

# The Advisor

A quarterly publication from Ables, Iannone, Moore & Associates, Inc.

## Market Update – *Third Quarter, 2019*

**THE FIRST HALF OF 2019** is in the books and it did not disappoint. At the end of June, the U.S. economic expansion tied the period from 1991 – 2001 as the longest in history. Currently, it stands by itself as the longest on record. The S&P 500 also made a run at historical levels as it posted its 8<sup>th</sup> best first half of the year since WWII. All sectors, except Energy, posted gains in Q2 with Financials, Information Technology and Consumer Discretionary leading the way. For its part, the Dow Jones Industrial Average posted its best June in 81 years. That is not a misprint. It was 1938 the last time the Dow posted a better June.

Let's step back for a moment. Do you remember just 6 short months ago when 2018 came to an end? If not, here is a quick refresher. The market was crashing, falling nearly 20%. The roar from the bears was downright scary. It was the end of the global economy and possibly the world.

Many investors, driven by emotion, let panic set in and quickly moved to de-risk their portfolios away from equities. Even more, many of those same investors did not return to the markets and have missed out on some or all of the recovery here in 2019. That's a normal reaction though, is it not? Unfortunately, the answer is yes. It is human nature to have cognitive biases that influence and even direct our behavior. Specifically, loss aversion and recency bias come to mind in explaining much of the last 6 months for that investor who sold low and missed at least a portion, if not all, of the 2019 first half market gains.

Recency bias is our tendency to place a higher level of importance on the most recent information or data when projecting what will happen next. The inverse of this is also true – we are less likely to believe an event that happened long ago will happen again in the near future. It is easy to see how this cognitive bias can affect investment decisions.

Loss aversion is self-explanatory. Behavioral science has shown that humans tend to feel the pain from loss to a much larger degree than they feel pleasure from gains. Take a look at the chart below from Goldman Sachs Asset Management. It shows the average gain an investor would need in order to offset the fear of losing \$100 on a coin flip. The number? \$300. And that is for the average investor. The more conservative investors stated they would require significantly more.



You may be asking, what is the point of all this? The answer is we are facing a cautious set-up in the markets as we head into Q3 and this quarter may prove to be a test for the overly emotional investor. Sam Stovall from CFRA states, "the third quarter is notorious for delivering the weakest average price return, while recording the deepest decline and greatest volatility." This is especially true when the first half of the year is as strong as it was. In addition to history, the market continues to grapple with China, trade tensions and pockets of global economic weakness as the Q2 reporting season gets underway. According to S&P Capital IQ, consensus estimates show a 1.7% decline in operating earnings. Early forecasts for Q3 do not look much better and companies are likely to provide tempered guidance given the aforementioned headwinds have not subsided.

There is good news. On the valuation front, the S&P 500 is not egregiously rich. In fact, on an inflation-adjusted basis it is not only in-line with history but appears to have more room to run when looking out over the next 12 months. The U.S. economy is still proving itself resilient, inflation is under control, the consumer continues to exhibit signs of strength largely on the back of low unemployment data and the Fed has all but promised a rate cut at their next meeting. Even more, history tells us that after such strong gains during the first half of the year, it is wise to expect additional gains in the second half.

But are these tailwinds enough to support current market levels? Say hello to TINA, which stands for, There Is No Alternative. It is used to describe an environment where the market continues to rise despite its respective conditions that otherwise would not appear to be the most attractive for investment. Applying a TINA filter to this market, it makes sense considering that central bankers around the world are keeping rates extremely low and the U.S. economy is in a much better position of strength compared to the rest of the global economic backdrop. Simply stated, the U.S. stock market has been the de facto place for stable growth and profitability when compared to other alternatives for capital investment.

We continue to stress the importance of keeping the long-term in focus while monitoring the short-term data within historical context. Opportunity remains inside the many secular shifts happening in our world today. The market will continue to reflect this but stocks do not move up in a straight line. They will go down and there will be periods of sluggish performance. It will be in those moments that investors can define their path forward with discipline and patience instead of emotion. History suggests those investors will be rewarded.

As always, thank you to our clients for the many referrals and allowing us to continue working to meet your needs. Please do not hesitate to contact us if you experience any material changes in your personal situation or would like to discuss any specific matters.

To our other readers, we take our role as fiduciary very seriously. If you would like a complimentary review of your investment accounts or any other financial matters, please do not hesitate to contact us. We will happily provide you with an unbiased opinion based on your specific situation.



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