BODNAR
FINANCIAL ADVISORS, INC.
Registered Investment Advisor
Established 1988
*Financial, Estate & Employee Benefits Planning*

Everything under heaven is in chaos; the situation is excellent.
**— Mao Zedong (1893–1976)**

"You want to be greedy when others are fearful. You want to be fearful when others are greedy. It's that simple."
**— Warren Buffett (2008)**

Here's a riddle for you…..

Q: What do Mao Zedong and Warren Buffett have in common?

**Buffett and Mao: Separated at birth?**

A: They are both masters of ***Situational Opportunism*****.**

* * *

Mao and Warren don't share a lot of qualities, but their philosophies are both driven by the belief that moments of fear and uncertainty are not times of panic- they are times of opportunity.

If you don't know by now, U.S. stocks ended last week in the red. This simply means there were more sellers than buyers in the capital markets.

For the week, the S&P 500 fell 5.77%, the Dow lost 5.82%, and the NASDAQ slid 6.78%.

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As I wrote this at 1 pm on Monday, August 24, 2015: the Dow was down another 285 points to 16,175. (Which was pretty good, considering the DOW opened down 1,000 points that morning!)

Hopefully you have the TV and radio turned off, and you're outside reading this and enjoying the last days of summer. But in the event you're a news junkie or an "indoor kid," then you probably already know that the talking heads are pointing their fingers at Chinese officials, whom unexpectedly devalued China's currency two weeks ago.

A few short months ago, people like my father (as most of you know, my favorite person to pick on) were panicking about the rise of China's economy, in fear that they would surpass the United States. I have long written about this exaggerated fear in past Bodnar white papers, so I will spare you that rant (….for now).

But long story short- I wasn't worried about China then, and the numbers finally prove that we shouldn't be worried about China now. Various economic releases indicate that the world's second-largest economy is rapidly slowing.

Told ya, Dad.

After granting the fact that the Chinese economy is slowing down, people found something new to worry about: the Chinese slowdown's effect on commodities, especially oil.

Oil breached the $40/barrel level on a combination of supply and demand worries. Though domestic producers have cut back on drilling operations, OPEC producers like Saudi Arabia and Iraq continue to hold the spigot wide open in the hopes of chasing U.S. producers out of the market.

When markets take a dive, it's natural to worry about what's happening and where markets will go next. However, part of being a stock investor is taking market swings in stride. ***<u>Now is the time to stay cool-headed and focused on your long-term goals.</u>***

While we can't predict where markets will go in the next days and weeks, my job as your financial advisor is NOT to predict the direction of capital markets, but to inoculate you from the poison of the media frenzy.

(Yes, those popping sounds you heard over the weekend were the producers of CNBC's Squawk Box uncorking the champagne.)

Remember – the media's goals are not aligned with yours. They want to keep viewers glued to their televisions and newspapers, waiting for the sky to fall. While the market continues its trend upwards, they exploit the drama and excitement in the (relatively) smaller peaks and valleys of the market's volatile climb.

As my daughter who spent the past 5 years working in political media reminds me, "Network news and 'stock ticker' stations follow the same headline-driven tabloid model as entertainment news… they just use bigger words on the air."

So, as a public service, here is my list of the Top 4 things you should NOT do after last week's market pullback:

**1. Do NOT listen to the talking heads.** This is not 2008 all over again. Last week's drop in the market was a widely anticipated pullback in the middle of a 7-year bull market. As of Friday, the S&P 500 had gone 1,418 calendar days without a 10%+ drop (between 10/3/11 and 8/21/15).

Regardless of what the pundits are saying, the S&P 500 is down just 7.51% since its peak in mid-May. Markets experienced a similar selloff in September and October of last year.

The sky might be falling in TV land and on the top of the Drudge Report, but out in the real world our managers are taking a look at the numbers behind the selloff and making prudent adjustments where they feel it's necessary.

**2. Do NOT panic and hit the eject button.** Corrections are a normal part of market cycles. Since 1927, the S&P 500 has experienced pullbacks of 5% or more about every 3.5 months. While the past can't predict the future, research shows that panicking and exiting the market is often the worst thing you can do when markets swing.

Investors are notoriously terrible at picking market tops and bottoms; since periods of high growth often occur during turbulent times, investors who sell off and sit on the sidelines frequently miss out on the good days.

Like our expert situational opportunist Warren Buffett says: "You're dealing with a lot of silly people in the marketplace; it's like a great big casino and everyone else is boozing. If you can stick with Pepsi, you should be OK."

**FREQUENCY BY SIZE OF DRAWDOWN, 1928–2014**
Threshold analyzed independently*

| Drawdown Threshold | Historical Frequency | Typical # Per Year | Typical Recovery Time |
|---|---|---|---|
| 20% | Once per market cycle | 0 | 20 months |
| 10% | Once per year | 1 | 8 months |
| 5% | Once per quarter | 4 | 2 to 3 months |
| 3% | Once per month | 11 | 2 to 6 weeks |
| 2% | Often | 18 | 1 to 4 weeks |

Source: Standard & Poor's, FactSet, J.P. Morgan Asset Management. Returns are based on price index only and do not include dividends. For illustrative purposes only. *Analysis based on each type (size) of drawdown being independent. For example, the market does not typically see four 5% drawdowns and one 10% drawdown in the same year, but rather those 5% drawdowns may compound into a single 10% drawdown for the year. Data are as of 1/31/15.

For example, an investor who stayed fully invested in the S&P 500 between 1995 and 2014 would have experienced a 9.8% annualized return. However, if they had traded in and out of the market, missing just the 10 best days of the market, their return would have plummeted to just 6.1%. Six of the 10 **best** days of the S&P 500 fell within two weeks of the 10 **worst** days.

The lesson learned? Stick with Pepsi, and fortune favors the steady-handed.

**3. Do NOT think like a day trader instead of an investor.** Stock markets are driven by fear and greed. Right now, traders are in full-on fear mode and are selling off indiscriminately at any hint of bad news. Long-term investors are taking a look around and seeing what opportunities the pullback is offering.

Another gem from Buffett, our featured Situational Opportunist: "Price is what you pay; value is what you get. Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down."

**4. Do NOT get complacent.** Pullbacks offer you the chance to ask yourself if you're honestly prepared for a correction. If you can sleep well at night knowing that you have a prudent strategy and a well-diversified portfolio, then you're better prepared for a potential correction. This is known to Bodnar veterans as doing your "Life Boat Drills."

**These kids know the drill.**

No one knows if the current selloff is a short-term blip that will reverse in a few days, or the beginning of a deeper slide. Whatever the outcome, the finger pointing is toward CHINA. But, could it be something else? And if so, what might that be?

I can spend all day telling you what it isn't……

- The level of corporate earnings
- Corporate liquidity
- Household net worth (which is at an all-time high)
- Consumer debt defaults (which in percentage terms are at an all-time low)
- The banking system (which is still sitting on all those excess reserves from QE)

- Car sales (which are running around $17 million a year)
- Home prices, or home sales (Bidding wars are back with a vengeance in New Jersey)
- Stock buybacks, cash dividends, or mergers and acquisitions, which are each hitting all-time highs
- The job market, where wages are increasing and skilled labor shortages are rampant and rising (even though the overall labor force participation rate is lowering)

The list can go on, but to no useful effect. Asking the question “why” when it comes to the market is the ultimate in navel-gazing. The facts of the matter are more than sufficient to the case: we have gone 1,418 calendar days without a 10% correction, the third longest such run in the last half a century. It’s been 20 years since we have had a single year without at least a 5% drop.

The average intra-year decline since 1980 has been 14.2%, and during that time the S&P 500 Index went from 106 to 1,970—and that does NOT count dividends!

The best “why?” answer for the market dip can be found in the long-term trends of the market, not the short-term trends of the media cycle and international politics.

We were overdue. That’s all. We were just…overdue.

| Data as of 8/21/2015 | 1-Week | Since | 1-Year | 5-Year | 10-Year |
|---|---|---|---|---|---|
| Standard & Poor's 500 | -5.77% | -4.27% | -1.08% | 16.78% | 6.16% |
| DOW | -5.82% | -7.65% | -3.40% | 12.23% | 5.59% |
| NASDAQ | -6.78% | -0.63% | 3.84% | 23.18% | 12.04% |
| U.S. Corporate Bond Index | 0.56% | -2.22% | -1.79% | 0.64% | 1.01% |
| International | -4.58% | -1.03% | -8.72% | 4.19% | 1.27% |
| Data as of 8/21/2015 | | | | | |
| Treasury Yields (CMT) | 0.02% | 0.21% | 0.36% | 1.44% | 2.05% |

Notes: All index returns exclude reinvested dividends, and the 5-year and 10-year returns are annualized. Sources: Yahoo! Finance and Treasury.gov. International performance is represented by the MSCI EAFE Index. Corporate bond performance is represented by the DJCBP. Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly.

Enjoy the rest of your summer,

John Bodnar, CFP®, CIMA®
August 25, 2015



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