Equity markets across the globe are continuing their downward spiral today after the drastic sell-off last week as investor fear over Chinese/Emerging Markets growth and potential action (or lack thereof) from the Fed next month finally caused an exodus from the seemingly ever resilient U.S. stock market. Not surprisingly, emerging markets have led the carnage so far in August and are down close to 16% in the 3rd quarter and more than 13% YTD through Friday. Commodities and MLPs also continue to suffer with both down more than 30% over the past 12 months. Despite the rout last week, most other equity markets across the globe are showing minor losses in 2015. It is also important to note that the S&P 500 and Russell 2000 have returned low-mid teens annualized over the past 5 years. In other words, investors need to put all of this into context and focus on the larger picture.

Diversification has been a nasty word over the past couple of years as U.S. stocks ran circles around almost every other asset class. It is no secret that equity valuations have become stretched and that the Fed and China were certainly the top candidates to finally cause an increase in volatility and an overdue sell-off. The natural reaction to this market dislocation is that some type of action must be taken immediately. In reality, diversification, capital preservation and risk management are key tenets when building long-term strategic portfolios and this approach should shine when the markets become more turbulent. That does not mean that nerves won’t be frayed and losses will be totally avoided as short-term correlations often spike during panic sell-offs, but the pain should be less than if an investor has all of their eggs in one or two baskets. Markets do not go straight up over time and periodic corrections can be healthy and often create opportunity.

The question foremost on everyone’s mind is what happens next. The easy answer to that is nobody (not even the so called experts who make dramatic and outlandish predictions) has a clue as markets are not always rational and are impossible to predict. Certainly, the severity of the slowdown in the emerging markets likely holds the key to where the markets head next. The U.S. economy is holding up reasonably well and Q2 GDP is likely to be revised upward to close to 3% later this week. Housing, jobs and consumer confidence have all been improving throughout the year and gas prices are expected to head even lower over the next several months. Outside of the energy sector, earnings remain solid and this correction will likely bring valuations to more supportable levels. Inflation remains low, which does give the Fed somewiggle room if they decide the global economic situation is too fragile to raise rates in September or anytime this year. The Eurozone economy has also been improving and their QE program will last well into 2016. Bottom line, there are still a lot of positives out there, but also a lot of uncertainty which is likely to keep the markets volatile for the time being.

Since the hiccup during the spring/summer of 2011, it has been smooth sailing and this is likely a good reminder that market corrections will occur, but that shouldn’t cause investors to deviate from their long-term strategic plan. Times like these will likely test investor risk tolerance levels often leading to ill-timed emotional decisions. While there still may be more pain to come, significant market dislocations often create opportunities. We believe that this is usually a good time to remain calm, stick with your plan and ignore all of the short-term disruptions.
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