TRANSITIONS

WHY IS THE MARKET SWINGING

When I mentioned to expect some market volatility this year, the markets responded with the recent 1,000-point rout, followed by a 1,000 point surge in the Dow Jones Industrial Average. These swings would be breathtaking if this index was at 10,000. What the news lacks is some perspective. With this index over 32,000, these 1,000-point swings are meaningful but not devastating. They reflect high volatility for several reasons.

First, every few years, markets normally experience a correction. The seemingly unending sunny days of markets always moving higher for years, created the problem of TINA “There Is No Alternative”. The flawed TINA strategy means one always bought stock, regardless of price. This practice is a confirmation that we have not had normal markets. After a near straight up run since March 2020 without meaningful pullbacks, this correction will have to be larger, maybe a 20% to 25% decline instead of the textbook 10% correction.

Second, newer investors have been buying indexes and exchange traded funds. Buying these baskets of securities is more about renting, than owning stocks. When others react by buying or selling the baskets of securities, the fund manager must immediately buy or sell, often at the worst possible time, during an upsurge or selloff. In sharp contrast, many investors owning stocks have a sound perspective of not buying in the midst of an upsurge or selling because others are forced to sell.

Third, age matters. Older professional investors have decades of market perspective. Yet most of the Wall Street trading desks are staffed with people that only have seen up markets during their entire careers. Their “experience”, which includes “buying the dip” and selling when they see others sell, really is inexperience that exasperates selloffs.

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Fourth, valuations still matter. My 1951 edition of Securities Analysis by Graham and Dodd is the landmark book that shaped Warren Buffet's investing philosophies. Although a very dry read, it stresses the importance of fundamental investing and holding great quality companies. Quality stocks with defined earnings will ride out corrections and recover.

Fifth, changes in economic conditions also bring about these market swings. The Federal Reserve finally discovered their easy money policies created high inflation. Their policy reversal will discourage market speculation and may not support the markets as they have in past years. At the same time, corporate earnings will be impacted in the near term by a combination of ongoing supply chain issues reducing sales, and a stronger U.S. Dollar reducing overseas earnings.

It is too early to conclude the correction is over. Months may pass watching stocks move lower until the sellers are washed out. From what I have experienced in many of these market corrections, the markets need to spend some time forming a bottoming process. Then buyers conclude the selling is over and the opportunities to buy at attractive valuations are compelling. We continue to practice patience during these volatile periods, watch and wait for the opportunities to completely unfold.

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Visit our Resource Center for more market commentary and insights.

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