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Economy & Market Valuation

If you see the stock market as measured by SPY (S&P 500) on July 1,2018 and October 19,2018, you would think that the market has gone nowhere. It was almost at the same level on Oct 19 as it was on July 1. But looking at the SPY trajectory in Q3'2018 tells a different story. The market went up almost 8% from July 1,2018 to Sep 20,2018 and then gave up almost all the gains as of Oct 19,2018. The reasons are well known - i.e. rising interest rates and trade tensions especially with China. What triggered the drop on Sep 20 and afterwards, is that, the market is not getting a signal as to when, and at what level, the Federal reserve will stop raising interest rates. The higher rates are starting to impact the real US economy especially the US housing market. The housing market has slowed down as seen by indicators like new home sales and existing home sales. Sales of existing homes fell by 3.4% in September 2018 compared to the previous month. Existing home sales have dropped every month for the last seven months compared to a year ago. The factors cited are higher mortgage rates, high prices and low inventory. If the slowdown in housing persists, it could reduce the GDP growth rate of the whole US economy.

We expect the US stock market to exhibit volatility in near future. We are using caution and are not super aggressive in our investment decisions. Higher percentage of cash in the portfolio serves as a defensive position. It enables us to take advantage of volatility and deploy cash to add to positions or buy new positions at attractive prices. We deployed a portion of the cash in the portfolio during the market drop last week.

We will continue to use caution and take advantage of market rallies, as they happen, in this volatile period. We will be sellers at rallies and buyers at the market drops by adding to the stocks that meet our criteria of good companies and investments. You will see us increasing the cash position in the portfolio if we see the economic indicators deteriorate.