Berman Capital Advisors

December 26, 2018

Year End Market Update

As we approach the year end, the stock market weakness that began back in October has intensified. Times like these are disconcerting, but it's also a good opportunity to revisit how and why you invest. When you buy stocks, you are buying a share in the underlying business. In the short run, the market has and always will swing much more wildly than the intrinsic value of that stake. The longer you can hold, the more certain you are to receive the actual value of the piece of the business you have bought. This is hard to do when the financial news is covered with sensationalist bear market coverage! With that said, we wanted to give a few thoughts on what we think is happening and why.

The market has a long list of worries, most notably:

- Fed rate hikes and the balance sheet run-off despite signs of a global slowdown.
- The President's public attacks on the Fed and the continued government shutdown.
- Continued trade anxiety with China, Brexit negotiations and populist movements in Europe.

There are always some things to worry about, and these strike us as "normal" worries rather than deep crisis events. **The most striking thing about this downturn is the significant disconnect between economic data and market declines.** Just this morning, Mastercard reported that retail sales for the holiday season were the strongest in 5 ½ years. Reported equity earnings and most U.S. economic indicators have been solid. Economists expect about 2.5% GDP growth and slower but still positive earnings growth in 2019.

Market liquidity, or lack thereof, seems also to be playing a role in the market's sell off.
While difficult to measure, diminishing liquidity can be seen in several ways:

- During the holidays, the markets are generally very thinly traded and trading desks lightly staffed, so market movements can be more easily magnified.
- Per Goldman Sachs, the number of S&P 500 future contracts available to trade has declined 70% over the last year and is now at a decade low indicating market making participants are fewer.
- As noted in recent WSJ article, a greater portion of trading is now taking place via computer models. This year, momentum – a frequently traded factor in quantitative models – has declined and it is possible that initial selling begets more selling.
- With central banks around the world beginning to raise interest rates and otherwise tighten financial conditions, the broader global markets are seeing less liquidity overall, but again these shifts have been well telegraphed.

Can the market be wrong about the future? Yes, it can, and it has been many times in the past. We must go with the data, which says things are at least "O.K." If that outlook changes, we would react accordingly. In our opinion, this recent market decline isn't about valuation or fundamentals at all. Rather, it is about fear and negative momentum.

We thank you for your continued trust and wish you a happy holiday season!

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