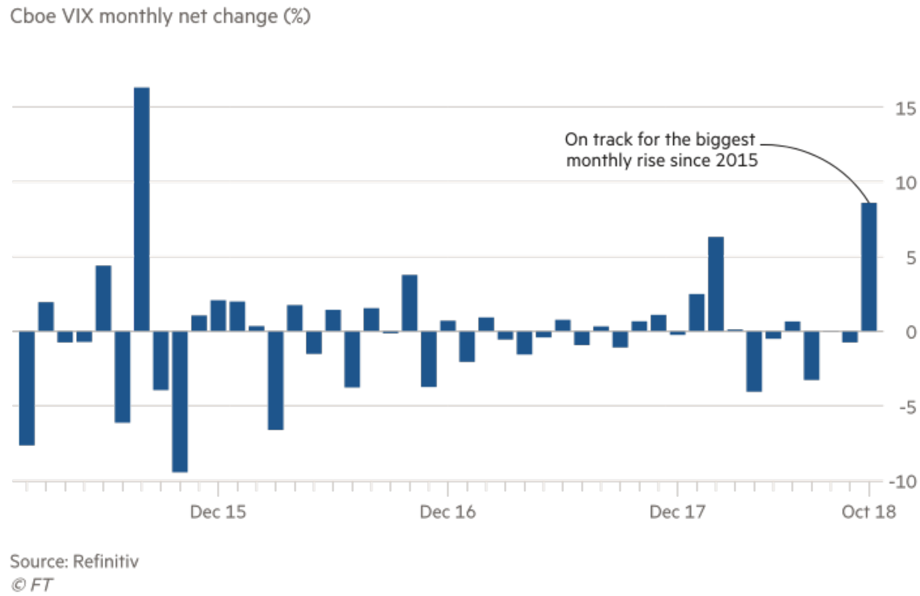
ACG Insights: October Volatility

Introduction

For the second time this calendar year, global equity markets have sold off rapidly towards “correction” territory resulting in intimidating headlines and increased media coverage. As we mentioned earlier this year, pullbacks are something typical of a normal market, but also something we haven’t seen in recent years. Our recent quarterly commentaries allude to heightened risks we have seen in the market making a correction of this magnitude increasingly probable.

What happened?

Volatility. Unlike some corrections, this moved-in swiftly over a matter of days versus weeks. As pictured below, the CBOE VIX Index, a benchmark used to measure expected future market volatility, spike to its highest monthly rise since 2015. Market pundits have quoted the index moves for the day in points instead of percentages and, despite very few economic data points, the S&P 500 index is currently on pace to finish the month down roughly 9%. This puts the S&P’s peak to trough for the year at 9.7%. 5% peak to trough declines are considered ‘normal’ while 10% declines are considered ‘corrections’ (2647 would be the official correction point for the S&P 500).

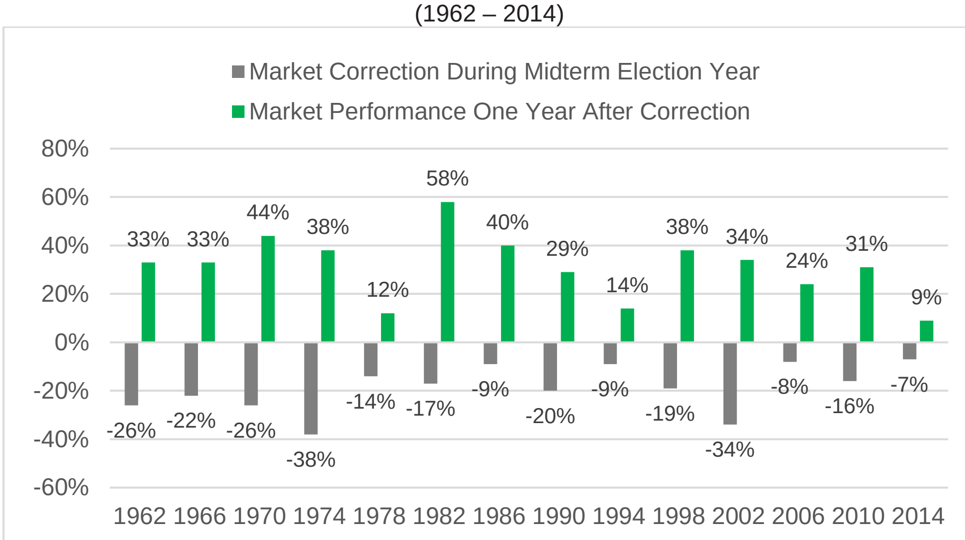


International equity markets have fared worse. International developed markets, as proxied by the MSCI EAFE index, are on pace to finish October down 11%, and Emerging Markets, as proxied by the MSCI emerging markets index, are on their way to finish the month down 10%.

What is causing this pullback?

It's tough to point the finger at one specific catalyst. Instead there could be a multitude of reasons for the recent spike in market volatility. Take for instance the recent US corporate earnings. Third quarter 2018 corporate earnings have been weaker than expected and therefore not as much of a backstop as investors had perceived at the onset of the quarter. We're halfway through earnings season with over 100 companies beating earnings while approximately 60 companies have missed revenue estimates, many of which issuing weak guidance for fourth quarter 2018. Combine this with the ongoing trade wars, the Asian (China) economic slowdown, rising US interest rates and geopolitical tensions and suddenly a market pullback starts to make more sense.

Performance During and After Mid-term Elections
(1962 – 2014)



Source: Marketwatch

It's also important to note that in the year-to-date period leading into mid-term elections, the S&P 500 has historically experienced an average drawdown of 19%. Post-election, however, the market typically rallies as investors focus moves back to fundamentals.

What Should We Do?

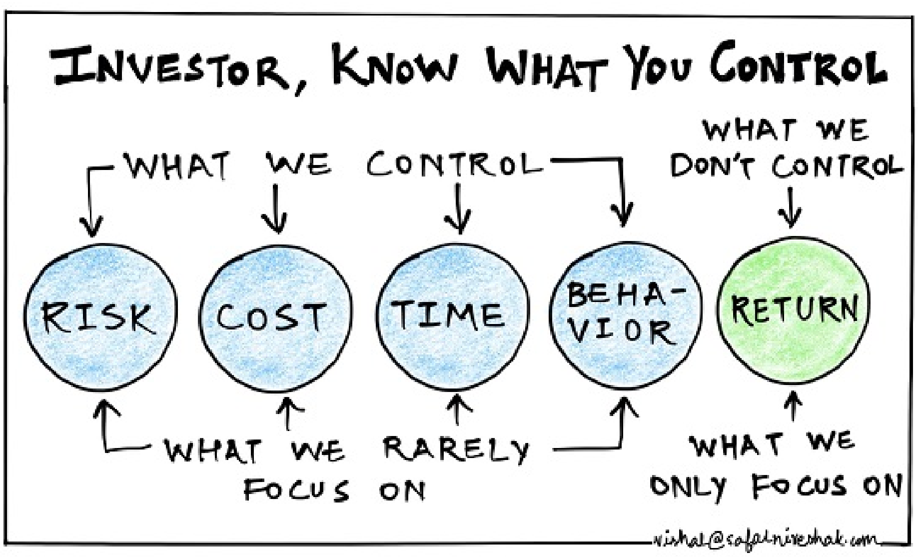
To put it simply – nothing. We build diversified portfolios with a long-term view of the capital markets and don't believe emotionally responding to market volatility is necessary assuming we have done our job as fiduciaries to build portfolios that achieve our goals with the minimum amount of risk.

Howard Marks said it best in a recent interview with Barron's; "The truth is: Investing is not easy; making money isn't easy. How can it be easy? Everybody wants to make money. It is a very competitive activity. But if you are disciplined, if you study, and if you can keep your emotions under control, then you can do these things. But one of the real keys is to keep your emotions under control. Everything in the environment conspires to make us do the wrong thing, to buy when things are going well and prices are high—and to sell when things are going poorly and prices are lower, which is the exact opposite of what we should do. But it all comes from emotion. We have to resist." Market volatility is inevitable and selling during a downturn/pull-back may result in locking in a loss. The S&P 500 has undergone 36 'corrections' of at least 10% or more since the beginning of the 1950s.

Source: The Motley Fool

The yellow highlighted lines in the above chart show (from left to right) Black Monday, the Great Recession, and the recent 2018 pullbacks. Taking a longer-term view of the markets put in perspective the magnitude of these recent bouts of volatility. And while there are reasons to be cautious, long-term investors can give credence to the benefits of portfolio diversification.

We believe the graphic below best represents our firm's approach to working with our clients. It is our job to continually refocus both ourselves and our clients on what we can control within the blue circles. Risk, cost, and time are fairly easy. In times of stress, it is our own behavior that we all need to recognize we can control.



Source: Safal Niveshak

If you have any questions regarding the recent market events, please feel free to give us a call or send us an email. Thank you for your business and trust.

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