CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

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From Placidity to Turmoil

By

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After more than a year of strong markets and exceptionally calm markets since the November 2016 election, and after a torrid start to 2018 during the first four weeks of January, stock markets took a tumble last week. The tumble became a rout on Monday of this week, before a wild day today. Today the stock market traded in a range of more than four percent, before closing up by 1.7%. Whew!

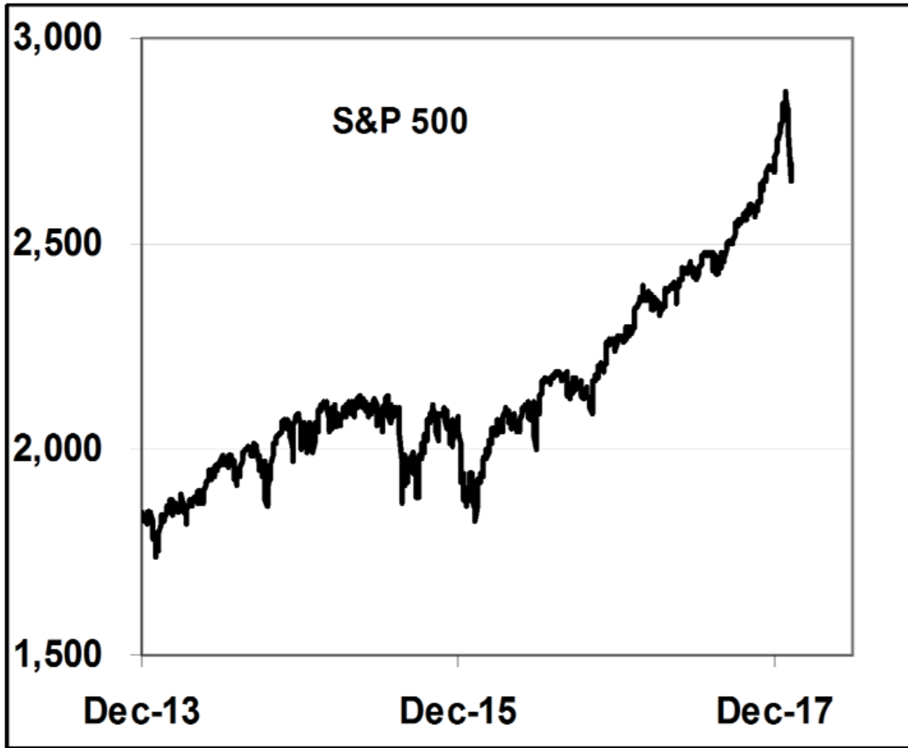
Bearing directly on the recent selling are the rising levels of bond yields and corresponding declines in bond prices. Treasury bond prices began to fall persistently in December and the slide accelerated recently. Last Friday's monthly employment report showed that wage growth, feeble for years, is now rising comfortably ahead of inflation. This is, of course, a good thing for the US economy and for workers struggling after several years of stagnant wages. However, it increases the likelihood that the Federal Reserve will be able to tighten monetary policy, in the confidence that stimulative policies needed after the financial crisis are no longer necessary. It is rather doubtful that stock markets will enjoy tight monetary policy.

The sustained buying stocks in recent months rendered them susceptible to some selling and the rise in bond yields provided the trigger. By contrast, the economic cycle still favors stocks and provides the impetus for more gains. Rising corporate profits and solid economic growth in America and abroad provide support for stocks. In addition, the recently-enacted tax legislation will likely provide a boost to the economy in general and to corporate profits in particular.

In fact, the rise in bond yields itself restores more normal relationships between the level of those yields and underlying economic growth, inflation levels and stock prices. The actions of central banks since the financial crisis of 2007 to 2009, while necessary and very helpful, pushed bond yields to exceptionally low levels. Indeed, in much of the developed world outside the United States, interest rates have been negative for more than a couple of years. In historical terms, interest rates on the ten-year Treasury bond, the bench-

mark for all the world's fixed-income securities, is still quite low.

The rise in bond yields comes about not because of monetary policy misjudgments or the view that government bonds have become more risky, but because of the of strong global economic growth, rising wages, deregulation and the fiscal stimulus provided by the recent tax legislation. Given the still-low level of bond yields and the favorable economic and fiscal backdrop, it is quite reasonable to remain positive about stock investments.



It is, of course, a fool's game to try to predict financial markets. We make no attempt to do so, but we have what we think are well-considered plans to reduce risk if the market rises from this very recent bout of selling or if it should continue to fall.

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