""The trouble with the world is that the stupid are cocksure and the intelligent are full of doubt".

The much anticipated and widely predicted market decline finally came to pass in the first week of September. The weakness was concentrated in the large capitalization high-tech area, notably the FAANG stocks (Facebook, Apple, Amazon, Netflix and Google / Alphabet, you can add Microsoft as well) which had previously been responsible for much of the strength. With its heavy weighting of those stocks the NASDAQ Index was down around 11% depending on exactly when and how you measure it, and the S&P 500 traded approximately 8% lower. After the extended market rise of the last five months a period of consolidation was not unexpected, the question remains will the decline be contained or lead to more meaningful weakness. History has suggested that moving averages (MA's) of an index can provide support in a downturn and many indices have already dropped to or just below their 50-day moving average. The next level of defense is at the 200-day MA about 7% lower from here or near 3100 for the S&P. These are price levels to be aware of but are not infallible indicators much as the NASDAQ and S&P 500 recently breaking out to all time highs did not provide the follow through many investors expected. While nothing is certain these days, given the strong headwinds we may see in the next few months including a second wave in the pandemic, election uncertainties and government discord it makes sense to be prepared for further downside. There are however some reasons to be encouraged such as the Russel Small-Cap ETF (IWM) was actually up last week by 2.7% and cyclical stocks held up much better than the large cap growth names. Both might indicate a broadening of the market and perhaps a rotation into new leadership. While I try to avoid being labelled a conspiracy theorist, I keep in mind that the Fed and the President's Working Group on Financial Markets (it was legislated into existence after the October 1987 crash and is often referred to as the "plunge protection team") may well be prepared to step in and provide support for markets.

The impression I get from watching and reading the news is markedly different from the reported economic numbers. While I am inundated with negative images of empty offices, malls and restaurants the US economic releases are surprisingly resilient although not spectacular. The unemployment rate continues to decline mostly as a result of fewer layoffs not new hires but still a positive. Disposable income was up 9.5% in July over the previous year in large part due to the support payments from the Federal Government, and Goldman Sachs has just raised its 2020 estimate from 4% to 6% given the strength to this point in the year. The ISM Purchasing Managers Index (PMI) rose to 56.0 in August from 54.2 in July, the best level since November 2018 and New Orders came in at 67.6 versus 61.5 the highest since December 2017. For the most part all economic series are grinding higher or at least have put the large negatives of the second quarter in the rear-view mirror. The reported decline in GDP of 32% in that quarter has been replaced by estimates of 25 - 35% growth for the third. It should be noted that the GDP reports are annualized and thus assume the following three quarters will continue to decline or grow at the same rate as the reported quarter, which is absurd.

Federal Reserve Chairman Powell testified before Congress that the Fed will do whatever is needed but can't rescue a "highly uncertain" economy without fiscal spending help. He promised low rates for 3 more years and a continuation of support for Treasury and mortgage backed securities. The Fed mandate has always been to provide "stable prices". Evidently the new policy defines that as an inflation rate over 2% at least for now.

Joe Biden continues to lead in the polls, and we need to focus our attention on what would change should he be elected. The negatives are a likely increase in corporate and capital gains taxes and more regulation particularly for technology stocks. On the plus side we would expect an increase in fiscal spending to support the economy and better foreign relations with both friend and foe alike. The worst possible outcome would be a contested or delayed election. The market hates uncertainty. In the meantime, we have to deal with interparty strife over a fiscal support package, when to vote on a replacement for Supreme Court Justice Ginsburg and an appropriations bill to provide money for government operations.

There is much talk about option markets and their impact on the broader market. Unfortunately, much of it is speculation but there are some facts that tell us there is something real going on. The volume of single stock options has exceeded regular share volume for the first time ever, and according to Goldman Sachs by 20%. In the first half of the current month, single share and ETF option contract volume was 92% higher than last year. Data from the Options Clearing House suggests small investors bought $500 billion of notional value call options (i.e. the value of the underlying stocks) in August which was 5 times the previous record. Large accounts are also in on the play, in particular the Japanese conglomerate SoftBank which has reportedly bought $4 billion worth of contracts. These purchases can affect the major indices since the Wall Street firms selling the call options hedge their positions by buying the underlying stock. While the overall impact is still hard to judge, the size and rapid increase in these trades is definitely a factor to be considered. To this point the pressure has been to the upside, if as and when the positions need to be unwound or the pressure reverses to buying protection it could be equally impactful on the downside.

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