One Bad Day, Not a Bad Plan: Your Questions on Market Volatility Answered

This live webinar from HCM Wealth Advisors and CPAs featured Doug Johnson, CFA, the firm's Senior Investment Strategist, and Matt Calme, CFP®, a financial advisor. They held it the day after a sharp market sell-off. Matt gathered questions from clients and other advisors, and Doug answered them. There was no live Q&A, but Doug invited viewers to contact their advisor or email him directly.

What caused the sell-off

Doug said no single cause explains the drop. He compared it to building a campfire, with several elements combining into a "perfect storm."

The logs: two competing AI narratives. The original bearish case on AI was that the huge infrastructure build-out would never earn enough revenue to justify its cost. More recently, the worry has shifted to whether there will be enough money to fund the build-out at all. Borrowing costs have risen for the hyperscalers with aggressive capital spending plans, and the market has punished those names, mainly the Magnificent 7. Doug noted the relationship works both ways: the money the hyperscalers borrow flows to "receiving" companies such as semiconductor makers. Those companies had performed extremely well until a few months ago.

The kindling: positioning and leverage. The AI trade has been very crowded. At one point, the Magnificent 7 and semiconductor stocks made up roughly 40% of the S&P 500's market cap, so anyone holding the index owned the AI trade indirectly. On top of that, 2x and 3x leveraged single-stock ETFs have become very popular over the past year. Most of them track the same mega-cap tech, AI, and semiconductor names, which amplifies swings in both directions.

The match: the midterm elections. Doug stressed he was trying to stay objective and nonpolitical. He explained that Democrats, who won a sweep, had campaigned on AI regulation, especially limits on data center construction. He compared the issue to fracking a decade ago. For reasons that aren't fully clear, the market reacted a day late and suddenly priced in the idea that Democratic officials would kill data center plans. Panic, retail selling, and forced liquidations followed. A tech-focused sell-off then spread into everything: defensive names like Procter & Gamble were up in the morning but sold off later in the day.

Matt asked why the reaction was so violent when a "blue wave" had been widely expected. Doug suggested the governor races may have been the surprise, Texas in particular, since it hosts many current and planned data centers. He said the Texas governor-elect, whose name he couldn't recall, has said existing data center deals would stand but new ones would face more scrutiny.

How big was the drop?

The S&P 500 fell 4.5%, which Doug called historic. Since 1950 there have been about 19,300 trading sessions, and only 30 of them saw declines of 5% or more. Even more unusual was the timing. Moves this large have almost always happened in the middle of major bear markets, after a 15% to 20% decline, not close to all-time highs. Even with a modest rebound, the S&P was only about 5% below its peak. Matt observed that the drop came just ahead of the usual December "Santa Claus rally" season.

Should investors be worried?

Doug said "worried" was too strong a word, but investors should be attentive. The AI trade has driven most market returns for the past two to two and a half years, so the key questions are what's left if that driver fades and whether the damage will spread to the rest of the market. Large bear markets rarely happen outside of recessions. That morning's jobs report was solid, but the real risk is whether pressure on the AI build-out spills into the broader economy.

Results differ sharply across the market. The Nasdaq is down about 15% from its high and the S&P about 5%, while some value and defensive areas are up substantially for the year. Diversified equity investors are likely still looking at high single-digit to low double-digit returns year to date.

International stocks, bonds, and alternatives

International markets have decoupled slightly from the U.S. Doug pointed to two pressures abroad: the ongoing Iran situation, which matters more to countries that import much of their oil and gas, and a dollar that has strengthened significantly since the Fed turned more hawkish. The sell-off could soften the Fed's stance. Markets had priced in two rate hikes for 2027, erased both during the sell-off, and added one back the next day.

On bonds, Doug suggested revisiting the firm's earlier blog post. If longer-term rates have peaked, it may make sense to lock in yields with intermediate maturities of roughly 5 to 7 years, rather than very short or very long bonds. The tactical models have held an alternatives sleeve (commodities, gold, and managed futures) to counter rising rates. The team is now reconsidering whether that money should move back into fixed income.

Direct AI exposure in client portfolios

The firm's most widely held models include a small, dedicated AI sleeve added about 12 months ago. The team deliberately avoided popular AI and tech ETFs, which are heavily concentrated in the same few names that dominate the S&P 500. Instead, the sleeve covers three areas:

- a broad AI ecosystem ETF that uses equal weighting and risk measures,
- an electrification and power generation fund,
- a cybersecurity fund.

In a 60/40 model, the sleeve is about 5% of the portfolio. Doug acknowledged it was hit significantly but said it's far too small to derail anyone's retirement, and adjustments may come later. Matt emphasized that the firm avoids large, concentrated bets. Doug joked that the firm wants to stay off the front page of the newspaper, whether for spectacular gains or spectacular losses.

What happens next

Doug's first rule is "don't panic," and his second rule is to refer to the first. Emotional, reactive decisions are usually the worst ones. He noted that clients tend to quote gains in percentages but losses in dollars, and said volatility is the price of being an equity investor.

He described the firm's "Bear Market Playbook" for its tactical portfolios, while stressing that he is not calling this a bear market. The playbook doesn't try to predict tops or crashes. It manages risk objectively as events unfold, using market internals rather than fixed percentage triggers. It can call for reducing risk if conditions worsen, or for buying when the market looks washed out. It worked well in 2022. The firm's saying is that every 40% decline started as a 5% decline, but not every 5% decline becomes a 40% one. Right now, neither the sell signals nor the buy signals have triggered. Doug reminded clients they have lived through 2008, 2020, 2022, and other downturns. A technical bear market is a 20% decline, and the S&P is at 5% and the Nasdaq at 15%.

Financial planning perspective

Matt explained that client plans are stress-tested with Monte Carlo simulations, which run thousands of trials based on historical conditions. The firm also runs a harsher scenario that assumes 0% portfolio returns for several years. If a plan still succeeds under that test, one bad day shouldn't change anything.

He urged clients to focus on what they can control:

- **Savings rate:** for those still working, maxing out 401(k)s and IRAs, since market drops are buying opportunities.
- **Cash flow:** for retirees, reviewing the budget for expenses that could be trimmed if needed.
- **Emergency fund:** making sure enough cash is set aside.
- **The HCM safety net:** for clients drawing income, defined-maturity bonds set aside to cover expenses so securities don't have to be sold at bad times.
- **Year-end taxes:** tax-loss harvesting, and carrying losses forward to future years.

Closing thoughts

Doug ended on a constructive note. The market's fundamentals remain strong, and forward S&P 500 earnings estimates just hit all-time highs, so there is "as much to like as not to like." The firm plans to return to its regular podcast schedule but may hold another live webinar if volatility continues.