Market Correction

Good morning,

You probably saw the news: On October 27, the S&P 500 officially slid into a market correction.

A correction is when the markets decline 10% or more from a recent peak. In the S&P's case, the "recent peak" was on July 31, when the index topped out at 4,588.1 On Friday, the index closed at 4,117 – a drop of 10.2%.[1]

Market corrections are never fun, and there's no way to know for sure how long one will last. Historically, the average correction lasts for around four months, with the S&P 500 dipping around 13% before recovering.[2] Of course, this is just the average. Some corrections worsen and turn into bear markets. Others last barely longer than the time it took for me to write this message. (On Monday, October 30, for example, the S&P actually rose 1.2% and exited correction territory.[3]) Either way, corrections are not something to fear, but to understand – so that we can come through it stronger and healthier than before.

To do that, we must understand why the markets have been sliding since July 31. I use the word "slide" because that's exactly what this correction has been. Not a sharp, sudden drop, but a gradual slide. While the S&P 500 dropped "at least 2% in a day on more than 20 occasions" in 2022, that's only happened once in 2023, all the way back in February.[4]

At first glance, it may seem a little puzzling that the markets have been sliding at all. Do you remember how the markets surged during the first seven months of the year? When 2023 kicked off, we were still coming to terms with stubborn inflation and rising interest rates. Many economists predicted higher rates would lead to a recession. But that didn't happen. The economy continued to grow. The labor market added jobs. Inflation cooled off. As a result, many investors got excited, thinking maybe the Federal Reserve would stop hiking rates…or even start bringing rates down.

Fast forward to today. The economy continues to be healthy, having grown an impressive 4.9% in the third quarter.[5] Inflation is significantly lower than where it was a year ago. (In October of 2022, the inflation rate was 7.7%; as of this writing, that number is 3.7%.[6]) And the unemployment rate is holding steady at 3.8%.[7] But the markets move based either on excitement for the future, or fear of it – and these cheery numbers no longer generate the level of excitement they did earlier in the year.

The reason is there are simply too many storm clouds obscuring the sunshine. While inflation is much lower than last year, prices have actually ticked up slightly in recent months. (I mentioned the inflation rate was 3.7% in September; it was 3.0% in June.[6]) As a result, investors are now expecting the Federal Reserve to keep interest rates higher for longer. Seeking to take advantage of this, many investors have moved over to U.S. Treasury bonds, driving the yield on 10-year bonds to its highest level in 16 years.

Since bonds are often seen as less volatile than stocks, when investors feel they can get a decent return with less volatility, they tend to move money out of the stock market and into the bond market.

As impressive as Q3 was for the economy, there are cloudy skies here, too. This growth was largely driven by consumer spending – but how long consumers can continue to spend is an open question. Some economists have noted that Americans' after-tax income decreased by 1% over the summer, and the savings rate fell from 5.2% to 3.8%, too.[5] Mortgage rates are near 8%, a 23-year high.[8] Meanwhile, home sales are at a 13-year low.[9] All this suggests that the Fed's rate hikes, while cooling off inflation, have been cooling parts of the economy, too.

Couple all this with violence in the Middle East, political turmoil in Congress, and a potential government shutdown later in November, and you can see the problem. Despite the strong economy, investors just aren't seeing a good reason to put more money into the stock market...but lots of reasons to think that taking money out might be the prudent thing to do. It's not a market panic; it's a market malaise.

So, what does this all mean for us?

There are a few things we should remember. First, take comfort in the very term correction. When the markets surged earlier this year, it was largely on the back of a relative handful of big tech companies. Similarly, much of the current slide has been those very same companies. In essence, the market really may just be "correcting" itself. Reverting back to the level it should be at for the time being.

Second, I mentioned how the markets move based on excitement for the future, or fear of it. In other words, on investor behavior. These types of investors tend to think in time frames of days, weeks, or months. But we think in terms of years and decades – because it's your long-term goals we're working towards, not an arbitrary number. Again, corrections are common. For us, they are just temporary roadblocks on a much longer journey.

All that said, we need to prepare ourselves for three possibilities: 1) That the malaise deepens and turns into a bear market. 2) That it turns to excitement. 3) That the markets continue to see lots of bumpy, playground-slide type days. Of course, there's no way to know which scenario will play out. But there is something you do know: My team and I will be prepared for all three. We will continue to monitor your portfolio. We will continue to keep you apprised of what's happening in the markets, and why. And we will always be here to answer your questions and address your concerns.

In the meantime, my advice is to enjoy the Fall weather! My team and I will focus on your investments, so you can focus on why you invest: To create happy memories and live life to the fullest with your loved ones.

Sincerely,

Graeme Sivertson, CIM®, CFP®, BComm.

Wealth Advisor & Portfolio Manager

Sources:

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