October’s S&P 500® return of 2.3%, a year-to-date Index return of 16.9%, and twelve straight months of positive Index returns would appear to be cause for investor celebration. Yet the State Street Investor Confidence Index, a measure of global institutional investors, has been coming down since a high in July. U.S. consumer confidence has dipped over the past few months. At the same time the CBOE VIX Index, which measures the perception of market risk has been subdued since some spikes in August around presidential North Korea rhetoric, even though that issue has hardly been put to bed. Is this a case of benign market advances against the proverbial “wall of worry,” or does it belie an underlying complacency for increasing risk? This is not a novel question in market dynamics and unfortunately, one whose answer is never clear until after the fact.

As has been the case for many years, central banks continue to play a major role in supporting global equities. While the U.S. Federal Reserve has been unwinding some of its bond positions and telegraphing its intention to move rates higher, the European and Japanese central banks have remained aggressively stimulative, providing ample liquidity to power worldwide markets upward. Word that current Federal Reserve Governor Jerome Powell is the likely candidate to succeed Janet Yellen as Federal Reserve Chair signals a continuity in policy that should cause few market ripples.

Perhaps one of the sobering factors this October was the thirtieth anniversary of Black Monday, October 19, 1987, the worst day in U.S. market history, when the Dow Jones Industrial Average dropped 22.6% in one trading session. By the end of that October the major U.S. market indices had lost around 40% of their value. The crash followed a long and steady bull market and was driven by hostilities in the Middle East, fear of higher rates and was exacerbated by new and untested computerized trading programs. While market circuit breakers have been implemented to prevent a repeat of this single-day catastrophe, the anniversary certainly raises the question of whether a similar market panic could occur again.

The fact is that terrible things can happen in the world and the human psychology which drives panic selling has not changed. Tempering this recognition is the acceptance that such risk is omnipresent and investing for the worst case scenario would preclude participating in the equity markets at all. Earlier this year, in response to some client anxiety regarding the presidential election, we quoted Warren Buffett’s post-election interview in which he argued that the momentum of the U.S. economy was a far greater force than that exerted by any given president. It is this long-term faith in economic expansion and the ability of great companies to maintain profitability over time which allows investors to look beyond the ever- looming crises and remain invested in the market.

This kind of steadiness might have been extremely difficult during the panic of October, 1987, but the fact remains that the greatest bull market of all time began in 1982 and continued for eighteen years, overwhelming the setbacks of Black Monday. While investors may daydream about having stepped out of the market for periods like October, 1987 or the Great Recession market of 2008, it’s a dance which can only be accomplished retrospectively. The more common and unfortunate human response has been for frightened investors

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to sell securities late into these bear markets and miss great swaths of the market recovery which followed. Just as market losses can be concentrated in short periods so can market recoveries. While investors have shown little facility in avoiding the precipitous down periods, they’ve been much more “successful” in missing out on the periods of rapid recovery, slashing long term returns.

We continue to support the notion that the best way to manage risk is to avoid the more speculative edges of the market and to sustain the asset mix appropriate to an investor’s goals and overall financial situation. If these criteria are met, then we see no reason not to enjoy the results of the previous twelve months of positive stock returns. We believe constant monitoring of individual stocks, active evaluation for stronger and more fruitful investments and regular asset rebalancing are vital activities to retaining the proper risk/reward balance. This trailing year has been one in which the rewards have been steadily positive. The fact that the next twelve months are unlikely to be so unremittingly rewarding is no reason not to remain steadfast and upbeat regarding the value of disciplined investing.

Additional Information:
Bonds are subject to certain risks including interest rate risk, credit risk and inflation risk. Equity risk is the risk that securities will fluctuate in value due to general market or economic conditions.
An investment cannot be made directly into an index.
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