CORDASCO
FINANCIAL NETWORK

First Quarter 2018 Knowledge College

Volatility in Perspective

The stock market over the last few years has acted, to some degree, like a lullaby. With strongly positive returns coupled with little market volatility, investors had been lulled into thinking this was the new norm. For those investors, the first quarter of 2018 was likely a rude awakening. We all know volatility and risk are a necessary evil to the capital markets. However, it is often difficult to judge what is normal and what is abnormal. While historical volatility is not a good predictor of future volatility, it does give us a baseline to compare against and set expectations of what we were willing to endure.

The Shock

The hardest part of coming off of a period of low volatility is the shock of its return. With benign market moves both up and down in 2017 investors were not accustomed to reading headlines of market pullbacks or seemingly dramatic changes in the dollar value of portfolios. We believe this is one of the reasons the first quarter of 2018 felt so jarring.

Year	Total Number of Trading Days	Trading Days with Moves Greater than 1%		Trading Days with Moves Greater than 2%		Trading Days with Moves Greater than 3%	
		Count	Percent	Count	Percent	Count	Percent
2017	251	8	3%	0	0%	0	0%
Q1 2018	61	23	38%	6	10%	2	3%

Over the entirety of 2017 we observed only eight trading days when the S&P 500 Index was up or down more than 1%. In the first quarter of 2018 alone 23 such moves have occurred. When it comes to moves of greater magnitude, 2017's largest daily move was -1.82%. We have experienced six days with equal or greater moves in the market in the first quarter, mostly to the downside and the largest of which was -4.10% on February 5th. So how do we put this into perspective? Was 2017 a normal year or the bright star of low volatility?

1) *Bloomberg*

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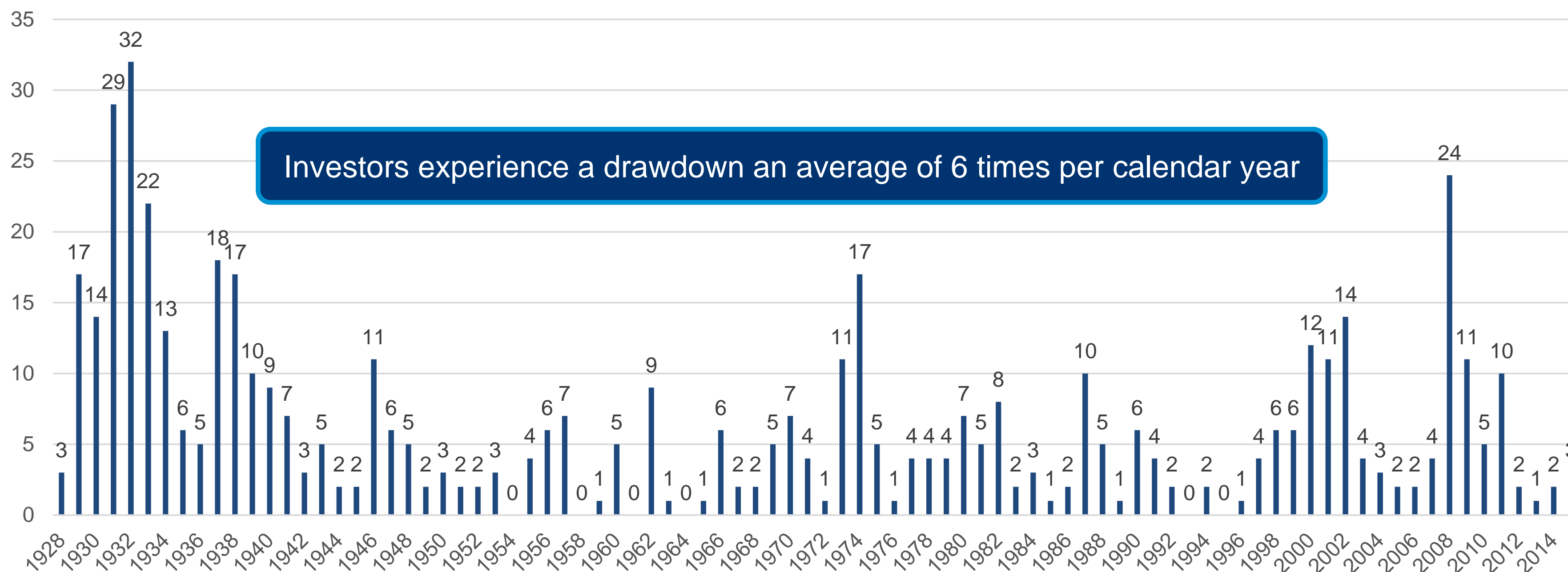
It's All Relative

We all tend to remember with greater clarity and assign more weight to recent events. Behavioral finance has dubbed this phenomena "recency bias" and it explains why many investors feel as if the start to 2018 is the outlier when it comes to volatility. Frankly, investors feel this way for good reason. While 2017 is the most recent example of low volatility, it is not the only data point in recent years. Since the financial crisis, there have been numerous years that have exhibited lower volatility than history would suggest. However, if we expand beyond recent memory and compare 2018 to years past it seems 2018 may shape up to be the norm, with 2017 as the outlier.

Number of 5% Drawdowns Per Year[2]



When examining the frequency of pullbacks since 1928, as defined by a drawdown of 5% or more, there are on average 6 drawdowns per calendar year. Since 2012, there have been far fewer than 6 of these events per year anchoring investors' recent memory to this abnormally low volatility. By historical standards, 2018 is on pace to be an average year rather than an outlier. If we are indeed returning to normal volatility in the market, we believe it is important to remember two things: 1) prudent and thoughtful diversification remain critical to protect capital, and 2) emotional reactions to the shock of volatility can often be the most detrimental to long-term returns.

2) Standard & Poor's, FactSet, J.P. Morgan Asset Management. For illustrative purposes only. Returns are based on price index only and do not include dividends. Data are as of December 31, 2015

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