The Trust Company of Virginia

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Nervous Markets

To say markets have been volatile lately may be an understatement. The reason for the volatility, however, is up for debate. The media is fanning the fires on everything from ISIS to Ebola; Europe is going through prolonged economic weakness, the Fed is ending quantitative easing and a rate hike is looming. And more recently, weak retail sales and producer price numbers have caused inflation expectations to plunge to three year lows. What does all this mean? Basically the environment is ripe for uncertainty and volatility.

Historically, similar market movement has taken place during an expansion. Market pullbacks are actually quite common, but the lack of them in recent years has caused investors to be less accustomed. But here's the good news: considering the current market, we feel it is unlikely that recent volatility is an early signal of a recession or bear market.

The S&P 500 rose or fell by at least 1.5% each day for three days on October 7–9, 2014, marking the first time since November 2011 that the S&P 500 experienced such wild swings over three consecutive trading days. That last bout of volatility accompanied the U.S. debt ceiling debacle and the threat of the Eurozone breakup. In the period following the late 2011 volatility, the S&P 500 went on to return 7.3% over the next three months and 14.6% in the next year. Prior to that episode, May 2010—around the so called "flash crash"—was the last time the market experienced three days or more of 1.5% swings. Markets endured similar volatility in late 1998 as the Asian financial crisis swirled. Following those episodes, markets recovered quickly and the economy continued to expand.

On the positive side:

- The U.S. economy continues to expand at a pace well above its long-term average: the labor market has created over 2 million jobs in the past year, and the unemployment rate is 5.9%.
- The European Central Bank is preparing to add a much needed dose of monetary stimulus to the European economy, following the results of European-wide bank stress tests later this month.
- Valuations on the S&P 500 remain near historical averages, and while no longer cheap, remain reasonable given the interest rate and earnings environment.
- Concerns around global growth have driven oil and gasoline prices sharply lower, which may support consumer spending.
- The decline in bond yields in 2014 has lowered borrowing costs for corporations, which in turn lower expenses and help support profitability.
- Mid-term elections are usually followed by a "relief" rally in the market. Regardless of the outcome of the elections, the uncertainty disappears and the stock market rises.

While we acknowledge this can be a disturbing time for some investors, we continue to urge everyone to focus on the long term instead of the short term. September and October tend to be the weakest months in the market in any case. Pullbacks are always unwelcome, but they are often a short interruption in the context of a longer-term bull market. From March 2009 to October 9, 2014 the S&P 500 and has returned 218%. We continue to believe the U.S. economy is expanding and the upcoming corporate earnings season is likely to reveal that growth is robust.