OPAL WEALTH ADVISORS

Historical Perspective On Market Volatility

On Monday, August 5th, stocks dropped sharply with the S&P 500 losing 3% in a single day. The impetus for this falloff are fears of an escalation in the U.S./China trade war. However, if we look more closely at market trends—both in the short and longer term—we will realize that the recent volatility is not so extraordinary and that should be a calming reminder to rattled investors.

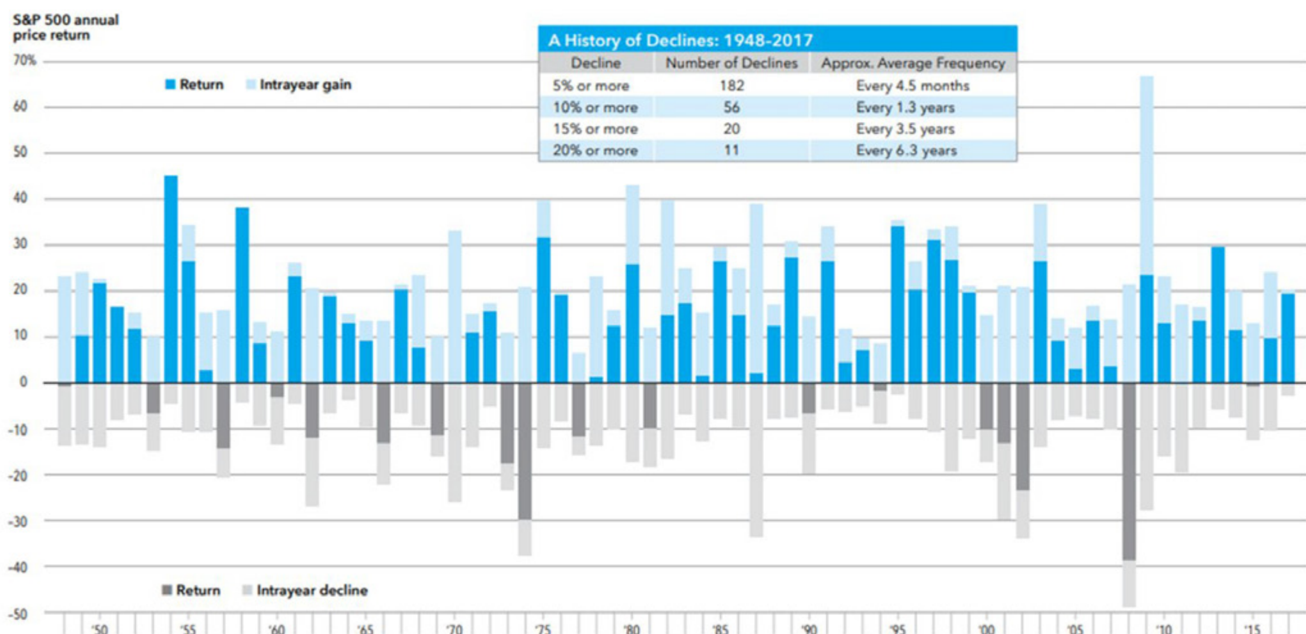
The August 5th trading session was the sixth consecutive negative session resulting in a 6% cumulative decline for the S&P from its all-time high on July 26th. This is the second 5%+ pullback of 2019 and the 31st of the bull market that began in March 2009.

Putting this in perspective, the S&P 500 is up 14.8% year-to-date through Monday's close. Over the past twelve months, the S&P has had three drops of 5% or more:

- From September 20, 2018 through December 24, 2018 the S&P plummeted 19.4% in reaction to Vice President Pence's speech on trade with China and a hawkish Fed rate hike in mid-December. Since the Christmas Eve low, the S&P rebounded 29% and hit an all-time high on July 26, 2019.
- Within that period, the S&P suffered a 6.6% drop from May 3rd through June 3rd in reaction to President Trump's tariff increase from 10% to 25% on $200 billion of Chinese products.
- The drop over the past six trading days marks the third 5%+ decline in the past twelve months. Since 1926, 5% corrections have occurred on average 3.3 times per year. So, in historical context, the past 10 years (including YTD 2019) have evidenced rather average volatility.

From Capital Group

Intrayear declines in the S&P 500 have averaged 13.4% since 1948, yet annual price returns have been positive in 51 of those 70 calendar years.

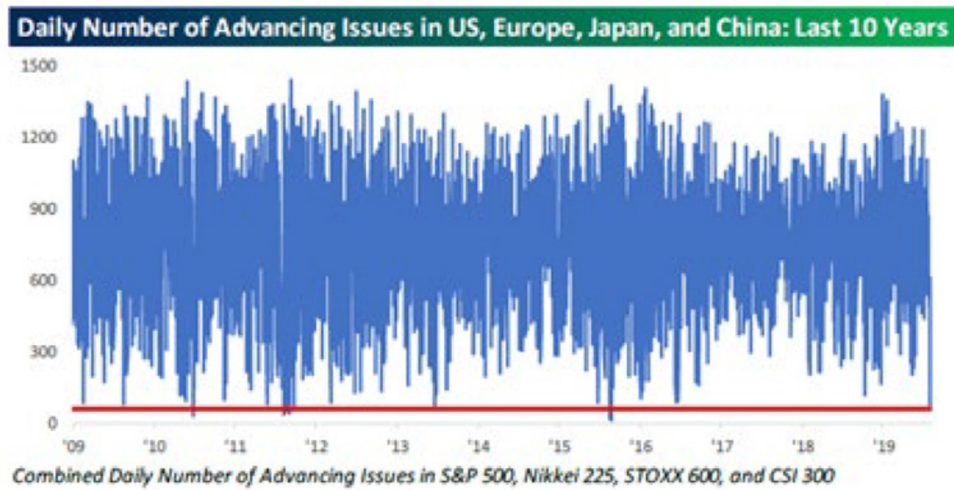


A History of Declines: 1948-2017

Decline	Number of Declines	Approx. Average Frequency
5% or more	182	Every 4.5 months
10% or more	56	Every 1.3 years
15% or more	20	Every 3.5 years
20% or more	11	Every 6.3 years

A Technical Perspective

One of our better technical sources (Bespoke Investment Group) highlighted the extent to which global markets are washed-out short-term. Historically, these periods are often followed by strong counter rallies as exhibited by the following chart:



Combined Daily Number of Advancing Issues in S&P 500, Nikkei 225, STOXX 600, and CSI 300

S&P 500 Performance Following Drought of Advancing Issues

Date	Combined Number of Advancing Issues	S&P 500 Performance (%) One Wee	One Month	Three Months	Six Month
6/29/10	29	-1.3	5.8	9.9	21.0
8/8/11	35	7.6	5.9	14.0	20.6
8/18/11	47	1.6	6.6	6.6	19.3
9/5/11	43	-1.0	-2.6	7.1	16.2
9/22/11	56	2.7	9.6	11.0	23.3
6/20/13	60	1.6	6.5	7.7	14.5
8/21/15	26	0.9	-0.2	6.0	-2.7
8/24/15	11	4.2	2.1	10.3	1.9
8/5/19	63				
Average		**2.0**	**4.2**	**9.1**	**14.3**
Median		**1.6**	**5.9**	**8.8**	**17.8**

Occurrences within 30 days of prior occurrence (shaded rows)

The U.S. vs. China

Late last week, President Trump tweeted that the U.S. planned to impose a 10% tariff on an additional $300 billion in Chinese imports into the U.S. In retaliation, China allowed its currency to fall below a key psychological threshold of 7 Yuan to the dollar and halted imports of U.S. agricultural goods.

While Trump's tweet seemed to take his own negotiators by surprise, China's retaliatory measures were relatively predictable. This next round of tariffs, if implemented, will directly and more quickly impact the US consumer (textiles, toys, clothing, computers, cell phones, electronics) than the previous rounds of tariffs. From a political standpoint, unhappy consumers could hurt Trump in the polls and undermine his reelection prospects.

It is interesting to note that the next round of US China/trade negotiations are scheduled to begin September 1st, the same day the 10% tariffs go into effect. China is also motivated to reach a trade deal as their

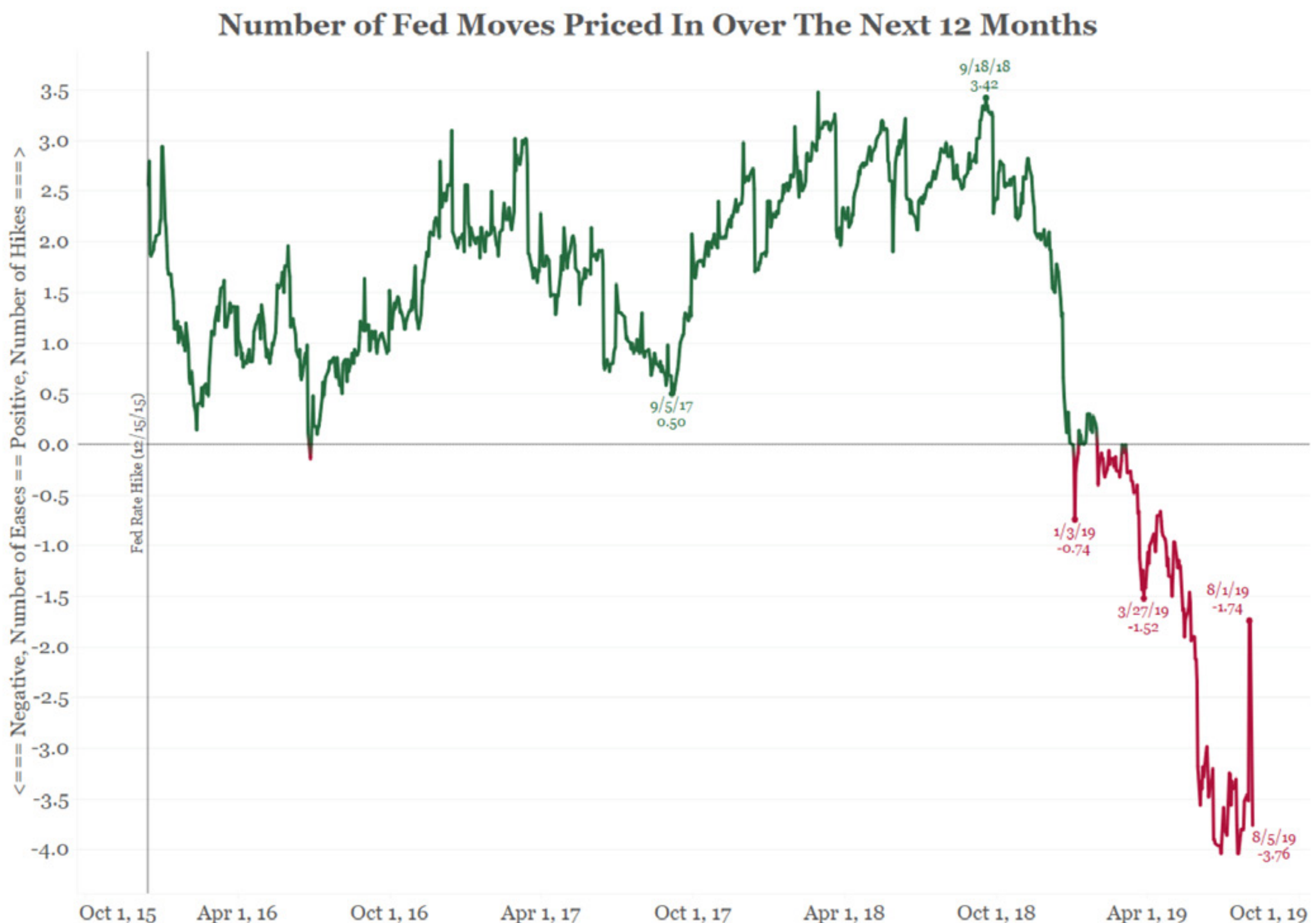
economy continues to slow. The tariffs are also causing a reshuffling of supply chains and manufacturing to the detriment of China. Devaluing their currency to soften the impact of the tariffs has not proven to be a sustainable strategy in the past as it results in panicked capital outflows as the Chinese aristocracy tries to preserve their wealth. The fact that China blinked this morning allowing their currency to slide back into an acceptable range could indicate the headlines in today's news cycle are really just negotiating tactics.

However, if this devolves into a real escalation of the trade war, a more cautious asset allocation stance would be warranted.

The Federal Reserve

While the Fed did cut rates by 25 basis points and pledged to end its balance sheet runoff in August (two months earlier than previously indicated), Powell's reference to the move as a "mid-cycle adjustment to policy" suggested that further cuts are far from guaranteed. Additionally, he indicated that the Fed is not currently at the beginning of a lengthy cutting cycle. Coupled with the trade escalation, this resulted in a one-two punch for the markets over the past week.

Nevertheless, as evidenced by the chart below, the market continues to price in rate cuts. This is likely a good predictor of things to come. As the saying goes, "The Fed decides when to raise rates, but the market decides when to cut rates."



Conclusion

In summary, by historic standards, the stock market's drawdown over the past week is quite normal. In the past 12 months alone, there have been three such drawdowns that were fueled by trade war headlines and/or the Fed's rhetoric.

Though geopolitical events can cause short-term spikes in market volatility, attempting to predict geopolitical events is a fool's game. Setting aside the current drop (which seems to be dissipating as we draft this memo), the market always returns to focusing on underlying fundamentals, which can be punishing to those investors who reacted to headlines over the past twelve months.

We believe the same scenario holds true in the current environment as we turn our focus to the strength of the U.S. economy, solid earnings and revenue growth, stimulative monetary and fiscal policy, and reasonable valuations. However, we do acknowledge there are an inordinate number of geopolitical mile markers (trade war, Brexit, Iran) dominating the near-term calendar.

Thus, our guidance is that investors should stick to their long-term, strategic asset allocation targets. If equity positions have exceeded long-term targets as a result of this year's robust stock market returns, we recommend clients scale back equity exposure to bring allocations back in line with their planned targets.

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