



Mitch on the Markets

Market Insights from Mitch Zacks



Why to Expect More Volatility in 2018

By Mitch Zacks
Senior Portfolio Manager

2017 was a year of solid double digit returns and subdued volatility for the S&P 500; a welcome outcome that may bring fresh optimism for 2018.

But, high returns and low volatility is somewhat unusual. Take a look at the S&P 500 returns and intra-year drawdown figures (maximum pull-back) since 2009 below.

Year	Intra-Year Drawdown	Total Return for the Year
2009	-28%	+23%
2010	-16%	+13%
2011	-19%	0%
2012	-10%	+13%
2013	-6%	+30%
2014	-7%	+11%
2015	-12%	-1%
2016	-11%	+10%
2017	-3%	+19%

Source: J.P. Morgan

Notice the magnitude of the S&P 500 intra-year drawdowns the market experienced in any given year – some are pretty high. You’ll see that 2017 stands apart with little downside volatility.

2017 looks somewhat like 2013, a year when the market surged 30% and only pulled back a modest 6%. Every other year (except 2014) experienced a double-digit correction, which is actually quite normal for equity markets. Downside volatility is a normal, natural part of equity investing which is why 2018 is poised for a healthy, cyclical correction of 10% or more.

The technicals appear to argue for more downside volatility in 2018, but I think the fundamentals do too. The combination of steep valuations, rising expectations for corporate earnings growth, and tightening at the Federal Reserve could be a formula for volatility. Optimistic market sentiment is also more widespread, which tends to make investors less risk averse and drive up risk asset prices. Additionally, the

output gap in the United States has closed for the first time in 10 years, and there is very little economic slack to spare.

Bottom Line for Your Clients

I can't tell you when a correction will occur, how long it will last, or how large it will be. If any analyst or pundit attempts to time a short-term market pull-back, I'd ignore the forecast - it simply can't be done.

What we do know is that in only two of the last 37 years (1995 and 2017), the market did not pull back more than 5% at some point during the year. Bull market years like 2017 are rare, and equity investors should not get too comfortable with low volatility/high return investing. Markets tend to revert to the mean, and while I think 2018 will be another good year for stocks, I also think volatility is poised to return. Investors should keep that in mind as the year unfolds.

Mitch

About Mitch Zacks

Mitch is a Senior Portfolio Manager at Zacks Investment Management and has published two books on quantitative investment strategies. Mitch has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.



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