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BURKE
FINANCIAL STRATEGIES
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Take Heart – Stock Market Losses are Not Permanent, Unless you Sell

The stock market (we use the S&P 500 to define the stock market) had not had a correction in almost four years, until August. In August, the S&P 500 lost just over 6%, but it was down almost 12% from its 2015 high - a 10% decline is considered a correction, a 20% decline or more is considered a bear market.

Those losses are not permanent, unless you sell or unless the stock market never recovers.

But the market has been even more discouraging than in a traditional correction. As of the this writing, September 3rd, the S&P 500 is at the same level as it was in June of 2014. Since investors typically diversify with foreign stocks, which have performed worse, most investors are in the red for this period of time.

How low will it go before it recovers, if it recovers, because there is no guarantee? How long will it take, if it recovers? Consider these facts:

- Since 1929, there have been 44 market corrections. In every case, the market did come back, with an average recovery period of 234 days. It has been 105 days since the market hit its high on May 21st.
- Currently, 87% of stocks are at their 12 month low. Since 2002, whenever this level is above 85%, equity markets have risen 94% of the time over the next four months, with a median gain of 11%.

This correction started with a series of moves by the Chinese government which indicated to investors that the Chinese economy, the second largest in the world, has at least slowed down and possibly even stopped growing. The market was ripe for a sell-off because earnings have not been very good. In fact, on average, earnings growth was negative for U.S. stocks in the second quarter.

But there are no signs that the U.S. or European economies are sliding back into recession. In fact, these two economies are looking as good as, or better than at any other time since 2007. And there are certainly no signs that the financial markets are experiencing either the bursting of a speculative bubble, or worse, a collapse of financial institutions as experienced in 2008.

The one thing to look out for is evidence that we are falling into a deflationary trap, as Japan did starting in the '80's, or like the U.S. did in 1929. The first sign of this is falling commodity prices, which we have in fact seen. The next signs would be falling consumer prices, or worse, falling wages. We have seen no signs of either of these, therefore falling commodity prices are probably signaling that the world simply built excess capacity for commodities. That is, the world dug too many wells and built too many steel mills, iron ore mines and copper smelters.

As long as the lost jobs from the commodity sector are replaced by jobs somewhere else, the economy will be fine. In this country, we could say that as long as lost jobs in the oil drilling field are replaced by home construction jobs, healthcare jobs or technology jobs, things will be fine. In fact, it takes time for this to happen. It also takes time for savings from the drop in commodity price to flow through to consumer pockets; something that is just starting to happen.

As investors, we have three tools to deal with falling stock prices:

1) We can put cash to work at lower prices.
2) We can move money from bonds to stocks. Bond prices have gone up in the past week.
3) If stock prices experience a large sell off, we might even consider investing in more speculative ideas like small and mid-cap stocks, which we had held back on for fear of this market correction.

Don't be discouraged by stocks. Over the past 35 calendar years, the market has posted positive returns in 27 of them. And within each of those 27 years, the largest intra-year drop averaged 11.3%.[1] Over longer periods of time, market risk has historically reduced. Since 1950, the worst rolling five-year period experienced a loss of 2%/year. Over the worst rolling 20-year period, the rate of return was a positive 6%/year.[1]

Finally, our investors should take heart because we focus on dividend paying stocks. Dividend paying stocks tend to hold up better during corrections and bear markets. Dividend paying stocks would also be favored in a deflationary period.

Please call us if we can help with your concerns.

Sincerely,

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[1] JPMorgan Guide to the Markets - U.S. | 3rd Quarter | As of August 31. 2015