Johnston Investment Counsel
LIFE THE WAY YOU PLANNED IT.

Stock Market Volatility Increases

During the past several weeks, worldwide stock markets have seen returns decline as volatility increased. For the month of August, U.S. stocks returned -6.0%, developed international stocks returned -7.4%, and emerging market stocks returned -9.0%. For U.S. stocks, it has been almost four years since we experienced a lower one-month return.

At times, the market has met the "formal" definition of a correction which is a -10% return from its highs. Depending on the day, we may or may not have a negative return for the year as +/-2% moves are becoming more common.

Background of Current Events

The media likes to attribute a single event that "caused" a market decline. Nice, simple, and neat. While one event may be the spark, it is almost always a series of issues. The fact is that stock market participants are always assessing new information in determining current prices. Are U.S. valuations too high, is China's growth slowing too much, will Europe's economy ever start to rebound, what is the potential impact of rising U.S. interest rates, could all be considered factors, among others, in the markets recent decline.

Often times market over-/under-shoot on both the upside and the downside. But, over the long term (an admittedly undefined length of time), economic fundamentals will take hold. The market will ultimately reflect expected growth in corporate profits. There are, of course, recessions when corporate profits fall, but recessions are not all that common and, over the past couple of decades, have become even less frequent.

Currently, the U.S. economy is experiencing consistent, modest growth so a U.S. recession seems unlikely in the near term. However, many countries worldwide are struggling to maintain economic growth. Given our global economic society, it is clear that poor worldwide economic growth could have implications here at home. The question is one of magnitude.

Putting Recent Events Into Context

With the events of the Great Recession still fresh in many of our minds, you may be asking if this is 2008 all over again. The short answer is we do not know – and no one else does either.

Usually severe bear markets do not start unless there is an impending steep recession. And while the scars of 2008/2009 are still with us, historically speaking, the level of decline we experienced during that period has been very rare.

History suggests that, after a long bull market (which we have been experiencing), it is common for investors to become somewhat complacent. We forget how common losses actually occur. For example, a 5% decline typically occurs four times in a calendar year. A 10% decline generally happens once per year with a recovery period of eight months. *See the attached chart for more information.*

In addition, since 1926, the U.S. stock market has had a negative calendar year return more than one out of every four years. Although, this has become somewhat less frequent during the most recent 25-year period (about one in every five years). *See the attached chart for more information*

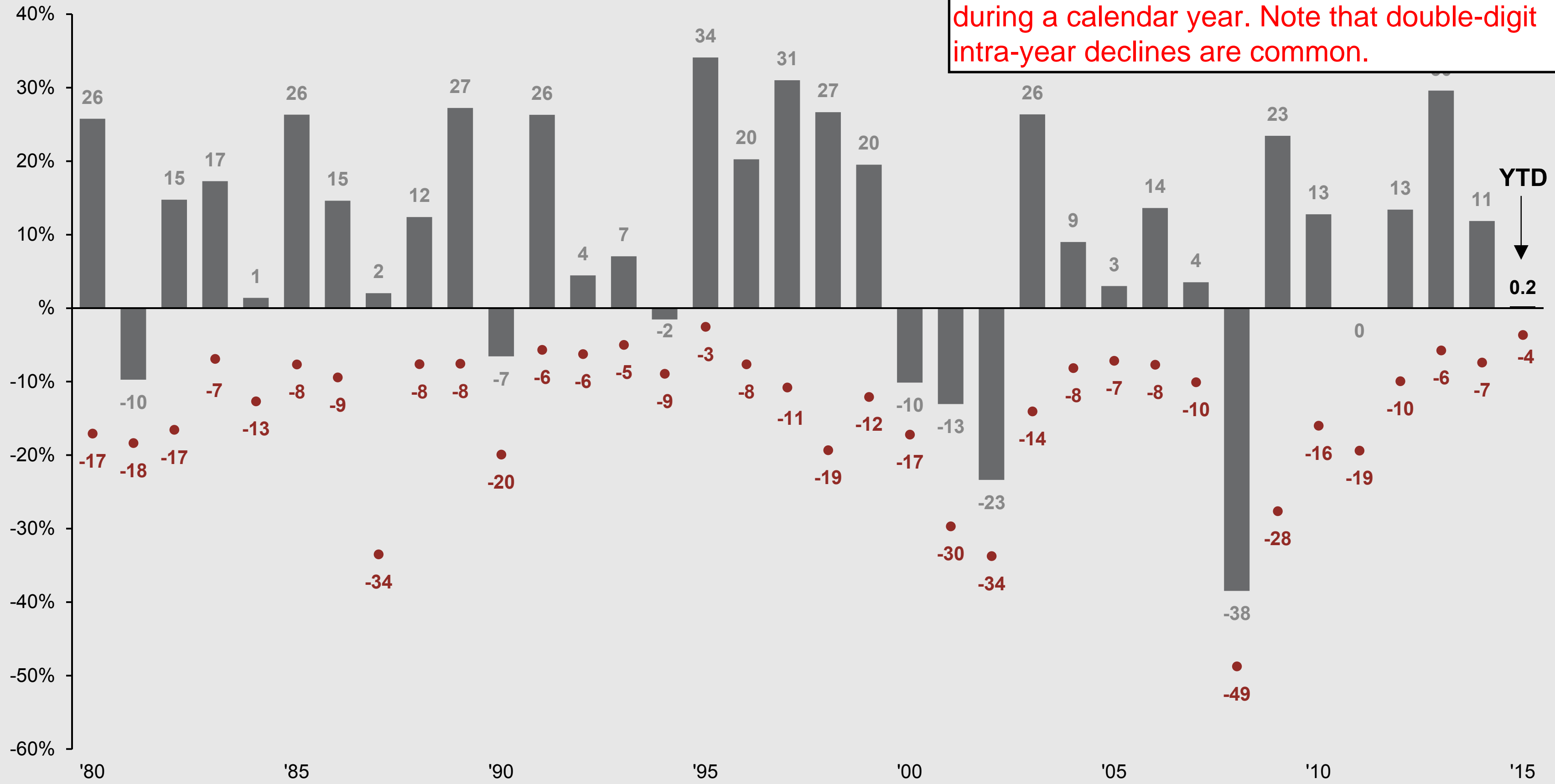
So What Do I Do Now?

Remember that you are not 100% invested to stocks. While we are all frustrated with the low-return environment of bonds, their diversification benefits are highlighted at times like this. In our hyper-active society, we do not think the best course is to make wholesale changes but, rather, move slowly, not letting our emotions get the best of us, and to make as rational of investment decisions as possible. Evaluate opportunities that may now be considered a bargain.

Behavioral economists have highlighted the counter-intuitive decisions investors often make. Investors often sell after a decline -- when markets should be "on sale". And, after a market (or stock) has done well, individuals often chase the hot return. We do not believe either approach is a good-long term investment strategy and is one reason why rebalancing can be a powerful ally.

History has consistently taught us that making investment decisions based on short-term events is rarely (if ever) a winning long-term investment strategy. Your investments with JIC are designed to help you through decades, not days. Nevertheless, if recent events are leading to sleepless nights, we encourage you to call or set up a meeting to discuss your specific portfolio strategy.

Equities



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. *Returns shown are calendar year returns from 1980 to 2014 excluding 2015 which is year-to-date.
Guide to the Markets – U.S. Data are as of June 30, 2015.

J.P.Morgan Asset Management

Percent Below Zero Returns, Average Loss, & Largest Loss (Annualized Returns)
Different Holding Periods & Portfolio Allocations
1926 to 2014

Percent Below 0

	100% Bond	25% Stocks / 75% Bonds	50% Stocks / 50% Bonds	75% Stocks / 25% Bonds	100% Stocks
1 Year	11.2	12.4	20.2	23.6	27.0
3 Years	0.0	2.3	5.7	14.9	17.2
5 Years	0.0	0.0	4.7	5.9	14.1
10 Years	0.0	0.0	0.0	0.0	5.0

Percent of returns that have been below 0 for different portfolios over various holding periods. Only represents historical data.

1 Year Summary

	Number Below 0	Avg. Loss	Largest Loss
100% Bond	10	-1.6	-5.1
25% Stock	11	-3.5	-12.9
50% Stock	18	-6.5	-23.4
75% Stock	21	-10.2	-33.6
100% Stock	24	-13.6	-43.4

3 Year Summary

	Number Below 0	Avg. Loss	Largest Loss
100% Bond	0	--	--
25% Stock	2	-3.3	-4.0
50% Stock	5	-5.5	-11.6
75% Stock	13	-5.4	-19.2
100% Stock	15	-8.4	-27.0

5 Year Summary

	Number Below 0	Avg. Loss	Largest Loss
100% Bond	0	--	--
25% Stock	0	--	--
50% Stock	4	-1.5	-2.7
75% Stock	5	-4.8	-7.2
100% Stock	12	-4.6	-12.5

10 Year Summary

	Number Below 0	Avg. Loss	Largest Loss
100% Bond	0	--	--
25% Stock	0	--	--
50% Stock	0	--	--
75% Stock	0	--	--
100% Stock	4	-0.8	-1.4

Returns are annualized.

The average and maximum loss when for different portfolio allocations when returns are below 0.Only represents historical data.