"Fasten Your Seat Belts, It's Going to be a Bumpy Night"

- Margo Channing (Bette Davis) in All About Eve

Here, in the first days of 2016, the ride has already been bumpy. The long bull market in stocks -- in this case the S&P 500 -- which began in March of 2009, has lost over 7% in the first two weeks of January. This most recent action affirms, for the time being, the persistence of a correction in a bull market, defined as a decline of at least 10%, but less than 20%, from a previous high. The market has technically been in correction mode since August of last year, when prices dropped 10% from their historical high and have yet to return to that level. Corrections in bull markets are signs of age, but not necessarily signs of decline: since WWII, there have been twelve bull markets, including the current run, and the number of corrections per bull has ranged between one and six with an average of two. This correction will end in greed or fear: either bargain hunters will bid up prices to new record highs or desperate people will push prices into bear market territory (down 20% or more from the previous high). For long term investors -- those who have limited requirements for their assets over the next year -- the current volatility may create anxiety, but should not cause panic: the average bear market since 1929 has lasted only about 12 months (maximum of 30.5 months, minimum of 2.2 months) and lost about 37% from the previous high. In contrast, the average bull market, once underway, lasted 8.1 years and gained about 440%. Long term investors are better served by risking bear markets than by risking being left out of a bull market.

2015 was also a bumpy year. After setting a new record high in July, the S&P 500 delivered the aforementioned correction in August. After all the excitement and anxiety, by December 31, the S&P 500 managed to produce a positive return of 1.4% for the year. Of course, most of this came from dividends: the index itself -- minus dividends -- was actually slightly negative. And, without the plus 17% contribution of the ten largest stocks in the index, the return would have been much worse than slightly negative. Judging by the early days of January, there's little reason to believe that 2016 will be much different from 2015, at least in terms of volatility. It will be a bumpy ride, but we suspect the bumpiness we're seeing in January will be the most violent part of it.

Many of the issues facing the markets in 2016 are unchanged from 2015. The U.S. economy remains in a sluggish pattern of low growth, with last year's GDP and this year's forecasted GDP registering between 2% and 3%. Low gasoline prices still provide a support for the consumer, while low and lower oil prices remain a negative for oil producers. The Fed, which in December finally began its long anticipated lift from zero of the Fed Funds rate, remains accommodative: even with the announcement that it plans to raise rates four times in 2016, the likely result of a 1.25% level is hardly restrictive. Inflation is still a non-event in the Fed's timing. China's GDP continues to slow as its planners work off overcapacity and attempt to convert the country to a more consumer driven economy. The U.S. dollar remains strong against most currencies, particularly those of emerging markets, because our sluggish economy continues to outperform that of the even more sluggish world.

The market declines we're seeing in the early days of 2016 are driven by the fear that oil prices are declining. The fear is not that Saudi Arabia is trying to drive out its competition by flooding the market with cheap oil, but that the world economy is shrinking and paring back its demand for oil at almost any price. The primary source for this fear is China. The fear is that China, the world's second largest economy, is not only growing at a less than 7% rate, but is decelerating to a 6% rate and may be slowing even further. And, since data from China's planned economy is filtered and significantly obscured by its bureaucratic planners, there's great uncertainty about the veracity of reported numbers. Uncertainty is only a short distance from doubt, doubt is only a hair's breadth from fear and fear is the driver for corrections and bear markets. We expect the current correction to run its course over the next few days and, perhaps, weeks.

What will return the markets to stability? Time, an objective appraisal of economic, and market conditions. Oil prices will not go to zero. China is not headed for economic collapse. The world's largest economy, the U.S., is still growing and should continue to do so throughout 2016. Valuations in the market are not extravagant: 16 times earnings for the S&P 500 is about average for the last eighty-nine years and only slightly higher than the 14.2 times earnings of its recent ten year past. Despite signals from the Fed about raising short term rates, the interest rate environment is very accommodative to economic growth: we believe the Fed will raise rates in response to economic strength, not to impede it. And fear is not a long-lived emotion. It's stronger than greed in the short term, but only in the short term. Greed eventually returns and lasts, on average, eight times longer.

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