A Dramatic but Necessary Correction

Yesterday's dramatic fall in the equity markets was a continuation of last week's market drop. We wrote yesterday before the open that we were long overdue for a correction. What happened last week was just that and investors should not panic. Yesterday's 4% fall in the Dow has not changed our opinion. There are a number of reasons we believe this is a correction and not the start of a bear market. Bear markets seldom, if ever, begin during an economic expansion. Employment and wages continue to grow at an accelerating pace. Inflation, although increasing, is nowhere near a danger zone. A Treasury note approaching 3% is not a crisis. Earnings continue to be strong, there is very little undesired inventory build-up and confidence remains high. Both the U.S. and global economy appear to be in good shape.

If this were the start of a bear market, we should expect certain changes in markets other than the equity markets to confirm a bear market. There has been no discernable flight to safety. Treasury bills and other short term debt instruments have not seen massive purchases. Investors should expect the spread between the high yield fixed income securities and treasury bonds to widen significantly as investors' fears of corporate weakness intensifies. None of these signals are present!

Investors should recall how frequently market analysts have been calling for a correction. The long wait for a correction and the extraordinary acceleration of the equities markets has intensified the correction. Yesterday I wrote about some serious concerns but most, if not all, if they occur will occur in 2019.

Our view is we are in a market correction. This correction may be a bit more severe than the average which is about 5%. This is not because investment conditions are worse than most corrections but because, as we wrote earlier, the rally has lasted far longer and been far stronger than in the past.

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