# Mitch on the Markets

## Relax, the Stock Market Correction is Normal

By Mitch Zacks
Portfolio Manager

Global equities markets took many market participants for a spin over the last couple of weeks. The sharp declines took many by surprise, especially considering that the S&P 500 had just completed its longest stretch in history without a drawdown of at least -5%. Indeed, from February 2016 through the end of last year, the S&P 500 delivered an annualized return of 20% against a volatility (VIX) of 6, which is very low by historical standards. It makes sense that a sudden, sharp decline would rattle many investors.

Even if more declines are on the horizon – which they could be – **we believe that now is a time for investors to remain patient and to stay the course**. We see this pullback and renewed market volatility as part of a short-term market correction – not the start of a cyclical bear market.

If you look closely at some of the factors and events surrounding this market action, it's fairly clear in my view that is has all of the hallmarks of a classic stock market correction:

- ✓ Sudden, scary declines in equity prices
- ✓ No material changes to economic fundamentals, which we believe remain very strong globally
- ✓ Analysts and pundits reaching for 'causes' of the market correction, with what seems to be no clear answers
- ✓ Media abuzz with commentary over whether this could be a major downturn
- ✓ Investors shifting focus to day-to-day price fluctuations instead of focusing on long-term objectives

What's more, if one were to review the "causes" given for the market correction, you would likely find are old, recycled fears and stories that may be too marginal to matter, in my view. So far, we've heard the correction was caused by rising inflation concerns, worries about concurrent rising interest rates and rising stock prices, fears about global central bank tightening, anxiety over the possibility of trade wars, and even the product of an obscure ETF that bets on the inverse of the VIX. The ETF, ticker XIV, fell some 85% and Credit Suisse is reportedly ending trading for it later this month.

We believe that the root cause of the correction could be any one of those events or none of them. Market corrections do not come with playbooks or detailed explanations, and they are very difficult to be timed.

My advice: *ignore it all.*

**A Long Time Coming**

If investors were to review my weekly market commentaries over the last year, you would find at least a dozen instances where I warned of a looming market correction. It's not that I have a crystal ball – it's that corrections are normal parts of equity investing, and every bull market throughout history has had them. If anything, the last two years of near-zero volatility and strong equity gains has been the abnormality in this stock market – not the market volatility we're seeing today.

Remember, too, that in the background of all this market action we appear to still have global growth, a strong job market, high and rising leading economic indicators, robust manufacturing data across the world, and businesses and households spending freely. Lost in the shuffle of market volatility and declines has also been the nicely positive reports so far in the earnings arena:

- S&P 500 (50% of the companies have reported so far): Sales up 8.88%, EPS up +15%
- Russell 2000 (25% reported): Sales up 11%, EPS up +18.75%
- Russell Mid Cap (37% reported): Sales up 9.6%, EPS up +17.7%

These are seemingly robust figures that few people are talking about, because that is what corrections can do – they can cause investors to forget about underlying fundamentals and instead focus on day-to-day price movements. We encourage investors to avoid the trap, and to stay the course.

**Bottom Line for Investors**

Famed mutual-fund manager Peter Lynch once quipped that "far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves." Corrections can lead even the most steely-nerved investors to make emotional knee-jerk reactions that adversely affect long-term returns. When an investor gets caught up in the negative news stories and sells into the downside of a correction, it can mean capturing the losses but failing to participate in the recovery, which can be a recipe for sub-optimal returns over time. In our view, it is smarter to just stay the course and keep focus on the long-term.

**About Mitch Zacks**

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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