February 6, 2018

Statement Regarding Recent Market Volatility

On Friday February 2 the Dow Jones Industrial Average fell 665 points, or 2.54%. Then yesterday, Monday February 5 the Dow fell an additional 1,175 points, or 4.60%. What is our take? First, markets go up and markets go down. Volatility is simply a part of investing. But for the past 15 months through January, daily volatility has been at record lows while the market has appreciated every single month. This is unprecedented in modern U.S. markets. During this period, economic results have been quite positive. This generally increases valuations of stocks. We're good so far. But it is also true that against this backdrop, short term interest rates have been rising over the past year while longer term interest rates started rising in late summer. As underlying valuations are a function of interest rates as well as fundamental results, this increase in interest rates at least partially offset the benefits of a strong economy. Nonetheless, a combination of complacency regarding risk and optimism regarding growth has led to a stretching of valuations. At some point, something had to give, even if only for the short run.

Now this doesn't mean that equities as a whole were particularly expensive. But on the other hand, stocks certainly weren't cheap. This is especially true, in our opinion, where the market has focused on projections for rapid revenue growth and distant profitability. After the recent run-up in response to tax reform legislation, there was little to propel markets higher. It is true that 4th quarter 2017 earnings have been coming in fairly strong. But given the prior high returns in stocks, this hasn't been enough to propel markets further. All it took to change the tide was a little movement in the opposite direction. Unfortunately, given the recent uninterrupted stock appreciation, once a trend broke, traders jumped on. This has been only exacerbated by computerized trading.

While a correction is healthy in the long term, obviously there is pain in the short term. We can't rule out further declines. Still, we see the economy as fundamentally strong. Joblessness is heading down while corporate profits are heading up. And while interest rates have been rising, they certainly have not moved far enough to seriously impede economic growth. All markets correct. This may or may not be a major correction. Our advice to clients is to maintain their focus on their long term goals. Just as it is unwise to focus on near term paper profits, it is also unwise to obsess about near term paper losses.

Pinnacle Capital Management, LLC

100 Limestone Plaza
Fayetteville, NY 13066
(315) 234-9716 • Fax (315) 637-0090

244 North Main Street
Mansfield, MA 02048
(774) 719-2759

www.pcm-advisors.com