Dear Client:

It was only a short time ago that I last wrote to you about volatility in the stock market, yet we felt another quick note was warranted. Actually, we wouldn't be writing to you today if the media hadn't been making so much hay over the yield curve, August's 10-year performance record and fears of a recession. But since there's so much coverage on radio, TV, in newspapers, on the internet and on social media, we wanted to set the record straight.

It's not taking much for investors to get spooked – partly because some simply seem ready to be pessimists. It's been 10 years since we've had a recession, they argue, so a recession must be around the corner. True, we typically have a recession about every four years, on average. So the longer we go without one, this argument goes, the closer we must be to the next one. But many have been making that argument for years, and we suppose they will – until one day, when a recession occurs, they'll be able to exclaim, "See? We were right!"

Which brings us to this week's rationale for a recession. For the first time in 14 years, we now have an "inverted yield curve." Before I explain why that is being blamed for the market's decline, let me explain what an inverted yield curve is.

Normally, short-term interest rates are lower than long-term rates. A 30-day T-bill pays less than a 30-year bond. If you were to plot interest rates on a graph, the line would curve upward – from lower left to upper right. But lately, short-term rates have become higher than the long-term rates. As a result, the curve on that graph is moving from the upper left to the lower right – the opposite of normal. It's called an inverted yield curve.

Almost everybody in the media, it seems, is saying that this is predicting a recession. Pundits point to a clear statistic: Since 1956, there have been eight recessions. And in every case, those recessions were preceded by an inverted yield curve. Therefore, the logic goes, this week's inverted yield curve must also be predicting a recession! And, in the resulting panic, stock prices have fallen sharply.

Our view is that this is nonsense. Here's why. First of all, let's go back to that statement you learned in grade school: All dogs are animals, but not all animals are dogs. By the same notion, it's true that every recession was preceded by an inverted yield curve, but it's not true that all inverted yield curves led to recessions. In fact, since 1956, there have been 14 inverted yield curves, and only eight of them were followed by recessions. In the other six times, the stock market later hit all-time highs. In other words, you could make the absurd (but rather funny) statement that "the inverted yield curve has predicted 14 of the past eight recessions."

The second reason not to panic over the inverted yield curve is this: Even when it does predict a recession, the recession doesn't occur until 22 months later, on average. Our last inverted yield curve, for example, was December 2005; the Credit Crisis didn't hit until 2008, nearly three years later.

So, sure, let's acknowledge the inverted yield curve, but let's not conclude that it means the world is coming to an end.

The media, of course, isn't limiting its nonsensical tirades to the yield curve. Some are also noting that it's August, and in every year for the past 10 years, August has been the worst-performing month for the stock market.

What a silly statement. It's called data mining; look backward at market performance and try to find a pattern. When you find one that fits your view, tout that data as proof that you're right. So, someone somewhere decided that they wanted to tell investors to sell stocks in August, and they dug through the data until they discovered that August has been the worst month for 10 years in a row.

Fine. But this scary statistic doesn't seem so scary when you discover that the average loss for the S&P 500 in August since 2009 has been a mere .75 percent. It gets even less worrisome when we realize that, over the last 50 years, August isn't the worst month. September and June have worse records.

There are only 12 months, after all, so six of them have to be worse than the other six. To cite any one of them as the time to sell (or buy) simply makes no sense. We believe Mark Twain said it best: "October: This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August and February."

The fact is that, when confronted with a media barrage, it's easy to lose focus of your long-term goals. When hearing about losses from yesterday, one can start to fret about what might happen tomorrow.

Are we headed to a recession? Maybe, maybe not. The point is, none of that matters. It's your long-term financial goals that matter.

My point, then, is to ask that you simply ignore all this. Instead, keep in mind that bad news pops up from time to time, and although major events, such as political crises, wars, social issues, natural disasters, acts of terrorism and so on can cause disruption in the markets, that volatility is usually short-lived.

As evidence, look at the following chart, adapted from my award-winning book, The Truth About Money. It shows that the stock market falls sharply when a major event occurs – but that prices recover within a short time. So, if you have a long-term time horizon and a properly diversified portfolio, you can look at current events and say, "Huh. It's raining outside. I guess I'll wait until it stops." That's a much better idea than letting yourself get drenched.

Stocks During and After a Crisis

Crisis	Change in S&P 500	Next Six Months	Next Year
Korean War	-15% in 5 weeks	+ 31%	+ 36%
Sputnik	-10% in 3 weeks	+ 8%	+ 30%
Steel price rollback	-20% in 8 weeks	+ 11%	+ 24%
Liquidity crisis	-12% in 4 weeks	+ 15%	+ 42%
Arab oil embargo	-17% in 9 weeks	- 1%	- 28%
Nixon resignation	-19% in 5 weeks	+ 30%	+ 27%
Hunt Silver Crisis	-12% in 4 weeks	+ 26%	+ 29%
Crash of '87	-26% in 3 weeks	+ 7%	+ 16%
Gulf War	-12% in 3 weeks	+ 11%	+ 25%
September 11th	-12% in 2 weeks	+ 7%	- 17%
Enron	-5% in 9 weeks	- 6%	- 17%
Tsunami in Japan	-4% in 4 weeks	- 1%	+ 7%
Hurricane Katrina	-2% in 6 weeks	+ 7%	+ 10%
S&P Downgrades Greece Debt to Junk	-16% in 10 weeks	+ 24%	+ 31%
S&P Downgrades US From AAA to AA+	-18% in 10 weeks	+ 29%	+ 32%
Chinese Stock Market Crash	-12% in 5 weeks	+ 5%	+ 16%
Chinese Stock Market Crash Cont.	-12 % in 6 weeks	+ 20%	+ 27%
Inflationary and Interest Rate Hike Concerns	-10% in 2 weeks	+ 11%	+ 5%
Trade War and Interest Rate Concerns	-10% in 4 weeks	+ 9%	tbd
Average	**-13%**	**+ 13%**	**+ 16%**

Sources: Ibbotson and Associates and Bloomberg

You can be confident that we'll continue monitoring events closely and that we'll provide you with additional updates as needed. In the meantime, as always, please feel free to contact your advisor if you have any questions or concerns.

Regards!

Ric Edelman

Founder

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