2018 Market Recap: Wall Street Caps Off Worst Month Since Financial Crisis as S&P 500, Nasdaq Fall to the Bears

The 10 year bull market has finally come to an end. The longest bull market in more than 70 years ended in dramatic fashion during the final quarter of 2018 with the S&P 500 and TSX total return index down -4.5% ($U.S.) and -8.7% respectively. In December alone, the S&P and TSX (including dividends) each declined -8.8% and -5.2% respectively. Virtually all asset classes ended the year in negative territory. The correlation between asset classes became homogenous as almost all asset classes produced negative returns during 2018. As a result, investors swiftly moved into gold and other safe haven investments.

Market Meltdown

The long-awaited Santa Claus rally was too little, too late in December, as stock prices headed for their worst month since the financial crisis. At the height of the selloff, the Nasdaq Composite Index and S&P 500 Index entered bear-market territory, which is defined as a loss of 20% or more from a recent high. During the downturn, the major indexes fell to their lowest level in a year-and-a-half, obliterating the record-setting gains of the previous quarter.

Losses would have been far worse had it not been for a post-holiday rebound that began on Boxing Day. The Dow Jones Industrial Average rallied nearly 1,100 points that day, its biggest point gain on record.[1] Just a few weeks prior, stocks were on track for their worst year-end performance since the Great Depression.[2]

Wall Street's collapse exerted a gravitational pull on global stock markets, with indexes in Japan and the Eurozone falling into bear market territory. In Canada, the S&P/TSX Composite Index finished the month with a loss of -5.8%. For the year, it was down -11.6%.

Volatility the New Norm

One of the major themes to emerge out of the fourth quarter was the sudden and dramatic return of volatility. This unsettling trend is a reflection of the paradigm shift underway in the market – one that is marked by wild swings and expectations of further turbulence down the road.

The CBOE Volatility Index, also known as the VIX, tripled over the past three months, reaching a settlement high of 36.07 on Christmas Eve. That was the highest reading since February 2018. The so-called “fear index”, trades on a scale of 0 to 100, with 20 being the long-term average. The VIX ended the year at 25.42, having gained nearly 120% during 2018.

Multitude of Risks

Despite a strong end to 2018, stocks face a multitude of risks ranging from geopolitics to economic growth. The latest controversy comes out of Washington where Democrats and Republicans remain deadlocked over President Trump’s proposed border wall. The impasse led to a third government shutdown of the year, which has now extended into 2019.

The United States and China appear to be making progress on a new trade agreement, though a comprehensive deal has not been signed. President Trump announced last week that both sides were moving in the right direction.

“Just had a long and very good call with President Xi of China,” the president tweeted Dec. 29. “Deal is moving along very well. If made, it will be very comprehensive, covering all subjects, areas and points of dispute. Big progress being made!”

That said, U.S. Trade Representative Robert Lighthizer has warned that additional tariffs on Chinese goods may be needed to get meaningful concessions from Beijing.[3] Negotiations will continue until at least March 1 when the current 90-day truce runs its course.

What’s Next?

During 2009-2017, the S&P 500 experienced just one decline of more than 15% - in 2015. Normally, the markets experience an annual decline of at least 15%. We believe we are currently in a cyclical bear market, which are generally shorter term in nature and last generally no more than a year. Secular bear markets last many years as experienced during 1998-2014.

In all cyclical bear markets since 1950, the average peak to trough decline was 21.7% lasting an average of 6 months.[4] During 2018, the peak to trough decline of the TSX/S&P and S&P 500 index was

16.9% and 20.2% respectively. A decline of 20% or more officially put the U.S. market into a bear market during 2018, the first bear market since 2008.

Given the unusual lack of downside volatility from 2009-2017, the current volatility feels completely unusual. It’s not. It’s just that investor’s most recent experience has been a period of abnormally low volatility which exacerbates the recent volatility.

No one knows with certainty where the market will be in 2019. There are simply too many economic and political factors that can influence the short term results. If history is a guide, then it is reasonable to believe a large portion of this bear market is now behind us. While we will maintain our current defensive stance, we will look for a shift in new demand to increase our equity investments.

If you have any questions regarding your investment portfolio, or this summary, please call us.

Sincerely,

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[1] Thomas Heath (Dec. 26, 2018). “Dow soars more than 1,050 points, its biggest point gain in history, recovering from days of losses.” The Washington Post.
[2] Michael Sheetz (Dec. 17, 2018). “The stock market is on pace for its worst December since the Great Depression.” CNBC.
[3] Fred Imbert (Jan. 2, 2018). “US Trade Rep. Lighthizer thinks more tariffs could be needed to get meaningful China concessions.” CNBC.
[4] Russ Visch, BMO Nesbitt Burns