

"Cup of Joe"

The market wanted a pullback in the worst way and we finally got one. Why? Because the value of the underlying companies rose too quickly based on the anticipation of tax reform. Over the last couple of market updates, we have been saying that some type of correction was due after the market's parabolic rise. So, now that we got what was expected, is it time to buy or is it time to head for the hills? I heard a great quote about the market's precipitous decline of 1600 points that we experienced last week: **"Markets go up the stairs and down the elevator"**. Wow, isn't that the truth! After months and months of strong gains, the market finally took its tumble, and what a tumble it was. The DOW dropped the most ever in a single trading day in history. Why, you ask? Let's look at a few possible scenarios -

1. Interest rates are rising (and rising fast)! This sent shockwaves through the bond market, causing many investors to panic. Remember, as interest rates go up, bond prices go down. This caused a weird phenomenon that saw interest rates rise as the market was dropping. Usually, when things become volatile, investors head for the safety of the bond market, causing rates to drop. Well, this didn't happen and, as the decline kept going, interest rates kept rising - the first signs that the bull market in bonds may be over. This is why we are not in your normal corporate bond vehicles.
2. There were numerous reports that someone was selling a LARGE amount of stock at one time and traders got wind of it. When they knew major selling was about to happen, they shorted the market (placed bets that the market would go down), causing a much bigger decline than one would expect. Could this have been one of the Saudi princes who was forced to liquidate their holdings to get out of jail (ok, the Ritz Carlton…but who's asking)? There is plenty of speculation to go around.
3. Investors are worried that the tax cuts are coming at the wrong time. If you inject money into the economy when the unemployment rate is already at historic lows, this could cause rapid wage growth and inflation. If everyone has a job and you artificially create more jobs, and you don't have any people left to fill the new jobs, companies offer a higher wage to take people away from other companies to do the work. If the wages go up, then everyone has more money to spend and they bid up the price of the things we buy, thus "Inflation"). The FED, in turn, could raise interest rates faster than expected, causing a market selloff. One way the Federal Reserve Bank controls the economy is to increase interest rates on things like credit cards and mortgages to take money out of the hands of you, the consumer, so you have less money to spend. This would create LESS demand on goods and services, and essentially reduce inflation.
4. Algorithms or complex mathematical formulas used by computers to buy and sell stock at high speeds were triggered when certain economic events took place and the machines sold and sold and sold some more, causing the market to become oversold and slide 1600 points. If you watched CNBC, Jim Cramer ranted

about this for a solid day or two.

All of these are reasonable possibilities to consider, but we may never know what really happened to cause the market to drop so swiftly. Here is what we do know. Nothing fundamentally has changed. Do we know that interest rates were going to go up, YES! Is the unemployment rate still at 4.1%, YES! Is there still global synchronized expansion with most companies blowing out their earnings estimates, YES! Are interest rates still way below the historical averages, YES! Are there still trillions of dollars on the sidelines that need to be invested in the market, YES! Did we need a correction to bring some lofty valuations of corporations down to reality, YES! So, if we know all the above are true and the economy is cruising right along, should we be scared? Well, we aren't scared, but when volatility comes back into the market, it should peak one's senses. When the market sells off, there is always a feeling of fear. No one likes to see their stock positions go down. But, as intelligent investors know, this happens all the time. And when most people are scared to death and selling, the smart advisers are buying stocks while they are on sale.

While we feel that the correction may not be over yet with possibly more to come, confidence remains high in the underlying fundamentals of the economy. We believe Europe is still years behind the U.S. in their recovery and Emerging Markets are looking attractive as well. We also believe that this bull market is not over and may not be over for several years. We look at this pullback as a nice buying opportunity for people who were waiting to enter the market. We also feel very comfortable with our move out of bonds over the last couple of years. Moving forward, we will keep a close eye on interest rates and the FED's monetary policy for clues of more volatility on the horizon. In the meantime, we are excited about our portfolios and look for another positive year for our clients at Chapel Hill.

As always, we hope everyone has a great spring and a very prosperous 2018! And feel free to check out some interesting articles we have included below.

Please note: if you have received this e-mail from a friend and wish to discuss an investment relationship with our firm, please feel free to contact us.

*Disclosure: Chapel Hill Investment Analysts Inc. is long AAPL.

-Joe, Ryan, and the Chapel Hill Investment Team

CONTACT US

jsc@chapelhillinvestment.com
rmc@chapelhillinvestment.com

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Chapel Hill Investment Analysts, Inc.
126 Mathews Street, Suite 1600 | Greensburg, PA 15601
P: 724.830.2600 | F: 724.830.2795
www.chapelhillinvestment.com

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