Market Update – 8/24/2015
Written By: Doug Ciocca

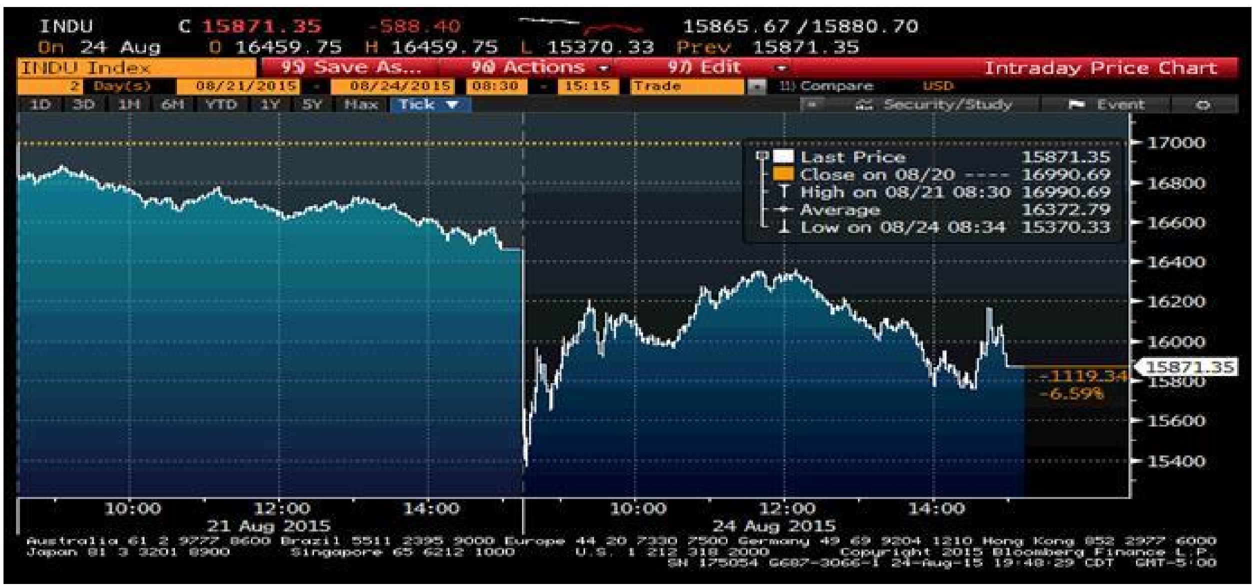
I wanted to check in quickly tonight and shares 3 charts, 1 link and just a few thoughts to put today's stock market action into perspective.

13.5 hours before the US markets open for business, the trading day begins in Asia.

Monday's action in Asia was directionally similar to that of our markets on Friday (negative) but with even greater magnitude.

The contagion carried into the European markets which experienced drops averaging 5%.

Then when the bell rang @ the New York Stock Exchange, it appeared that the weight of the world was driving it down. As the 2-day chart below (source: Bloomberg Market Data) displays, the Dow Jones Industrial Average broke down quickly this morning– registering a loss of 5.3%, 1,088 points – in the first 15 minutes.

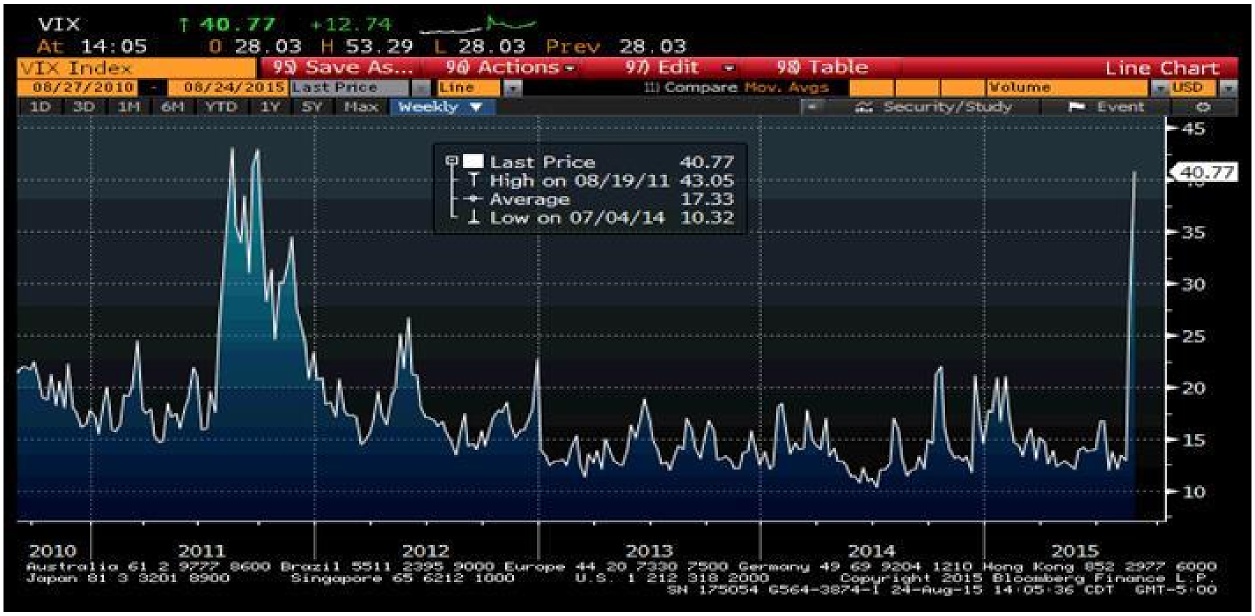


Thankfully some buying interest emerged, and at lunch time the Dow was lower by only 94 points – an intra-day reversal of nearly 1,000 points. It failed to hold this bounce but thankfully finished 500 points off of its lows.

Today's drop put the S&P 500 into what is known as "correction" territory – which is a decline of 10% from its recent peak level. (The Dow entered such a state on Friday).

This type of downside trading has both an economic and emotional component and in general creates a negative & fearful feedback loop. Such a loop is measured in the market by what is known as the VIX (technically defined as an estimate of future volatility based on the underlying prices of protection available in the options market).

The VIX index is plotted below (source: Bloomberg Market Data). As you'll see we touched levels today that had not been seen since the last time the market was in a "correction" – 2011.



And 2011 was not only the last time that the market has dropped more than 10% in the 2010s, it was also the *only* other time. The first time is dissected below (source: also Bloomberg Market Data), when the S&P 500 fell 17.61% in 2011:

Since the hitting its low point in 2011, the S&P 500 has returned over 80%, including the recent decline.

We think that fact is instructive. Market corrections can provide opportunities to responsibly put capital to work @ prices that temporarily detach from their fundamentals. The coming days and/or weeks may be such a time. Provided, of course, that the risk with which we are becoming reacquainted is not inconsistent with each client's temperament, comfort level & return objectives.

I know that I speak for the entire Kavar Capital team when I say: I hate when the market goes down! Unequivocally deplore it. However, as the following link discusses and I'll excerpt a bit of below, a drop in the markets can be very beneficial and even necessary to the long-term health of your portfolios.

> *"…..I want you to picture a world in which stocks never went down. What multiple would you pay for the earnings of a public company's stock if it was never going to drop? What would make you ever sell your stocks other than needing to use the money?*
>
> *In theory, you would pay an infinite multiple and you would hold on forever. A one-way asset would eventually surpass whatever price you paid in a best case scenario, but the worst case scenario would be flat returns.*
>
> *If that sounds great, I can assure you that it's a horror story.*
>
> *The Dow Jones would sell at thousands of times the earnings of its component companies rather than the 10-20 times it has traded at historically. It would all be based on nothing. For long periods of time, possibly forever, stocks would remain elevated and yet go nowhere to the upside. Some shareholders would sell and others would take their place at the same prices. No downside, but no upside either.*
>
> *An equilibrium would set in wherein no one ever lost money and no one ever made any. Under the weight of this reality setting in, stocks would eventually fall no matter what you did to guarantee against it. "Well, even though there is no risk, there's no reward – so maybe I'll just do something else with my investment dollars."*
>
> *An infallible market of stocks would have the seed of guaranteed fallibility implanted within from inception; a sort of* original sin*.*

The only reason stocks can go up is because they can also go down. It is this risk that keeps investors in check and that keeps people from paying an infinite amount of money for shares in a business. The reintroduction of risk, in the context of this summer's sell-off, is the best thing that could have possibly happened."

Link to the whole article by Josh Brown: http://thereformedbroker.com/2015/08/23/why-the-stock-market-has-to-go-down/

We are working through this summer slip in the markets and will keep in touch as things progress. Have a nice night. dc