Third Quarter 2015 Commentary

The stock market, which had been smoothly gaining altitude for the last few years, finally hit some turbulence in the third quarter. After more than six years of strong gains coming off the bottom of the 2008/09 financial crisis, most major market indicators took a significant hit in August that persisted through the remainder of the quarter. For the three-month period which ended September 30, the S&P 500 index declined 6.4%, the Dow Jones Industrial Average declined 7.0%, and the average U.S. stock mutual fund declined 8.2%. Most pundits attributed the choppiness to the two big near-term issues of the day: a slowdown in the Chinese economy combined with the imminent and long-overdue raising of interest rates by the Federal Reserve's Open Market Committee.

All in Perspective

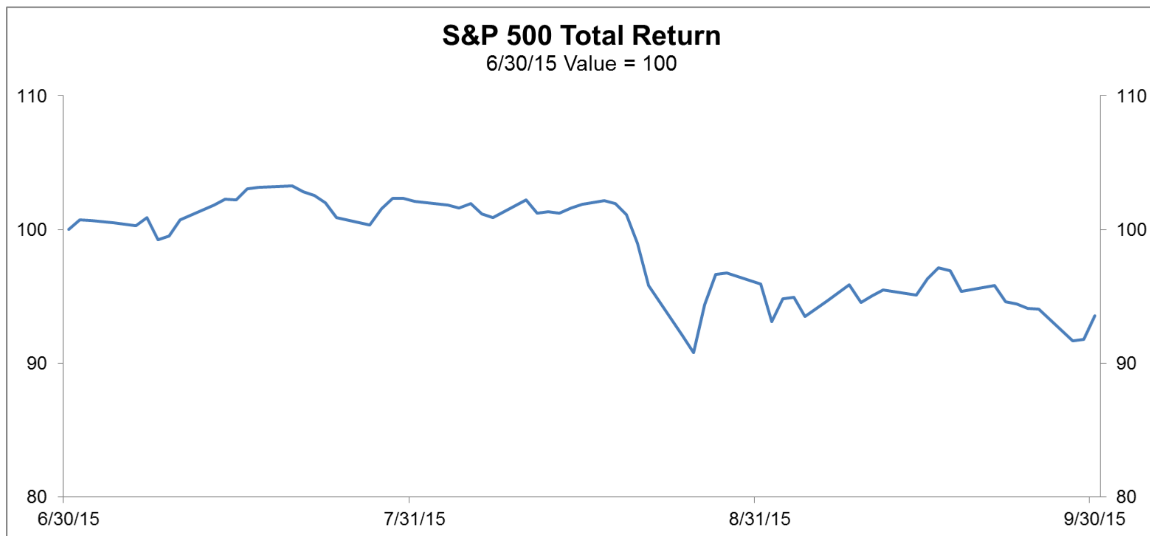
The third quarter was an ugly one for the U.S. stock market, no matter how you slice it.

In late August, the S&P 500 index finally entered its long-awaited "correction" territory. From the beginning of the bull market in March 2009 through its peak earlier this year, the U.S. stock market roughly tripled in value. When a market index declines at least 10% from its peak value, pundits say that it is in a zone of "correction." We spent the last week of August and most of September either in the correction zone or close to it.

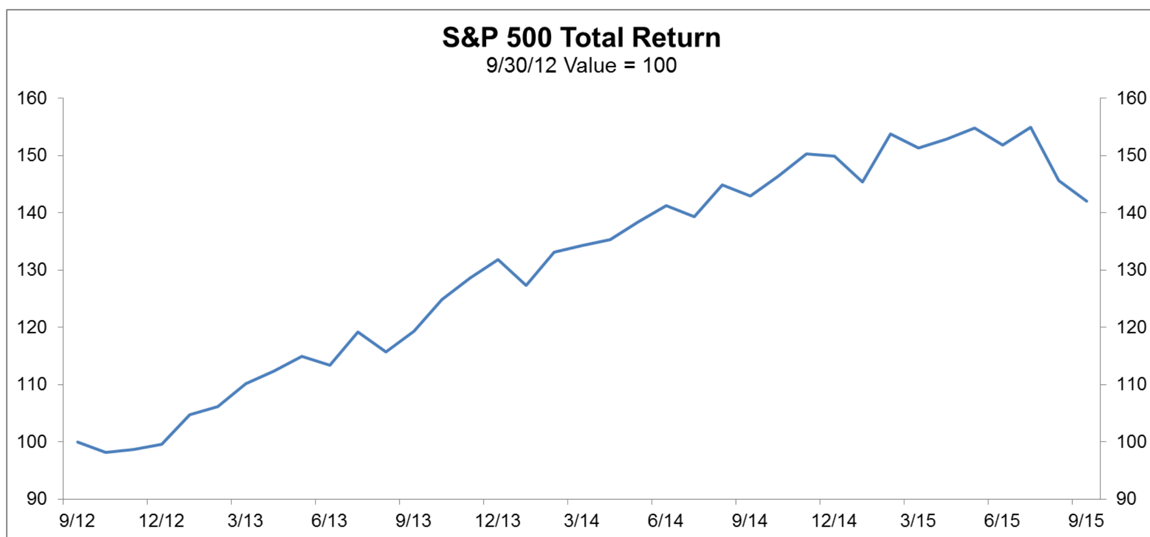
The next level down from correction is what's known as "bear." When an index such as the S&P 500 declines from its peak value by at least 20%, then we are said to be in a bear market. We have not experienced a bear market in this country since late 2008 and early 2009. And while the index itself, as measured by the 500 constituent companies in aggregate, is nowhere near bear territory right now, many of its individual components are.

That is, of the 500 stocks which comprise the S&P 500 index, many of those ended the third quarter at a level more than 20% below their prior peak value. In fact, slightly more than half of the index's stocks (253, to be precise) were in bear market territory.
And of those 253 stocks in bear territory, many of them belong to the beaten-down energy sector. With the price of a barrel of oil collapsing from 2014 levels above $100 to current levels in the $40-50 range, most energy-related stocks have declined significantly in price. Of course, that's the sort of thing that draws our attention, so many of our recent stock purchases have been of companies that participate in, or are largely dependent on, the energy sector.

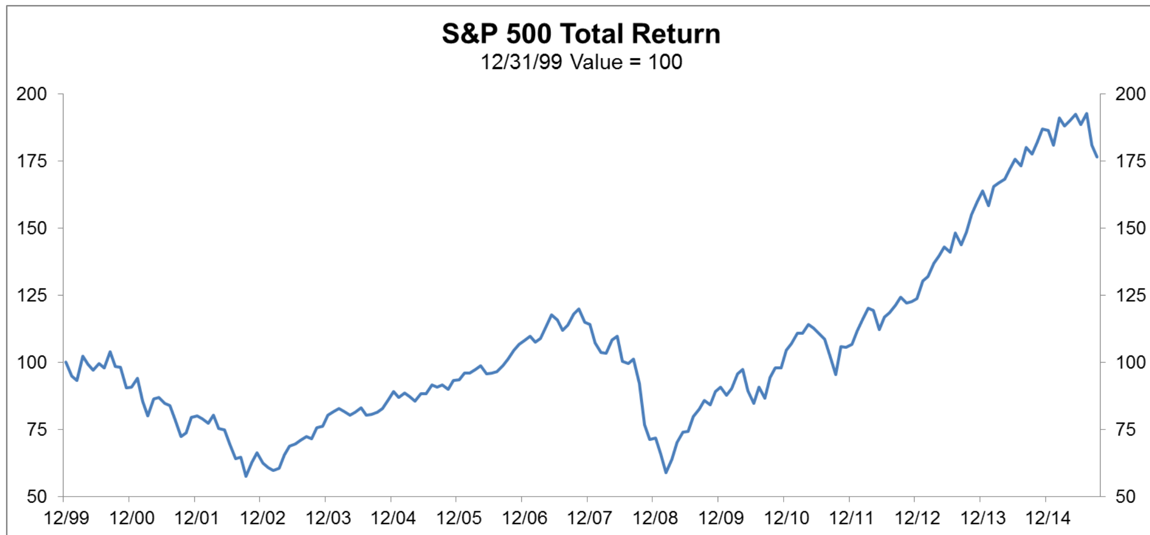
While this predilection of ours to buy stocks which have taken a recent tumble is negatively affecting our short-term returns, we believe that we will eventually be rewarded in the long term. While numbers like these may cause a bit of discomfort, it's important to keep all of these figures in the proper context. When looked at in a chart that shows only the third quarter of 2015, the market's return looks fairly poor:



However, if you widen your lens a bit more and put the recent decline in the context of the most recent three years, you get the sense that the current state of things is not so bad:



And then if you widen your lens even further and look at the stock market's performance over the entire 21st century to date, you can glean a few more lessons:



First, the current downdraft is nothing like others we have recently experienced. Second, while there are certainly violent swings in the chart both downward and upward, the general trend of the U.S. stock market is upward. And finally, as a corollary to that second point, a portfolio that invests primarily in stocks will see its value move up and down quite a bit over the course of time, though it should generally trend upward. Any investor who hopes to participate in that general uptrend should be emotionally prepared for the gyrations that inevitably occur in the meantime.

Conclusion

Inkwell's position is that the forces driving the stock market in the short-term are transient in nature. While many market participants are today concerned about either China or the level of interest rates, we believe they will move their concerns on to other matters in another quarter or two. We cast our vision even further down the road than that, and we believe that the companies you own in your portfolio have the staying power to weather whatever storms may come from a dip in China's economic health, an increase in U.S. interest rates, or whatever the next "crisis" is that comes along.

We thank you once again for your support and your like-mindedness in a long-term outlook, especially during volatile investment periods such as the current one. We continue to work hard to take care of your hard-earned money, and we look forward to reporting our progress on that front again in early 2016.

Sincerely,

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