In the beginning of the year, I had written a prediction that developed markets would outperform developing (or emerging) markets for 2015. While the prediction may be correct, it has yet to be profitable. Nevertheless, I am encouraged as we approach the end of the year that we will move much closer to positive territory. When we encounter significant volatility in markets, it is always important to separate fact from fiction. I believe the market capitulation on August 24th (as evidenced by a 1,000 point intraday decline in the Dow Jones Industrial average) was erroneously blamed on China – having less to do with market fundamentals and more to do with technical factors in the marketplace. While China may have the world’s second largest economy, “China represents a grand total of 0.7% of U.S. GDP,” according to market strategist Dave Rosenberg.\footnote{Contrary to popular belief, an overdue correction does not need an excuse. Furthermore, the panic was magnified when investors in exchange traded funds (“ETFs”, or weapons of mass destruction in my opinion) experienced liquidity constraints when they attempted to sell. The net asset values of ETFs were priced at large discounts to the actual value of their components. Investors could not consummate their trades or settlements were delayed. When I think back in time to the day the market reopened after September 11th 2001, my large sell-side firm at the time was experiencing record retail withdrawals from their separately managed accounts (SMA) business. There were so many wires going out that there were massive delays in processing them. Per the oft quoted Mark Twain, “History doesn’t repeat itself, but it does rhyme.” In 2001, retail investors were more concentrated in “active” strategies compared to today as more “passive” strategies are en vogue.}

Periodically (like today), the stock market does not mirror the economy. The two will separate or diverge from one another; just as investor sentiment may be poor, yet consumer sentiment positive. Currently, the U.S. economy is growing and the prospect of a recession highly doubtful. Per Rosenberg, “our yield curve is not inverted, and every recession since the end of World War II had an inverted yield curve.”\footnote{Also, recessions are preceded by sustained, multiple periods of Fed tightening – the Fed has not even instituted its first tightening move during this cycle. Furthermore, inflation remains low and wages are improving, while business and consumer spending is increasing. The perception of our perennial lower U.S. productivity is about to become a “misperception”. Most encouraging, yet conveniently ignored, is the long-awaited acceleration in U.S. GDP, which clocked in over 3% in the second quarter.}
There is also a misperception between the price of crude oil and the health of the global economy. Anatole Kaletsky of Gavekal recently introduced a most salient concept related to the inverse relationship between oil and the economy. “The predictive significance of the oil price is indeed impressive, but only as a contrary indicator: Falling oil prices have never correctly predicted an economic downturn." Kaletsky adds that “conversely, every global recession in the past 50 years has been preceded by a sharp increase in oil prices.” Ultimately, the effect of lower prices is positive as global consumers enjoy a significant “stimulus”, which is often spent rather quickly. As the U.S. continues to enjoy an acceleration in housing activity (along with the multiplier effect on related industries), I believe the improvement in the economy will be more apparent to the market in the coming months. In the meantime, investment opportunities will arise during the volatility. As the long-time investor Peter Lynch has said, "Far more money has been lost by investors preparing for corrections or trying to anticipate corrections than has been lost in corrections themselves."


2 Ibid.


4 Ibid.

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