Polaris Greystone FINANCIAL GROUP, LLC

Polaris Greystone Educational Series

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Let Cooler Heads Prevail

Today's price movement in the stock market was enough to rattle the most seasoned investor. The S&P 500 had the largest single day decline in the indices' history. Be careful listening to the media, however. The S&P's 113 point loss was the largest ever, almost twice as much of a loss as "Black Monday." This 113 loss amounted for a 4.10% decline for the day. While this was a historic day, it's a far cry from the 20.47% loss experienced on October 19, 1987. Today's decline doesn't even rank in the top 20 single day declines in the market's history. Today's drop, with the help of an ugly market on Friday, wiped out what had been a tremendous beginning to the market year.

The S&P 500 crosses below the 50-day moving average, triggering computer generated selling.

The S&P 500 bounces off the 100-day moving average, a point of support for the day.

Why Did This Happen?

The stock market has been on a juggernaut upward trajectory. The S&P 500's price rose 7.45% in the first 18 days of trading, after providing almost 20% price returns in 2017. Some say that Friday's sell-off occurred as a result of a higher than expected wage data, indicating inflation and a higher probability of Fed action in 2018. Today the market opened down, but nothing of significance. In fact, after about an hour of trading, the markets had fought their way up into positive territory. Most blame computer generated trading to be the cause of today's significant market drop. In other words, there was no fundamental reason for this correction to happen.

The reality is a pullback in the market was inevitable. Friday's trading ended the longest period in market history without a 3% pullback in the S&P 500 at 312 days. Today's historic pullback sent the S&P 500 down 7.79% from the highs we were experiencing only a few days ago. This ended a 400+ day streak without a 5% correction, pushing the S&P 500 into negative territory for the year.

What Happens Next?

First thing that I would advise is to expect more volatility. When fear grows in the markets, so does volatility. The VIX, also known as the Volatility Index, is a great measurement of fear. Viewing the chart below, you will see that the VIX has already spiked to over 37, up over 20 points today alone. The historical norm for the VIX is around 20. When the VIX gets over 35, it has historically marked the short-term bottom of most corrections (as seen below).

S&P 500 Monthly Price Movement with VIX (Volatility Index) Comparison
January 1, 2010 through February 5, 2018

Source: TD Ameritrade, Standard & Poors, and Polaris Greystone Financial Group

It Could Get Worse Before It Gets Better

Most market corrections take weeks or months to happen. We have just experienced a seven percent correction in two days. We have not seen a 10% correction in the market in over 500 days. It is very possible that we will see the market correct over 10%, given the rapid panic that has occurred in the market. Even if things do slide a bit more from here, it is most likely that we have seen the majority of the correction.

Polaris Greystone's Reaction

We are a tactical manager. We rely on fundamental research, macro-economic research, technical research, and the sentiment of the market to make clinical decisions in our strategies.

Fundamentally, the markets are sound. Earnings season is well under way, with 50% of the S&P 500 companies having reported their earnings. 75% of these companies have reported positive earnings surprises. According to FactSet, all eleven sectors are reporting growth. Q4 2017 growth is estimated at 13.4%.

Economically, things look very strong, with promise of even stronger numbers once Trump's tax reform has impact. The economic indicators that we track are bullish, with virtually no chance of a recession.

Most of our technical indicators were bullish until the end of Friday's market, when they moved into a neutral territory. Today's movement quickly moved them to bearish territory. This is where the human element has to be drawn upon, relying on over 20 years of portfolio management experience. With such a severe sell-off, many technical indicators are already showing that the stock market is oversold. We are already well positioned for what has happened over the past few days. We won't fall prey to fear by selling at what is most likely close to the short-term lows of the market. This sentiment-driven correction. We are most likely closer to its bottom than the top, and will quickly be forgotten like so many other corrections before it.

Polaris Greystone may do some trimming, but only to make way for companies we feel will perform better for you in the future. In other words, we might do some spring cleaning and reposition your portfolio for the next leg up. We do not expect this correction to be anything more than exactly that - a correction. As we've discussed many times in the past, corrections are a normal thing during a secular bull market.

As always, I welcome your questions and comments, and I encourage you to meet with your Polaris Greystone wealth advisor to keep up to date with our service offering.

Sincerely,

Jeffrey J. Powell
Managing Partner, Chief Investment Officer