Is the Market Pullback a Cause for Worry? Not So Much

Presented by Christopher Phelps

It has been a tough couple of days in the markets, and it looks like today will be another. Not only is the market down in pre-market trading, but this is also a quadruple witching day (i.e., when four types of derivatives all expire on the same day). That often leads to volatility and, in the context of the past couple of days, means today could be difficult as well. I see the effects in my portfolio, and you may have seen them in yours as well. Should we be worried? In a word, no.

Expanding the Time Frame

Looking at the market day-by-day can be scary. If we expand the time frame, though, we see a much smoother path. Yes, there are bumps in the road. But, in retrospect, they invariably look smaller than they did at the time. When your goals extend over years, what happens in a couple of days is nothing to worry about.

Often, it isn't even a matter of years. If we put right now into a slightly longer perspective, we see that after two good months, the recent pullback leaves us about where we were at the start of November. Or, for that matter, about where we were in July. The market has bounced around and been both above and below where we are now this year. Rather than something unusual, what we are seeing right now is the same volatility we have seen all year.

That has been frustrating. But as rates have risen and markets have adjusted, that adjustment has left us better positioned for future gains. During that year, on the whole, the economic news improved. We are now much closer to the end of the Fed rate increases than we were. Job growth has continued to be very strong. And inflation has started to come back down. Yes, markets have bounced around, but their economic foundations have solidified during that time.

You can see that in the markets as well. Corporate earnings have continued to improve. Valuations have dropped but are now down to reasonable levels typical of the mid-2010s. With growing earnings and reasonable valuations, there is both more cushion for the market and more potential for growth. Much better than we saw even six months ago.

Reality Better Than the Headlines

It's true there are things to worry about. Most recently, Chair Powell indicated the Fed would keep raising rates—and likely keep them higher for longer, which is what kicked off the recent pullback. But while the stock market has reacted badly, the bond market has yawned. And over time, the bond market tends to get it right. With inflation rolling over and growth slowing, the need for higher rates is likely to fade next year, meaning most of the damage from higher rates has already been done. The bond market has already started to recover. And at some point, the stock market will do the same.

We can say the same for recession risks. Yes, they are real. But with the strong job growth and other positive trends, even if we do get a recession—which is not guaranteed—it will likely be both mild and short. Right now, the market seems to be pricing in something more severe, leaving more upside potential than downside risk. So, while the risks are real, right now the reality is better than the headlines. And that means that over time, things will keep getting better, and the markets will eventually respond.

Is This an Opportunity?

But when? If you are a trader, that matters. If you are an investor, it doesn't. For long-term planning, a market pullback is a chance to buy stocks on sale before they head up again. For investors whose goals are measured in years and decades, this is an opportunity.

Should we pay attention? Of course. Should we worry? No. This is normal volatility, as the market tries to figure out where the economy and markets are going. This kind of market reaction is both normal and necessary—and something we will continue to see not just right now, but over and over again.

Keep calm and carry on.

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