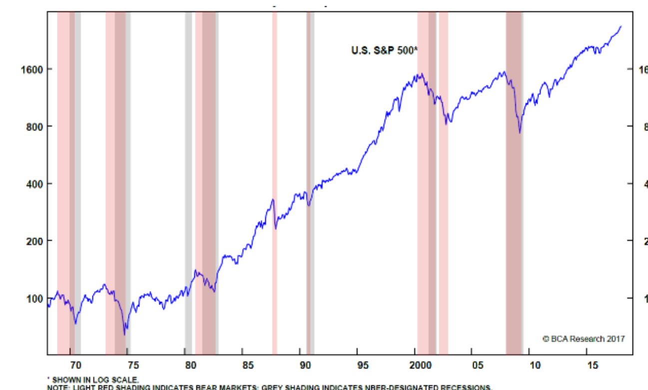
Stock market corrections are normal and healthy. The urge to extrapolate a correction into something more calamitous is natural, but we do not view the current correction as the start of a bear market. The ingredients simply are not in place. Economic conditions are healthy, corporate earnings are growing, credit markets are calm, and valuations are now in a normal range.

The selloff in stocks started on Ground Hog's Day when the January job figures were released and the data revealed a modest increase in the pace of wage growth. Fears over an incipient rise in inflation pushed the 10-year interest rate toward 3%. Rising interest rates can negatively impact valuations on stocks, although we do not believe that is yet the case. Multiples were at elevated levels following the almost 6% increase in the S&P 500 in January (the best January in 21 years), and an approximate 45% rise since the 2016 Presidential election. The rise in equities had been inexorable and as January unfolded, investor sentiment became extremely bullish with money pouring into stocks.

Bubbling inflation stokes concerns over how the Federal Reserve will respond. Inflation has been low for quite some time, but the economy continues to improve and the labor market has become tight with the unemployment hovering close to 4%. Were wage growth to accelerate, concerns over inflation would likely increase prompting the Fed to act more aggressively in raising interest rates. At some point, higher interest rates would negatively impact the economy and ultimately cause a recession.

As the decline in stocks accelerated over the course of the past week, various news stories regarding investor positioning in ETFs and "forced selling" of stocks began to make the rounds in the media. Volatility was low throughout all of 2017 with stocks rising each month of last year. To take advantage of this environment, investors could short (bet the price will fall) the ETFs that reflected volatility. If markets remained calm and volatility low, the prices of these ETFs would remain under pressure and being short was profitable. Last week, stocks started falling precipitously with volatility increasing sharply. If you were short one of these ETFs levered to volatility you had to cover, quickly. To cover these short positions, money managers are raising cash by *selling* stocks. Given the severity and pace of the declines last week, we believe so-called "forced selling" due to the shorting of these ETFs is playing a major role in the market correction.

The S&P 500 has fallen about 9% from its recent high. A bear market is typically defined as a decline of 20% or more from the peak. As the chart shows, bear markets and recessions tend to coincide with one another with stocks typically leading the way down into an economic contraction. For now, there is little sign of a recession. If anything, economies both here and abroad are gaining strength. The global manufacturing PMI hit a seven-year high in December. Manufacturing activity in the U.S. is at a 13-year high. Fourth quarter economic growth in the U.S. is estimated at 2.6% with January marking 103 consecutive months of expansion (the average expansion is 47 months). Odds are that this current U.S. economic expansion will end up being the longest in history.



Stocks ended the week on a high note with the Dow Jones Industrial Average rising in excess of 300 points after being down more than 500 points earlier in the day. Friday's performance added little solace to what was a bad week for stocks and indeed a bad month--February is now down 7.2% and thus far one of the worst Februarys in the history of the S&P 500.

Importantly, credit markets have not signaled much trouble. In past instances where the economy was decelerating and stocks were falling, it was the credit market--high yield spreads for example--that often foretold the difficulty. Spreads remain relatively narrow and this reinforces our confidence in maintaining a constructive view of equities.

As of Friday's close, the S&P 500 was trading at about 17x this year's earnings estimates. Having only recently been above 19x earnings, this broad index is now trading much closer to its long-term average of about 16x earnings. Importantly, earnings are projected to grow in excess of 10% this year, which underscores the broad economic strength referenced earlier. You are probably wondering whether the worst is over? Frankly, it is impossible to to answer that question. The lack of volatility last year was quite unusual historically. It is more common for stocks to decline 8%, 10%, 12% at some point during a calendar year, albeit not necessarily in one week! In this regard, the recent selloff is not all that unusual. We are surprised that the selloff happened so quickly. We are not surprised that it happenend.

In sum, our view is that the fundamental backdrop for the economy and therefore stocks is still positive. We would characterize the decline in stocks as a correction within a bull market. As such, we view recent events in the market as a healthy component of a normal market cycle rather than a harbinger of greater tumult in the weeks and months ahead. Our intent is to stay the course while looking for opportunities to buy shares of good companies and funds at more attractive prices.

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