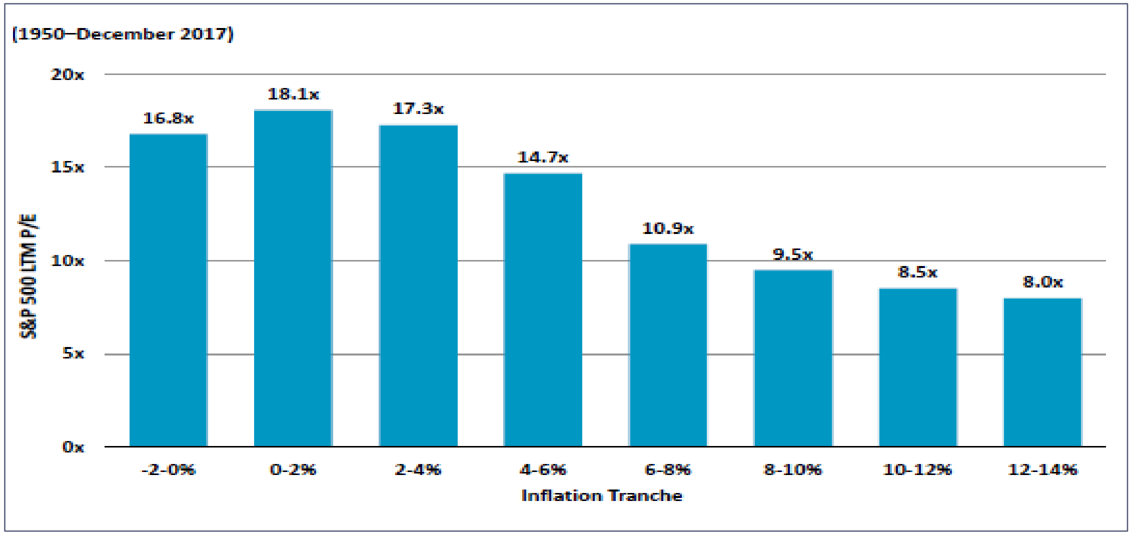
Market Recap

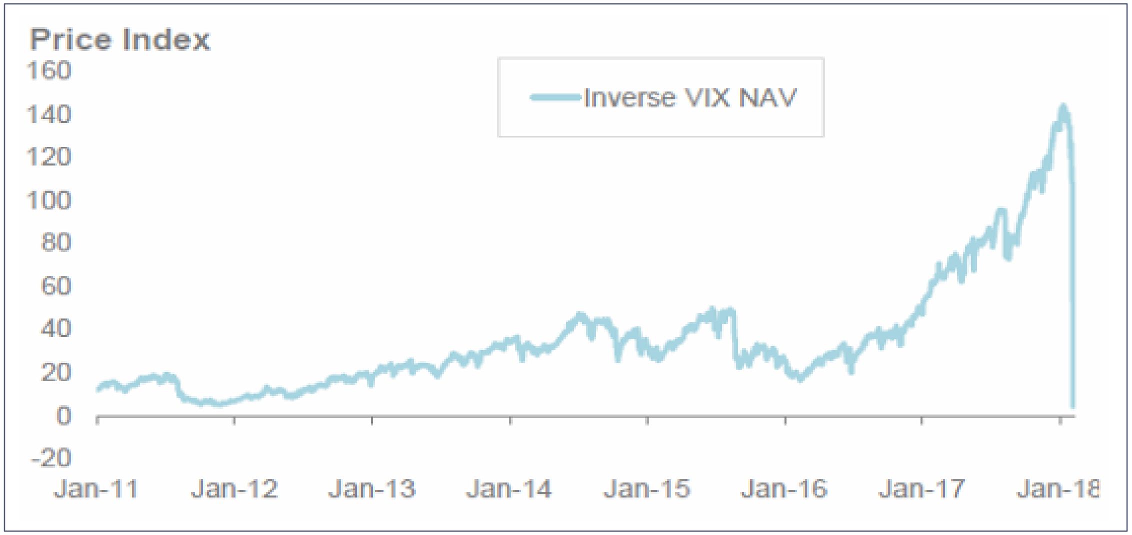
Rising Inflation is a Threat to Market Valuations



Source: Factset

As we have mentioned in past notes, there is an inverse relationship between levels of inflation and what investors are willing to pay for future corporate profits (i.e., valuations decline as inflation and the discount rate applied to future cash flows increases). For this very reason, increasing concern about rising inflation, as well as the Fed's response to it, appears to be one of the primary factors contributing to last week's correction. Although current valuations remain slightly above longer-term averages, history suggests that the market should remain on relatively firm ground as long as inflation remains moderate and stable. And while recent inflation estimates have increased from historically low levels, current levels remain moderate at only 2.1% annualized. At this point in the cycle, the more important question is whether future corporate profits will surpass future inflation.

Bets on Extended Low Volatility Backfire



Source: Morgan Stanley

February's market correction proved to be a painful experience for a group of investors who believed that abnormally low stock market volatility would persist. The Velocity Shares Daily Inverse VIX Short-Term Exchange-Traded Note (XIV), an instrument allowing investors to profit from a decline in the CBOE Volatility Index, crashed to zero as stock market volatility surged. The product will be discontinued due to the sharp losses suffered over a very brief ten-day period. Indeed, some market pundits have argued that the unwinding of the XIV (and similar leveraged products) was responsible for the severity of last week's downdraft. Although it's difficult to fully ascribe meaningful swings in the market to the activities of any one group of investors, this episode is a stern reminder that long periods of low volatility often lead to investor complacency

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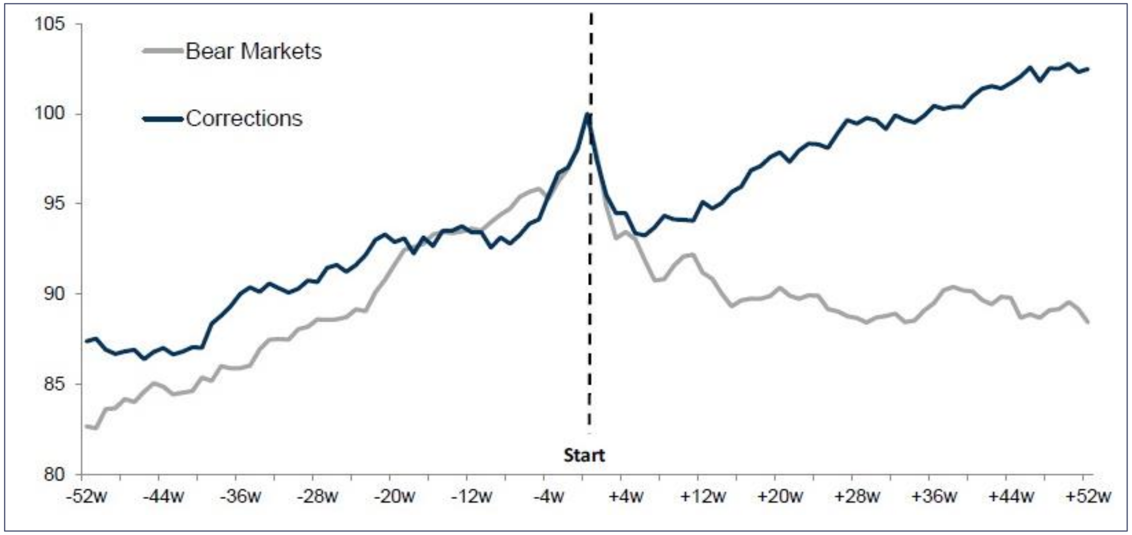
Historical Length of Recovery from Market Drawdowns



Source: Goldman Sachs

A correction is typically defined as a stock market decline of between 10% and 20%, while a bear market is typically defined as a stock market decline of least 20%. Corrections are rather common, occurring approximately once per year. In most cases, corrections offer an opportunity for investors to find attractive entry points for stocks. However, reflexively "buying the dip" is not without risk, as any benign correction could ultimately transform into a more serious bear market. Despite this lingering concern, a bear market is most often associated with a recession, and the current economic environment remains favorable, characterized by accelerating economic growth and moderate inflation

The True Cost of Eating Out

Source: Credit.com

While spending a dollar or two more on breakfast every day may not seem like much, the numbers add up over the course of a year. The daily cost of eating oatmeal for breakfast in the comfort of your own home is a mere $0.16. Conversely, stopping at McDonald's or Starbucks for the same meal on your way into work would cost you $1.99 and $3.45 per day, respectively. If we extrapolate those costs to cover five days per week and fifty-two weeks per year, we end up with a significantly larger difference; approximately $42 to eat oatmeal at home, $517 to eat oatmeal at McDonald's, and almost $900 to eat oatmeal at Starbucks.

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