Rochester Financial Services

Fee-Only® Financial Management Services

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September 3, 2015	Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
	16,375	1,951	4,734	1,145	2.17%	6.41%	$1,125	$46.84

Investment Strategy Report

Stocks Break Down and Enter Their First Correction in a Year

Stocks got hit in August with several bouts of vicious selling as the stock market had its first correction since last October. For just about all of 2015, stocks have experienced very little volatility as prices have stayed within a very narrow trading range. This calm ended on Thursday, August 20th, when the Dow dropped 358 points. This was followed by drops of 530, 588, and 205 points on successive days that Friday through Tuesday for a total drop of almost 1,700 points in 4 trading days.

When stocks are faced with such extreme selling panics, as was the case here, the lopsided selling to the downside is almost always countered with rebound "panic buying" on the upside. This was the case last Wednesday and Thursday, Aug.26th and 27th, when the Dow gained 619 and 370 points respectively, to recover almost 60% of the losses. For those of you on my email list, I sent out an alert on Sunday night, Aug. 23rd in which I discussed the market volatility and how investor sentiment and psychology were having a major impact on the markets (for those of you not on my list, please send me your email addresses). I pointed out that staying the course was "probably" the best strategy since the probability of the above mentioned market reversal was high.

Most of the time, market sentiment does not play a major role in determining stock market direction. It is more fundamentals pertaining to economic growth, corporate profits, and possibly external factors such as geopolitical events that have more of an impact on stock prices. However, did the market fundamentals falter that much in 4 days to warrant a 1,700 point drop, and then improve to such an extent to warrant a 1,000 point rebound? No. It is investor psychology that takes hold of trading patterns to cause the wide swings that we have seen.

If history is any guide, this heightened volatility can last for weeks, and unfortunately, we are at that time of year, September and heading into October, which is known for its market gyrations. Over the next few weeks (the "short term"), we will be subjected to the vagaries of investor sentiment. This will involve more panic selling, caused by investors fearing another drop, followed by panic buying, caused by investors fearing that they will miss the boat if they don't snap up their favorite stocks at bargain prices.

The good news is that over the longer term, both the technicals (including market sentiment) and the fundamentals point to higher stock prices. I've already gone over the fact that the extreme negative sentiment that we experienced leads to a higher market over the short term. But over longer periods, such as 6 and 12 months later, there is also a good probability that prices will be significantly higher. I have also talked about the fundamentals of our economy being on a sound footing. Auto sales have been surging this year, as sales of 17.5 million vehicles are expected for all of 2015. The labor market continues to be strong, as average monthly job growth continues to be well over 200,000 (tomorrow's August jobs report will be a key indicator). The housing recovery is a bright spot in our economic recovery as low interest rates and low unemployment are leading to strong demand for homes.

Of course what I can't do is guarantee that everything will turn out all right and that the volatility we saw in August won't lead to more losses in the coming weeks. It seems like every analyst out there is saying that we have to re-test last week's lows before moving higher, that the market can't make a V-shaped recovery. However, I am also hearing that if the market does go lower, you have to buy stocks at those lower prices because it will be an opportunity to buy them before their prices go higher. This brings us back to the long term argument that 1) we can't predict market direction over the short term (markets can always go lower) but 2) over the long term, we should be OK. *Jeff Feldman*

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