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Permit us a moment of déjà vu. Last September, we wrote that the previous month, equity markets had seen a broad global sell-off triggered by anxiety over falling oil prices, a slowing China, and the uncertain impact of anticipated Fed rate hikes. While acknowledging these concerns, we argued that the conviction—widely shared at the time—that the U.S. economy was entering, or perhaps already in, a recession was unfounded, and that markets had both overshot the mark and failed to make a number of important distinctions, creating opportunities for investors who kept their heads. Indeed, in an October rally, the S&P 500 recovered all of its losses from the August sell-off.

In January, global markets saw another, nearly identical round of jitters sparked by the exact same worries. The Shanghai Composite fell by −22.6%, Japan's Nikkei 225 by −8.0%, Germany's DAX by −8.8%, and the S&P 500 by −5.1%. At the height of the sell-off, the S&P 500 lost two full multiples on its valuation (from 19.2x trailing P/E to 17.2x). The spread on U.S. high-yield bonds spiked to its highest level since the peak of the Eurozone crisis in 2011. In a "flight to quality" (or at least perceived safety), the yield on 10-year U.S. Treasury bonds fell 35 bps, back below 2%, while rates on even Italian and Spanish 2-year bonds went into negative territory. A lot of investors, right now, are hiding under whatever rock they can find.

Certainly some parts of the picture have grown cloudier since last Fall. Energy-related companies are under much more acute financial pressure, and default rates on their debt are rising. U.S. GDP growth registered an unimpressive +0.7% in the last quarter of 2015. Business investment fell for the first time in three years, down −1.8%, while a second straight quarter of inventory cutbacks shaved nearly half a point off growth, reflecting a marked decline in business confidence heading into 2016. The ISM Manufacturing Index saw its fourth month of contraction in January, with companies slashing jobs while working down backlogs to keep production lines running, and little sign of immediate improvement. New orders for durable goods fell −5.1% in December, down −0.6% from a year ago, with orders for core capital goods down −7.5% from a year before.

Other parts of the U.S. economy, however, are showing remarkable resilience. While the struggling manufacturing sector accounts for some 12% of the economy, the ISM Non-Manufacturing Index shows the remainder growing steadily, supported by a solid stream of new orders. Despite a somewhat sluggish beginning and end to the year, GDP grew by +2.4% for 2015 as a whole, matching 2014. Consumer spending moderated a bit in Q4, but—supported by strong job gains—still rose by +2.2%. Auto sales rebounded to a solid annual rate of 17.6 million in January, reflecting continued high levels of consumer confidence, which appears to have suffered little from global uncertainty or stock market losses.

Housing, in particular, is a source of strength. Residential investment grew at a +8.1% rate in Q4. New home sales in December were up +9.9% from a year ago, while existing home sales were up +7.7%, and housing starts were up +6.4%. The inventory of homes for sale, in terms of monthly sales, remains below the 50-year average, suggesting a solid basis for continued growth. The composite home price is up +5.8% from a year ago, enough to enhance homeowners' sense of wellbeing without undercutting demand.

The U.S. dollar rose +2.3% in January on a trade-weighted basis, up +10.8% from a year ago, highlighting a key vulnerability of the U.S. economy. While markets cheered in late January when Japan followed Europe in adopting negative interest rates on deposits, further easing by central banks abroad is actually a double-edged sword. By easing at the same time the Fed is looking to tighten, they induce capital to flow to the U.S., pressing down on U.S. interest rates, and supporting elevated U.S. equity valuations. But by strengthening the dollar, they also widen the U.S. trade deficit—which shaved −0.7 percentage points off GDP in 2015—and undercut U.S. corporate earnings abroad and pricing power at home. With China hemorrhaging capital, due to its own slowdown and policy miscues, there is a real risk that China's currency will be allowed to weaken further, triggering competitive devaluations by other countries, and creating additional headwinds for U.S. growth and corporate earnings. We think the potential impact of a stronger dollar is one reason why the Fed will act cautiously in raising rates in the coming months.

Without dismissing the underlying concerns, it is important to keep January's sell-off in perspective. These are not rare events. Since 1950, the S&P 500 index has seen a fall of at least −10% an average of once every two years. Since 1928, there have been 23 "bear markets" that fell −20% or more (the 1990s was the only decade that did not see a −20% decline). On five of those 23 occasions, stocks still ended positive on the year, while 57% of the years that saw a −10% drop finished positive. Despite these repeated and often unnerving declines, the compound rate of return on U.S. stocks since 1928 has averaged +9.8% per annum.

At the outset of this year, we said to expect sideways performance by U.S. equities at the index level in 2016 with periodic (but temporary) downdrafts due to recurring market anxieties. We continue to think that, much like last Fall, investors who keep their nerve will find opportunity amid these confused and volatile overreactions. During the Battle of the Marne in World War I—which he won decisively—French general Ferdinand Foch reported, "My center is giving way, my right is retreating. Situation excellent. I shall attack." In other words, while most people see volatility as their worst enemy, it can also be your best friend.

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