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PHYSICIANS THRIVE
INVESTMENT ADVISORS

WAS JANUARY A HARBINGER FOR THE STOCK MARKET OF 2018?

In past years, there have been times when the stock market has mimicked a roller coaster ride with regular rises and dips. Most investors don't like that kind of ride though, with the exception of day traders, who invite volatility.

Over the past eight years, the roller coaster has been mainly steaming up a tall incline in the ride without too many dips along the way. Twenty-seventeen saw record increases in stocks with five separate 1,000-point milestones during the year.

January 2018 was the best January in 21 years for the market. There was only some volatility seen at the end of the month. The month saw the S&P rise by 5.62 percent.

One trend, that is based on historic evidence, is known as the "January Barometer." From 1950 to 2017, a good January has been a predictor for the market 87 percent of the time. Since 1980, the January Barometer has predicted where the S&P would end the year 68 percent of the time.

This has resulted in a Wall Street axiom that goes; "As goes January, so goes the year."

While a trend that is backed by a high percentage of past years' results is convincing, it was the end of January and the beginning of February that threw a fly in the ointment. Also, since the year 2000, the indicator has been wrong eight times. Since that year, the market has either finished higher after getting off to a rocky start or ended the year lower.

End of the Month Pulls Back

The CBOE Volatility index (VIX Index), the so-called "fear index," which increased to 14.3 by January 30, had already risen by more than 20 percent the day before. Keep in mind that during the market disruption of 2008, the index hit 80.

Fears of inflation caused two of the last three days of the month to pull back. On January 29 and 30, the S&P dropped .7 percent and 1 percent, the first two consecutive days with drops over .5 percent in 310 trading days.

Valuations, that have exceeded many investor's comfort zones, have added volatility to the market that hasn't been seen lately, along with rising bond yields. For the past couple of years though, that volatility has been mostly suppressed amid geopolitical events and domestic political events that might have unraveled it in the past.

Part of the reason for this is that actions by the Fed have been minimal and some geopolitical events like Brexit have involved kicking the can down the road. Global fundamentals are also stronger with most developed counties enjoying full employment.

While January ended partially on a rocky note, February continued the trend with one of the worst weeks for the market in two years. The week ended with a drop of more than 1,000 points. If January was a harbinger for the year, it didn't tell February.

With that in mind, 2018 may end up as a roller coaster ride, and the end of the year may be at a peak, or it may be in one of the dips. Investors can only hope that at the end of the ride, as goes January, so goes the year.

BOND YIELDS SHOOT HIGHER ON INFLATION FEARS

A recent dip in the stock market the end of January was an unexpectant surprise in a rally that has been prolonged and without many hiccups. The Wall Street talking heads blamed the pull-back on bond yields as the culprit. The 10-year Treasury yield, went above 2.7 percent for the first time in three years. That might have come out of nowhere for many investors who had not had reason to think about any alternatives to equites in a long time; a sector which had been rewarding them consistently.

On February 1, 2018, the benchmark 10-year Treasury yield hit 2.783 percent, an increase of seven basis points and 2.85 percent on February 2. That brought it to the highest yield since April of 2014. The 30-year bond passed three percent for the first time since May of 2016.

Both the equities market and the bond market can be impacted by decisions made by the Federal Reserve.

During the Federal Reserves most recent meeting, the members decided to leave rates unchanged. Expectations are that the Fed will raise rates at their upcoming March meeting. This is a sign that the Fed is anticipating an increase in inflation in the months ahead. Wall Street is anticipating a quarter-point increase.

While the Fed's rate hike is not directly tied to the bond market, the signals they give investors about inflationary concerns, can impact bond holders; especially those who hold longer-term bonds.

Inflation Concerns

What is good for wage-earners is also challenging for the economy. Wage increases also can mean more inflationary pressure. The U.S. has experienced very little of this occurrence in recent years. The trend in recent years, and the status-quo for market prognosticators, has been no wage growth as the norm. This has been accompanied by a lack of concern over inflation.

With a new administration, and an energized labor market, 2018 has taken on a whole new persona. This year, there is a greater certainty of low unemployment, paired with an increase in hourly earnings.

We are in a bond bear market. Bond prices and yields have an inverted relationship. When yields climb, prices fall, a bad scenario for holders of long bonds. Higher bond yields also raise the borrowing costs for publicly-traded companies, impacting the stock market.

"Only three times in 60 years that there has been a decline in the equities market and the 10-year at the same time," according to Steve Weiss, founder and managing partner of Short Hills Capital. He says that immediately after each of those, there was a recession. He doesn't believe we are there yet. He says that you can have credit go down while rates go up without equity markets, which is normal. He also says that every recession has had an inverted yield curve, but not every inverted yield curve has there been a recession.

Treasury refunding plays into this equation also. The Federal Reserve is reducing their balance sheet by $400 billion this year. During quantitative easing, the Federal Reserve bought billions worth of bonds. They have shifted into a new phase where they have been lightening their portfolio.

In addition to the yields on the 10-year T-note and 30-year T-bond, the 5-year T-note yield was at 2.544 percent. The U.S. bond market is in competition with European bonds, where yields are rising. Shorter maturity bonds may not be impacted by volatility as much.

With a heavy focus on equities in recent years, it will take a real reversal to drive that many investors back into bonds, even with a three percent yield. Still, the changing dynamics of the U.S. and global economies will bring bonds back into focus.

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