Time has a way of sneaking away from us. Though the events of 2008 seem like only yesterday, by now six years have passed. In the darkest hours, few would have imagined the S&P 500 would climb 192%, real estate and employment would fully recover, the American financial system would repair itself, and the Seahawks would win the Super Bowl (had to squeeze that in). However, human emotions being what they are, we tend to experience pain at a rate much higher than we do pleasure. In economics and decision theory, this is referred to as loss aversion - most studies suggest that losses are twice as powerful, psychologically, as gains. So it is no surprise that the recent volatility in the stock market has perked investor’s attentions. Flashbacks to yesteryear are all too easy. Add this to seemingly widespread simultaneous tumult around the globe: ISIS, Ebola, Russia, fading Europe and China. It is not surprising senses are heightened and fears aroused.

Though the role of a financial advisor is multi-fold, in my estimation our most important role is that of counselor. One of our primary jobs is to help clients see the big picture, weigh the facts vs. the noise, and make well-informed unemotional decisions. With the stock market not having experienced a 10% pullback in over 1000 days, I believe we are at an inflection point when clients need their advisors the most. It is to this aim that I will lay out the reasons why, not only do I believe this pullback will provide a sigh of relief and a healthy pause for a market transitioning from a state of recovery to one of maturity, but also an opportunity for investors to allocate oversized fixed income holdings and cash to a market close to fair value that is trading at a discount to where it was a month ago.

- **Corrections happen and are essential to the long-term health of a market.**

As you can see by the chart below, going back to 1982 the market has experienced 26 of 34 positive years (76.5%), despite intra-year drops averaging 14.2%. While proportionately large intra-year losses were limited to some particularly bad years, 8-10% losses were quite common. In fact, according to the Stock Trader’s Almanac, the current bull market which began on March 9, 2009 is some 1800 days long and has experienced two corrections (-16% and -19.4% respectively), yet has not experienced a 10% or more correction in the last 1085 days, some 579 days longer than the average days between corrections (historical average of 506 days).
- Despite losing 8.8 million private sector jobs, we have gained 10 million private sector jobs since 2009\textsuperscript{x}. Ironically, this recovery has been referred to as a “jobless recovery” most likely due to a high rate of job replacement with part-time work and a net loss of government jobs. However, not only did part-time workers as a percentage peak in 2009 and have steadily decreased since, but also the net loss in government jobs in my opinion is a net positive for the economy because it shifts resources from the public to the private sector.
• Consumers are spending less of their income on debt service and essentials like food and energy. At the same time, household net worth is at an all-time high.

Some 68.5% of the US GDP is based off of consumption (e.g. consumers) so a populace that is both servicing less debt as a percentage of income and spending less of their income on essential food and gas, creates surplus income to put back into the economy.
• Corporate Balance Sheets are in good shape (cash as a percentage of current assets, and cash returned to shareholders via both dividends and share buy-backs are at record high levels)\textsuperscript{viii}. Profit margins maintain multi-decade high levels.

Some of my readers may recognize the following saying: “We buy companies not countries.” When most people think of the stock market, they take into account global macro challenges that may negatively impact the stock market. Although these challenges most certainly do pose risks to equity markets, what really matters is the underlying health of a company. A high percentage of cash and high profit margins are two strong indications of corporate strength.

![Corporate Cash as a % of Current Assets](image1)

![Cash Returned to Shareholders](image2)

• The US is experiencing a renaissance in manufacturing\textsuperscript{xiv}. The margin between the cost of labor (e.g. emerging market wage inflation vs. US manufacturing rates flat or decreasing) and the cost of inputs (abundant, cheap natural gas at significantly lower costs in the US) between foreign markets and the US continues to shrink, thereby creating a more competitive opportunity for US manufacturing. The US has not experienced this level of manufacturing employment growth in nearly 30 years.
Try as they may, individual investors historically are poor at making investment decisions. During one of the greatest bull markets since 1949, while institutional investors added $590B into US equity mutual funds and ETFs, individual investors pulled out nearly $649B\(^\text{vxi}\). In my opinion, in the age of 24 hour news there is so much information available to investors, it becomes difficult to separate fact from emotion.

Also, since 1994, nearly all asset classes have at least moderately outpaced inflation\(^\text{vii}\), except one: The individual investor.
• US Stocks appear reasonably valued\textsuperscript{xvii}.

The charts below show four different views why stocks appear fairly valued. Given these charts were updated through September, the recent pullback would effectively improve the current numbers.

In the end, the case for optimism does not deter from the fact that challenges still exist. Though humans are quite capable of dealing with adversity, it is difficult for us to deal with multiple sources at the same time. The current period is providing more than its fair share of reasons to pause. However, focusing on news that is well known by now (Russia militarily intervened in Ukraine in February 2014) or that is somewhat subjective (Ebola is far from a world-wide epidemic and does not appear to have the contagion characteristics typical of one\textsuperscript{xviii}) only detracts from our ability to focus on the big picture and the facts that matter most to the strength of the economy.

As the title would indicate, it is my belief that we have slowly moved from an economy in recovery mode to one that has reached a more mature state. Though investors should periodically assess their portfolios to ensure it reflects their long-term investment objectives and risk tolerance, it does not mean taking major action at the first sign of trouble. As one of the most famous investors and mentor/teacher to Warren Buffett, Benjamin Graham once said: “Most of the time stocks are subject to irrational and excessive price fluctuations in both directions as a consequence of the ingrained tendency of most people to speculate or gamble….to give way to hope, fear, and greed.”
S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. An investment cannot be made directly in a market index.

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