

"Cup of Joe"

Well, volatility is back in the markets! Currently, we are in what looks like to be a normal correction (a drop of more than 10%). Corrections happen, on average every 357 days. While this is never fun to experience, it's all part of how free markets work. We will explain the potential causes, provide our short and long-term views of where the market is going, and review some portfolio moves we have been making as of late.

First, what caused this recent market correction? **"Fear of the unknown"** The one thing markets do NOT like is uncertainty. And we have a lot of it. Who will win the midterms? How many more interest rate hikes will the FED authorize? How long will the trade tiff with China last? Will Italy's budget issues cause more populist uprisings throughout Europe? All of these events have been playing a role in the recent market volatility causing U.S. and foreign investors to sell first and ask questions later. So, let's review each event and quickly summarize our thoughts.

First, the midterms. Markets like when a President has control of both the House and the Senate. Why… because this enables the President to get things accomplished, spurring growth. When the President only has one of the two, it usually creates a stalemate, and nothing gets done.

Next up, interest rates. Let's summarize what's happening first and why the President doesn't like rising interest rates. In a nutshell, the Federal Reserve has a dual mandate…to keep inflation under control and to maximize employment. They keep the economy from overheating by raising interest rates (rising inflation means the cost of goods we all purchase are getting more expensive). The easy way to think about this would be like "dumping water on a fire". When the cost of borrowing goes up (your credit card interest), growth slows. With regard to the employment figures, we are currently at a 3.7% unemployment rate. This is the lowest in over **40 years**. So, this part of the mandate has been accomplished. Their main focus now is making sure the economy stays strong but doesn't get out of control. We feel as though the economy is strong enough to handle the rise in interest rates as the FED looks to normalize where rates have been over history. The psychological tipping point usually takes place around 4.5% to 5%. This level provides investors with a safer alternative to investing in the market. For example, when rates reach around 5%, an investor looks at the stock market and says, why invest in something that has produced an average 6% return over history when I can buy a 10-year government bond at 5% that's safe. For a little perspective, we are currently at 3.1% on the 10-year government bond.

One of the biggest worries in the market is the trade "tiff" with China. (Notice I didn't say Trade War) This is one of those events where we know it will hurt growth in the short-term, but is necessary for long-term growth in our country. China has been stealing intellectual property from the U.S. and our allies for years and we need this to end. We feel that the President picked a great time to pick this fight since our country is at full employment and the economy is in hyper drive. The longevity of the fight will determine how big of an economic impact this will have on the stock market however. We will be watching this closely. **(And no, we can't "time the market" to get out and jump back in because the events will occur literally overnight.)**

Currently, a much smaller story that could become larger; we are also watching Italy and their country's budget problems. While we don't feel Italy itself is a big deal in the overall picture, we are worried about negative populist sentiment growing in the Eurozone that could spread into other countries having similar issues. If the instability grows, this would put a damper on global growth already hurt by the ongoing trade saga and bring massive uncertainty to the future viability of the Eurozone.

Wow, that was a lot! A mini perfect storm of sorts affecting global markets at the same time. But, here is the good news. The economy is on fire, posting GDP over 3%. Unemployment is the lowest in over 40 years. Interest rates, albeit rising, are still historically low. The Saudis are flooding the market with oil, causing the price of oil to plummet, which is great for the consumer! And with this correction, stock market valuations have retreated back to 2016 levels. All good things! And once we do get a trade deal with China, we feel that the global markets will soar. Our advice for our clients is to sit tight, be patient, and treat this as a normal, bull market correction.

Lastly, we have been taking advantage of the extreme market volatility and adding to a couple new positions in our high-risk accounts. First is "Alibaba"…what some people call "The Amazon of China". We feel as though this company is fundamentally solid and is well-positioned for the long haul. Right now, any stock connected to China has been taking quite a hit. We are using this weakness to create a position in a company we think will perform well for years. We took a position a month or so ago and will be adding to this position in the next few months.

The other position we added to the high-risk accounts is Facebook. Facebook's stock has also been punished of late due to a recent data breach and an increase in spending to boost their firm's security to prevent "hacker manipulation" that was prevalent in the last election. With added spending comes lighter than expected revenues, which has hurt the stock in the short-term. In the long-term, we love what Facebook brings to the table. While we are not huge fans of the Facebook platform itself, we are HUGE fans of "Instagram" (which FB owns) along with "Oculus Rift", their virtual reality company and "WhatsApp", a popular messaging service. Facebook, in our view, has many companies in their portfolio that could be spun off and successful as standalone companies much like Pepsi owning Frito Lay. We took a position a month or so ago and will be adding to this as well over the next couple of months.

Overall, we still remain bullish on the markets as a whole and will be looking to take advantage of this recent selloff to put new client cash to work. Moving forward, we will be watching interest rates, oil prices and China very closely, along with the Italian budget crisis. If any of these factors turn the other way and become worrisome, we will look to make adjustments to our portfolios during our next global re-balance.

So, much like riding a roller coaster, hold on, and remember that the slow steady climb usually ends with the quick descent and the solid climb the next time around. Have fun over the holidays and enjoy!

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articles below!

*Disclosure: Chapel Hill Investment Analysts Inc. is long FB and BABA.

-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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