GLOBAL FINANCIAL
Private Capital
COMPREHENSIVE WEALTH MANAGEMENT

Emotional Responses Are Rarely Logical

SYNOPSIS

- Emotional absurdities that fuel the daily market swings cannot be predicted consistently, nor can investors do much to prepare for them.
- The stories that whipsawed equity prices in 2014 appear to be irrelevant in today's market movements.
- Focus on the fundamentals, which rarely change on a dime, and use the volatility to go discount shopping for stocks.

HEADLINE GRABBERS

The short-term price swings in equity markets never cease to amaze me. How a stock could be down, due to a geopolitical event in a country where a company has no exposure in a single day, is borderline comical, but it happens all the time.

Just go back to August 2013, when the president of Syria used chemical weapons against his own people. The day the news broke, the S&P 500 closed down over 2% over fear that the U.S. government would take action.

The revenue exposure in the S&P 500 to Syria is effectively zero, yet somehow companies like Apple and Verizon were immediately worth 2% less than the day before, due to exogenous reasons that have no impact to the fundamentals of their business.

This is just one example of the absurdities that fuel the daily market swings. These events cannot be predicted consistently, nor can investors do much to prepare for them. All we can do is simply be patient, let the volatility take its course, and look for opportunities to profit along the way.

For example, nobody predicted the terrorist attacks on September 11, 2001, but those who didn't succumb to the panic, watched the S&P 500 drop over 8% in a matter of minutes and create one of the best buying opportunities we've ever seen.

"All we can do is simply be patient, let the volatility take its course, and look for opportunities to profit along the way."

That day represented the worst attack on U.S. soil since Pearl Harbor, and it was still not enough to derail our equity market and/or economy. In fact, those who bought into the panic were rewarded just weeks later, as the equity market not only recovered but surged higher.

Think about some of the events that have grabbed headlines over the last few years. I can't be the only one who feels like the world has become more unsafe, and that politicians are pushing our way of life down the wrong path at times. Take these events that hit stock prices last year:

1. **Russia/Ukraine:** Russia invades this neighboring country with force not seen from a developed nation in a very long time. The U.S. immediately enacts economic sanctions, which crushes the Russian currency and risks natural gas deliveries to Western Europe.
2. **ISIS:** This radical Islam movement comes on the

scene with a level of brutality that shocks the world in an already unstable region, which continues to be a major source of oil for global customers.

3. **End of Quantitative Easing:** The Fed takes one step closer to raising interest rates by ending their multi-year bond buying program, which wreaks havoc periodically throughout the year, as traders assume that stocks must fall since the Fed is moving closer to hiking rates.

Each of these events impacted equity markets in the short-term because volatility is fueled on emotion, and emotions ran high in each of these situations. However, they were short-lived, and disciplined investors who bought into the panic were able to build to existing positions at very attractive prices.

NOTE*: Investors often ask how I can tell the difference between a volatility spike and a real reason to sell. The litmus test I use is to determine if the reason for the selloff will materially impact earnings for companies. If the answer is "yes," which is the case when our economy is entering a recession, then it's time to get out. However, the overwhelming majority of the time, the answer is a resounding "no," and this is the best time for a value investor to look for deals.*

ARE THINGS BETTER OR WORSE TODAY?

Let's now fast forward to present day, and assess where we stand by asking ourselves three basic questions:

1. Has the Russia/Ukraine conflict improved or gotten worse?
2. Does ISIS represent a smaller or bigger threat to the world?
3. Are we closer or further away to rising interest rates?

The Russian conflict is substantially worse. Ceasefires last for hours, the U.S. is increasing its military presence in the region, and sanctions against Russia remain in place.

ISIS is recruiting across the world, gaining access to new money and weapons, and becoming far more organized. They are conquering areas that pose tremendous risk to oil producing regions and even risk breaking up Iraq entirely.

Lastly, we get closer to the first rate hike since 2006 every day. Markets admittedly remain volatile, but less so on a relative basis to when QE was in place.

The one commonality across these examples is that in each one, <u>the root cause for the panic has amplified over the last year, yet its impact on short-term equity prices has fallen.</u>

Markets seem to ignore Russia and ISIS entirely these days, while fear of the arrival of rising rates has lessened over time despite us getting closer to the actual event as each day passes.

IMPLICATIONS FOR INVESTORS

It's hard to say why markets are fickle with stories that initially cause traders to panic. If pressed, I would guess that they just get bored, or perhaps more encouragingly, traders just realize over time that they don't matter to the direction of our economy.

Maybe it's why markets are so focused on the current Greek tragedy, China's equity market correction, and Puerto Rico's debt crisis. These stories are new, fresh, and dominate headlines in the media. Meaning, these stories are page one material while Russia is lucky to be found on page three.

I would wager that in a year's time, the situation in Greece will be worse than it is today, given the prospects for their economy now that their leaders have driven it into the ground. But will markets care, or will they have moved on to something else?

Truthfully, I really don't care all that much. I focus on fundamentals, and these rarely change on a dime. I watch the short-term movements in markets for the sole purpose of hoping to find stocks that go on sale for reasons such as a bank holiday in Greece or because the Fed "hinted" that the first rate hike in almost nine years may come a few months sooner than expected.

Sincerely,

Mike Sorrentino, CFA
Chief Strategist,
Aviance Capital Management
mikeonmarkets.com