March Market Update: Wall Street's Retreat Marks Worst Month in Two Years for Stocks

Investors made a hasty retreat from the equity markets last month, with Wall Street experiencing one of its most turbulent periods since the 2008 financial crisis. Major indexes from New York to Tokyo sold off between 1.5% and 7.5% during the month, as investors grew weary of central bank intervention on interest rates. The massive retreat was accompanied by an unprecedented surge in volatility, which led to the termination of one of Wall Street's most popular inverse-volatility products.

U.S. Stocks Face Major Correction

Stocks in the world's largest economy sank again in the final week of February, picking up where they left off at the beginning of the month. The declines drove the Dow Jones Industrial Average into negative territory for the year, a dramatic reversal from the more than 7% advance through the first five weeks of 2018.

February was also the first time in 11 months that the S&P 500 and Dow Jones Industrial Average failed to grow; their ten-month winning streak had been the longest since 1959.[1]

Although many factors contributed to Wall Street's down month, it was a report on nonfarm payrolls at the start of February that triggered the reversal. In that report, average hourly earnings jumped 2.9% annually, the highest in over eight years and sending a strong sign that inflation was making a comeback. For investors, high inflation usually means more aggressive stimulus cuts from the central bank.

Federal Reserve

The U.S. central bank is widely expected to raise interest rates when it meets later this month, with traders pricing in a more than 83% probability of liftoff, based on the latest Fed Fund futures prices. Back in December, the central bank predicted three rate hikes for 2018, although the recent upsurge in inflation may compel policymakers to raise rates a fourth time.

Jerome Powell gave a favorable view of the economy in his first congressional testimony as Chairman of the Federal Reserve. In his view, economic conditions have improved since December, with inflation on track to hit the central bank's 2% target.[2]

The Return of Volatility

Wall Street's remarkable drop at the beginning of February triggered a massive surge in volatility. The CBOE Volatility Index, commonly known as the VIX, rose more than 115% on February 5th for its biggest one-day advance on record.[3] Analysts have struggled to put their finger on exactly why the VIX rose so markedly, although a likely explanation points to algorithmic trading and after-hours bets on exotic volatility products.[4]

The sharp rise in volatility had the opposite effect on inverse-volatility products. None were harder hit than the VelocityShares Daily Inverse VIX Short-Term ETN (XIV), which was put out of commission by Credit Suisse on February 20th after it lost nearly $1.8 billion in assets in less than a week.[5] Designed to outperform stocks during a bull market, the XIV returned 1,200% since it was conceived back in 2010. By comparison, the S&P 500 Index doubled over the same period.

Canadian Stocks Continue Mediocre Pace

February was negative month for Canadian stocks, with Toronto's benchmark TSX Index falling 1%. The TSX is down 5% since the start of the year, with energy continuing to lag the broader market. The sector, which accounts for about a third of the total index, continues to face a mass exodus.

An outflow from Canada's oil patch was largely responsible for the sharp decline in foreign direct investment during 2017. FDI inflows fell 26% last year to $33.8 billion, Statistics Canada reported on March 1st. That was the lowest since 2010.[6]

The Month Ahead

All eyes will be on monetary policy this month, with the Federal Reserve, Bank of Canada, European Central Bank and Bank of Japan all scheduled to deliver interest rate verdicts.

On the political front, the debate over the North American Free Trade Agreement (NAFTA) continues after negotiators from Canada, Mexico and the United States concluded their seventh round of talks. As the meetings wrapped up, U.S. President Donald Trump announced new tariffs targeting steel and aluminum imports. The president did not mention which countries or products would be impacted but did articulate a 25% duty on steel and 10% levy on aluminum.

In terms of economic data, reports on jobs, inflation and consumer spending will continue to drive headlines throughout the month.

Sincerely,

Ferrie Petruccelli Wealth Management Group

David Ferrie, Portfolio Manager, Managing Director
T: 416-590-7667 david.ferrie@nbpcd.com

Anthony Petruccelli, Portfolio Manager, Financial Planner
T: 416-590-7675 anthony.petruccelli@nbpcd.com

Gabriela Boada, Investment Representative
T: 416-590-7637 gabriela.boada@nbpcd.com

Our Partners

Tim Simpson, Estate & Insurance Advisor
T: 416-359-7798 timothy.simpson@nbpcd.com

Tracy McClure, Director, Wealth Planning
T: 905-404-8929 tracy.mcclure@bmonb.com

Sources

1 Fred Imbert (Feb. 29, 2018). “Dow closes 380 points lower, snaps longest monthly win streak since 1959.”
2 Howard Schneider and Jason Lange (Feb. 27, 2018). “Fed's Powell nods to stronger economy, backs gradual rate hike path.” Reuters.
3 Jeff Malec (Feb. 14, 2018). “The Chart Showing Why This VIX Move Is Unique.” Seeking Alpha.
4 Bob Pisani (Feb. 8, 2018). “How small, exotic volatility trades had outsized influence on the market's free fall.” CNBC.
5 Sam Bourgi (Feb. 13, 2018). “XIV Is Dead: Credit Suisse Pulling the Plug on Inverse Volatility Product.” Hacked.com.
6 Theophilos Argitis (Mar. 1, 2018). “Foreign Direct Investment in Canada Plunges on Oil Exodus.” Bloomberg.