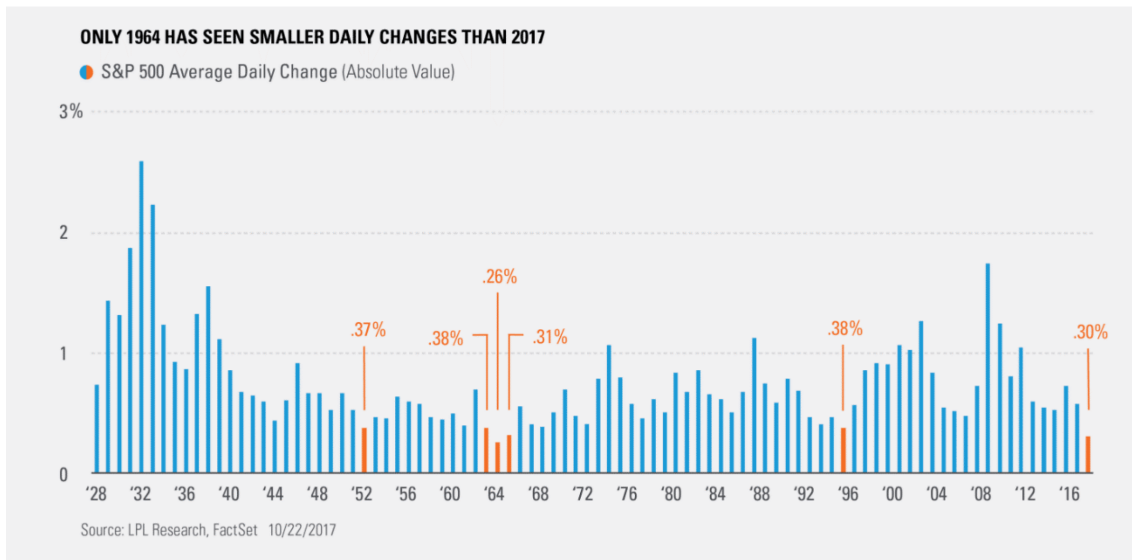
Repeat Performances

March 2018

"Remember, today is the tomorrow you worried about yesterday." – Dale Carnegie

One of the most pertinent and pervasive disclaimers in this business is that "past performance is no indication of future results." In simple terms, this means you should not base future decisions solely upon past historical patterns since the future is by definition unknowable. Unfortunately, this disclaimer is probably ignored more often than not, since we human beings tend to extrapolate weak or even fictional trends from the past and project them into the future. But sooner or later reality smacks us in the face and today becomes the tomorrow you forgot about yesterday.

This may be the case where the last few years of persistently low volatility tricked us into thinking we are in another "new normal" (a phrase I'm beginning to dislike due to its overuse and lack of usefulness). Reality, however, contrary to the past few years, is that volatility is more normal than not, and rising equity prices tend to occur in concert with periodic corrections. Thus, we believe the lack of volatility over the past few years, punctuated by 2017 (a year that saw only eight 1% daily changes in the S&P 500, and not a single 3% pullback), lulled people into a false sense of security where equity prices rise without incident; but the graph below reminds us of reality.



As you can see, in 2017 the average daily change for the S&P 500 Index was only 0.30%, second only to the 0.26% seen in 1964. So when the markets begin to swing wildly and (finally) enter correction territory, as they did this past February, the surprise shouldn't be from the volatile movement, but rather from the fact that it took so long to arrive!

You see, market volatility is the norm and not the exception – but it's also not something to fear or worry about. As LPL Research reminded us, "the last time we saw a market environment like this, in 1995, volatility increased dramatically over the subsequent four years, but that period also saw the S&P 500 double. [And] the huge economic and bull market boom of the mid-to-late '50s also *followed* historic calm, though volatility increased more modestly during that period."

So, the question that's begged is, what is going to happen in 2018? Well, the answer is two-fold. First, we use research to assuage your fears that volatility necessarily means trouble. Using the chart below, you can see that although "subsequent" years (those following extraordinarily calm years) had an average pullback of 12.1%, the S&P 500 still rose 8.5% on average.

LOW VOLATILITY YEARS TEND TO SEE MORE VOLATILITY THE NEXT YEAR

Year	S&P 500 Return	Max Pullback	Next Year Max Pullback	1% Moves	1% Moves Next Year	S&P 500 Return Next Year
1954	45.0%	-4.4%	-10.6%	15	42	26.4%
1958	38.1%	-4.4%	-9.2%	18	22	8.5%
1961	23.1%	-4.4%	-26.4%	14	58	-11.8%
1964	13.0%	-3.5%	-9.6%	3	8	9.1%
1993	7.1%	-5.0%	-8.9%	17	27	-1.5%
1995	34.1%	-2.5%	-7.6%	13	38	20.3%
2017	19.4%	-2.8%	?	8	?	?
Average	25.7%	-3.9%	-12.1%	12.6	32.5	8.5%
Median	23.1%	-4.4%	-9.4%	14.0	32.5	8.8%
% Positive	100.0%					66.7%

Source: LPL Research, FactSet 01/09/2018

Second, and (much!) more important, is to remember that past performance is no indicator of future results. Thus, no matter how good or voluminous the research, the fact of the matter is that no one can predict the future. So, the best way to prevent worrying today about tomorrow is to prepare, with good planning, for things to go right or wrong. Because just when you think the market is going to do tomorrow what it did yesterday, it will do the opposite and prove all the prognosticators either lucky or dumb.

As always, please call or email with any questions, or even if you just want to talk through some market (or non-market) related anxiety; we are always here for you. Take care!

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