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Lisa Santo: Volatility seems to be market's only stable element

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The market likes nothing more than stability, and if constant instability is the new norm then the market should be as happy as a clam.

Some days it is down at midday and up at closing, other days it is up at midday and down at closing and others it is too volatile to predict. So where are we at this juncture, where are we going and what is causing all the turmoil?

Mid-March shed some light on what is happening. Looking back at February's sharp swings, the market settled into an almost predictable series of upticks and downticks. Then, just before the St. Patrick's Day weekend, word began to spread that the European Union (EU) was considering a 3 percent tax on profits made by American tech giants; by Monday morning market futures were dropping steadily and the market opened well off the base.

The market opened roughly 400 points down and stayed there most of the day, closing down approximately 350 points as measured by the Dow Jones Industrial Average. This was spurred, according to most analysts, by the EU's consideration of applying a tax on U.S. tech companies. That made investors nervous.

Compounding that was inflation and interest rates. Investors already were a bit edgy with news of interest rates being pushed higher by the Federal Reserve to stem inflation. The Federal Reserve increased interest rates a quarter percentage point at the close of its two-day meeting March 21. The Fed also issued a new policy statement and updated economists' forecasts, while proposing an additional rate increase next year. Some economists expect the Federal Reserve to follow in June and September with two more rate hikes.

Stock and bond markets reacted with anticipated nervousness but finally ended roughly where they had been before the Federal Reserve's decision. Analysts say the Federal Reserve leaves investors in familiar territory: while the central bank continues to lift rates amid stronger growth and inflation, it doesn't yet see a reason to dramatically accelerate the path of tightening.

However, ongoing increases in interest rates are not a welcome sign to some analysts. I believe that we may see an increase in inflation, but analysts don't believe it will not spike. As well, I don't think there should be any extreme measures imposed on the economy just because it is growing, especially when the incoming data is in line with what has been forecast.

While the stock market is volatile, there has been some growth in the bond market, but that isn't necessarily a harbinger of long-term activity. The yield curve, the difference between short- and long-term Treasury yields, has been flattening in the last few weeks as long-term yields fell in response to some less enthusiastic projections on growth and inflation.

Investors watch the yield curve because it can signal that the economy is speeding up when it steepens or slowing down when it flattens.

Obviously, the impact of the Federal Reserve's interest rate decisions as well as an improved outlook for the spring housing market can help spur the market in one direction or another.

Overall, the underlying economy is in good shape with low unemployment and steady growth. But as with any silver lining, it may not come to pass and quicker and more frequent interest rate increases may come to pass. Investors should apply the same care and concern to their financial dealings now as they would during more depressed financial circumstances…and prepare for instability being the new stability, at least until things stabilize.

Lisa Santo is a financial adviser with the Global Wealth Management Division of Morgan Stanley in Manhattan and can be reached at 212-883-7707. She is a resident of Sleepy Hollow.