RBC Wealth Management

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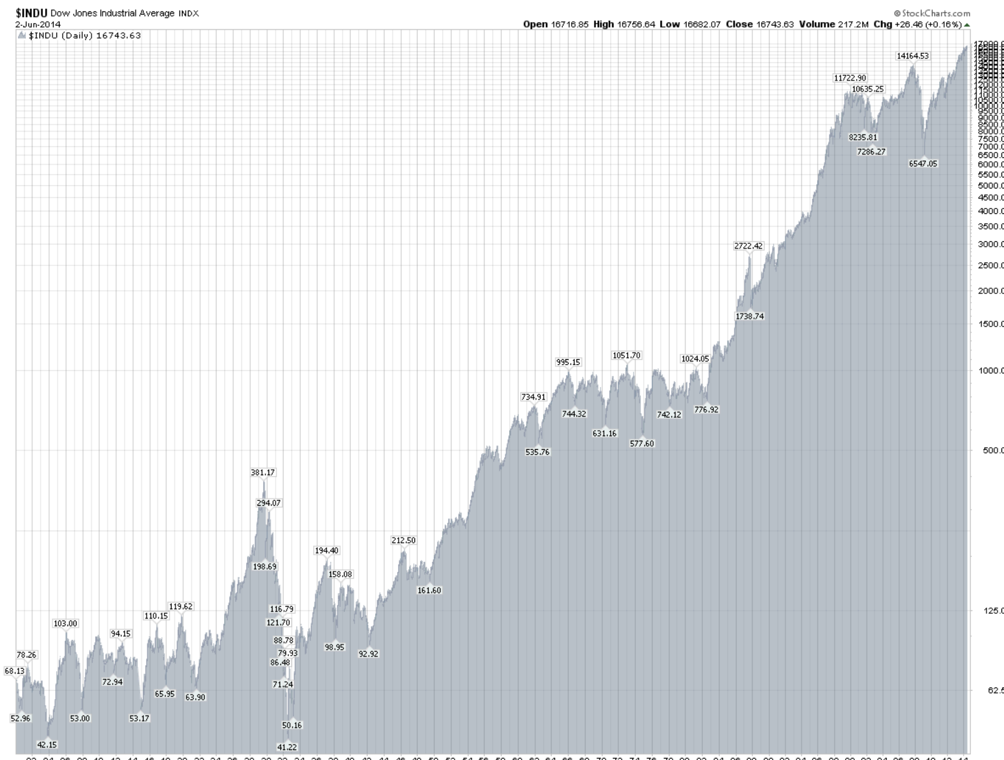
"Ebola Madness!"

Terry Webb



Dow Jones Industrial Average (1900-Present)

I'll always remember the gut wrenching feeling on **Black Monday, October 19, 1987 as the Dow fell 508 points, or 22.6%, the largest one day decline in history.** I had been working in the financial business for about 6 months and was a sales assistant on the trading floor of Merrill Lynch in Toronto (and basically a scared kid!). Bewildered, seasoned, professionals stared at their (now) antiquated Quotrons as though they would make sudden order of the senseless trading activity. I overheard one anguished sales manager beseeching a Jaguar dealership to take back the beautiful, red XJS delivered to him the previous Friday.

Few remember that the stock market rose by a stunning 44% in the first 7 months of 1987 creating conditions of euphoria and over valuation. The October correction had little to do with the state of the economy; rather the market behaved like someone running too fast with their shoe laces undone – when it tripped, it was ugly. The apparent causes of the correction were: program trading, portfolio insurance, sudden illiquidity, and panic psychology. Despite the ugliness of October, the Dow managed to achieve a modest 2.21% return for 1987, although it took almost 2 years for it to regain the August 1987 high of 2,722.

Over the next several years, markets actually performed well, rising from the October 19 closing level of 1,738 to a 1990 high of 2,999 for a cumulative return of 72.6%. If you bought the DJIA a week before Black Monday, and endured the subsequent 30% correction, you still would have enjoyed a 462% return over the next 20 years, and a return of over 800% (before dividends) to yesterday's closing price.

Since 1987 there have been a number of calamitous events and economic recessions: the S&L crisis of 1989, Iraq's invasion of Kuwait in 1990 followed by the deep back to back recessions of 1990 and 1991, the 1998 Russian debt default and collapse of Long Term Capital, the tech market meltdown of 2000-01 preceded the horrific events of 9/11, and another deep recession, the bursting of the housing bubble in 2007 and, of course, the credit collapse of 2008 which led to the worst economic retraction since the 1930's.

There have also been events over the last 5 years that caused corrections, not recessions, and have subsequently been largely forgotten: the 2011 Arab Spring, July 2011 terrorist attacks in Norway, Greek debt crisis, US debt ceiling debate and potential debt default, the Occupy Wall Street movement, Hurricane Sandy, Japanese earthquake, tsunami and nuclear meltdown, and now: Ebola, ISIS, the prospective elimination of quantitative easing, and fear of global slowing, have combined to create a huge spike in volatility and panicked investor psychology.

The Dow peaked this year on September 19th at 17,279 and closed yesterday (October 15) at 16,141 for a drop of 1,138 points or 6.6%. It is now down 2.6% year to date. I can't predict at what level this correction will bottom because no one knows what further fears the possible spread of Ebola may cause. **However, this is not the only correction of the year, the Dow closed on December 31, 2013 at 16,575 and by February 3rd had declined to 15,372 – a drop of 1,203 points, or 7.25%. From that February low, the Dow rallied 12.5% to the September high.**

Ultimately, it is my clear and strong belief that financial markets will do as they have over the course of modern history, and soon respond to economic realities. Those realities include: corporate profits are the highest in history and getting stronger, gdp is at record levels and growing, unemployment is rapidly improving (now 5.9% down from the spring of 2009 peak of 10.3%), initial jobless claims are falling at the fastest rate since data was first collected in the early 1970's which predicts an ongoing decline in unemployment, consumer balance sheets have been largely repaired, ISM data indicates manufacturing and non-manufacturing growth…and the list goes on.

Thinking back to 1987, I still have anxious moments as we work through corrective periods like this one. However, I have a great deal of respect for the lessons of history, the benefit of hindsight, and a few market miles to help me along. **Although clients pay us to make them money, I often think we earn it during times like this by refusing to capitulate at the precise moment we must maintain strategic investment discipline.** Looking forward, there is good reason to believe that the S&P could trade at 17X next years earnings which are likely to be around $135/share. That would lead it to a level of 2,295 by year end 2015 for a return of 25% from yesterday's close of 1,862. More importantly, we do not believe that recent events will derail the long term prospects for economic expansion, or the secular bull market which began in the Spring of 2009. This is why our focus for clients is on the promise of tomorrow rather than the angst of today.

Thanks for reading,

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