Keeping All This Volatility in Perspective
These recent ups & downs are reminiscent of past Wall Street swings.

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Fall might be anything but calm on Wall Street. Volatility is back, in a big way. The VIX, a popular measure of the implied volatility of the S&P 500, has risen more than 105% since the end of July. Additionally, 11 of the 15 trading days ending September 9 were "all or nothing" days in which more than 80% of the S&P 500 moved either higher or lower. In the last 25 years, the index has not had a 15-day period like this.[1,2]

Contrast that with the first 159 trading days of 2015, in which just 13 such days occurred according to Bespoke Investment Group research. In fact, during the first half of 2015 the Dow Jones Industrial Average was never more than 3.5% up or down YTD, on pace for the most placid year in its history.[2]

Writing in the *Financial Times*, the noted economist and portfolio manager Mohamed El-Erian recently identified a few factors driving these market swings – factors that may not subside anytime soon. Fundamentally, he cited the "spreading economic slowdown" in China and other emerging markets "eroding a fundamental underpinning of high and stable asset prices" – and bursting some asset bubbles in the process. Markets can be roiled with the emergence of "major global challenges away from the direct reach of the U.S. Federal Reserve and the European Central Bank," he adds, as too many (institutional) investors look to central bank activity for either direction or reassurance. Lastly, investors worldwide are wondering if the Fed will raise short-term interest rates next week.[3]

So, this turbulence may persist for several more weeks or months. How does an investor cope with it? It helps to put all of this recent volatility into perspective.

Remember that historically, the ups of the market have outweighed the downs. If your time horizon is relatively long, this particular fact may provide encouragement: as Ibbotson notes, since 1926 there has never been a 20-year stretch in which a diversified portfolio invested in large U.S. firms has had a negative inflation-adjusted total return. From 1926-2014, such a model portfolio (with dividends encompassing roughly 40% of the total return) yielded approximately 10% a year on average.[4]

These recent ups & downs compare to others. On August 24, the S&P 500 lost 3.2% and was down more than 4% during the course of the day. That was quite troubling, but not quite extraordinary: it was the fifty-fifth day since 1983 in which the broad benchmark had dropped 3.5% or more in a trading session.[4,5]

How has the S&P recovered from days like these? Historically speaking, it has recovered more often than not. Looking at the 12-month periods after the preceding 54 such trading days, there were 45 year-over-year advances and 9 year-over-year retreats. How far did the S&P fall, on average, during those 12-month retreats? The answer is 7.7%. How high did it rise, on average, during those 45 annualized ascents? A remarkable 27.6%. So while history tells us nothing of tomorrow, it does seem that the S&P has recovered amazingly well from the bulk of its major one-day drops in the last 32 years.[4]

After a long, steady ascent, it is easy to become lulled into thinking that the market only goes up. We all know differently, but even so it can be a rude awakening when the major indices rollercoaster or plunge. Even so, we should be patient rather than let emotion take over.

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Citations.

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