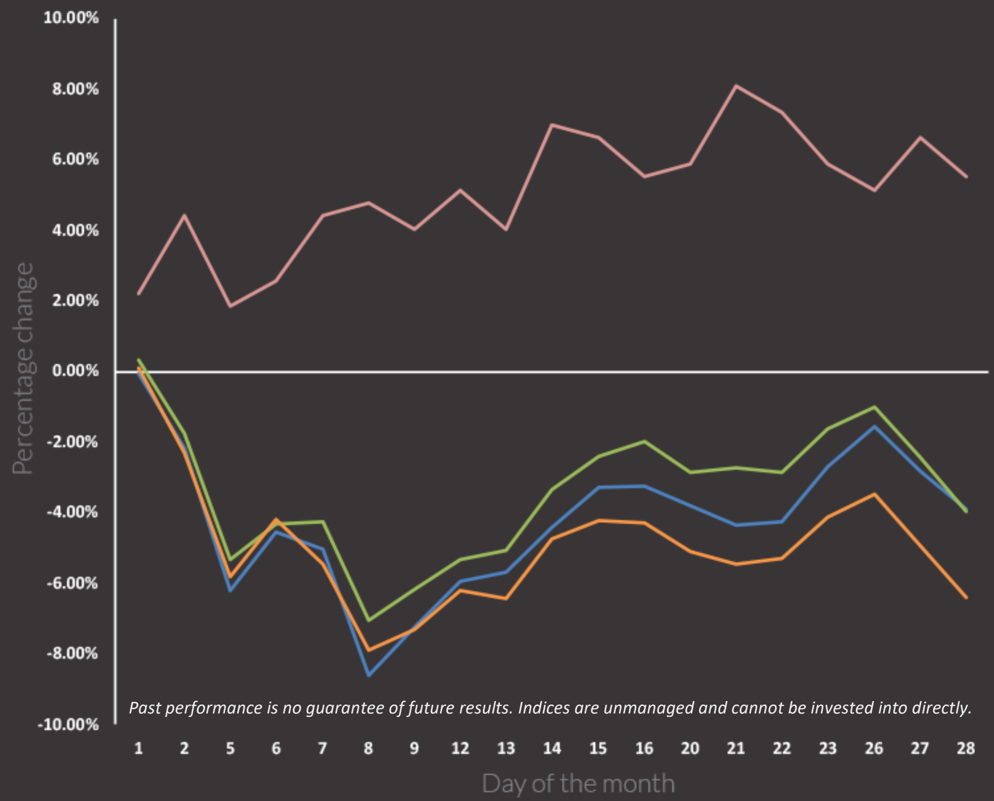
February

U.S. Large Cap
(S&P 500)
2,713.83 (-3.89%) ▼

U.S. Mid/Small
(Russell 2000)
1,512.45 (-3.97%) ▼

International Large
(NYSE International 100)
5,713.55 (-6.40%) ▼

U.S. Treasuries
(U.S. 10-year Treasury yield rate)
2.87 (5.51%) ▲



The market in action

- Coming off an incredibly prosperous year of growth, the Dow Jones Industrial Index experienced the worst point plunge in a single day when the index fell 4.6 percent on February 5. Some speculators believe that the increased volatility is a result of reports that inflation in the U.S. rose faster than anticipated in January. Though the markets recovered much of the lost value over the following weeks, February marked the first time since October 2016 that the S&P 500 finished negative over the course of a calendar month.
- In his first speech as Chairman of the Federal Reserve, Jerome Powell indicated that the Fed would continue increasing interest rates throughout the year, citing strong performance of major economic indicators as backing for the hikes.
- One in five Americans have more credit card debt than savings, according to a new study by Bankrate. This information might not come as a surprise, however, as a recent report from the World Economic Forum indicates that retirement savings are dismal throughout the entire world.
- Gibson, one of the foremost music retailers in the world for the past century, is facing bankruptcy. According to reports, the company has to address hundreds of millions of dollars in debt. In a statement, Gibson declared their intention of paying back the entirety of their debt within the next seven years.
- In a new release from the UN, the gender pay gap is roughly 23 percent throughout the world. At this rate, it will take nearly 70 years for women to achieve equal pay. In addition, women do roughly 2.6 times more unpaid care and domestic work than men.
- In late February, music streaming company Spotify announced that it would organize and file an IPO — officially joining the New York Stock Exchange. Early estimates indicate that the company could be worth about $23 billion.

Investing lessons from basketball tournaments

Basketball tournaments are a major delight for sports fans, often creating a frenzy in which both teams and fans alike become caught up. Filling out a bracket is perhaps the only thing more popular than actually watching the tournament games. Like investing, bracket picks are a matter of balancing expertise, expectation, risk, and reward.

1. **It is about getting the most right, not being perfect.**

   Investing, like a bracket, is not going to be perfect. The mathematical odds of correctly picking the outcome of every game in a 68-team tournament are 1 in 9,223,372,036,854,775,808 (in other words: nine quintillion). Statistically, each person on earth would have to fill out more than a billion brackets, all of which unique from every other bracket, before one would be perfect.

   The odds of all your investments continually producing above-market returns could be just as unlikely. Successful investing is not about being perfect — it is about making as many wise decisions as possible and getting more investments right than wrong.

2. **Do not forget to diversify.**

   No one turns in a bracket with results for just one or two teams and expects to earn enough points to win. People fill out the entire bracket to gather enough points and ensure that wins in one region can mitigate losses in another.

   Diversification is also incredibly important to investors. No matter how confident you are in an investment, it is usually not a good idea to put all your money in one place.

3. **Anything could happen, but that does not mean it will.**

   Although there are always some upsets, favored teams usually do reasonably well. Generally, investors should not assume that diversifying among long-shot stocks is a recipe for success. You could successfully score on every upset game of the tournament if you only picked underdogs, but there is almost no way those few successful games could counteract every matchup where things went as everyone expected.

4. **Last year's tournament was last year.**

   Past performance guarantees nothing about the future. Investors (and basketball fans) should never assume that their best picks from last year will have a repeat performance. A team generally wins because of skill and management; a hot stock should only be kept if there are sound reasons for its past (and future) success.

5. **Lucky systems are a myth.**

   Humans are hardwired to see patterns. It is a survival instinct that helps us find the things that we need and avoid dangerous situations. Superstitions form when people notice a pattern and choose to only remember the times when it worked. A foolish investment (or bracket) is one that relies on superstitious or "hunch" decision-making. Investments are ownership in a company, not a gamble. Successful companies are the key to successful stocks.

6. **The drama increases the closer you watch.**

   Though watching the action of a live game is an exciting part of being a sports fan, it is usually a poor idea when investing. Drama is good entertainment, but it almost never helps an investor. Watching every twitch of the market only leads to bad decision-making. A wise investor stays as detached as possible from daily stock fluctuations.

How they are different: *Investing is not a competition*

It is important to remember that good investing is not about being the best investor in the world; it is about securing enough money for your future. Unlike your bracket, you should not worry about "beating" others' investment strategies. A sound strategy might not be as impressive as someone else's high-risk approach, but it can still be successful.

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