FIVE THINGS TO KNOW
about market volatility

CARILLON TOWER ADVISERS

Volatility remains one of the big stories of the stock market in 2018. Giant point swings starting in October and continuing through December grabbed investors' attention, causing some anxiety over market losses. When sharp drops occurred earlier in 2018, they were followed by a bounce to record highs. Investors wondered if the pattern would repeat, but late in the year, the volatility had not ended. However, many analysts remain upbeat about strong economic fundamentals in the United States, even as they acknowledge that 2019 is likely to see more ups and downs in the market.

As investors plan their strategy, here are five things to consider about the current market volatility.

1. A multitude of causes

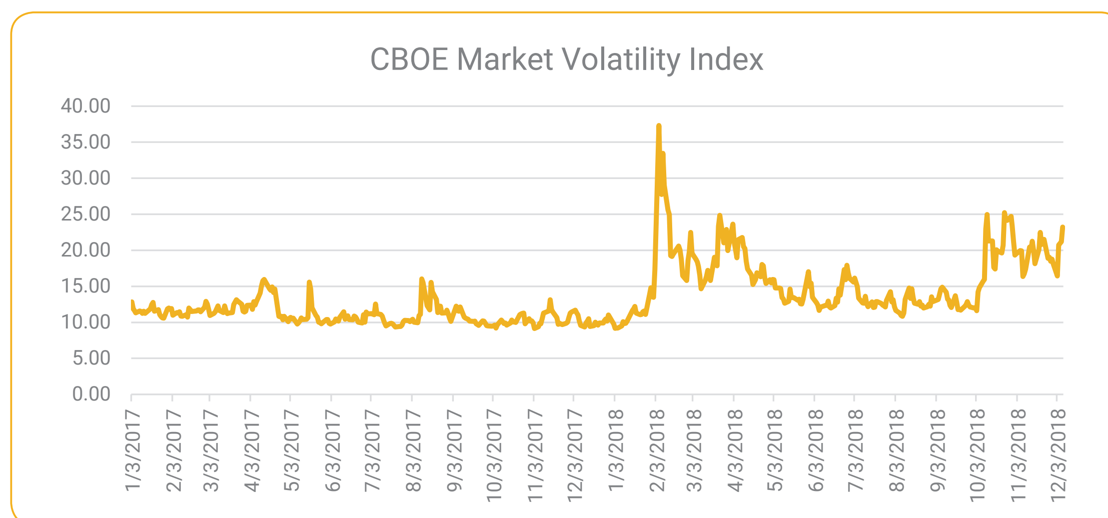
Many factors have contributed to the volatility in 2018's fourth quarter.

- **Tech/momentum sell-off.** Major technology stocks, and higher momentum stocks in general, took a large collective hit to their valuation. They were responsible for some of the biggest market gains in 2018 and comprise some of the largest weights in U.S. indices. So when the sell-off occurred, they brought the overall market down.
- **Trade worries.** The trade standoff between the United States and China continues to be a focus. In just one example, the Dow Jones Industrial Average saw a 1,088 point, or 4 percent, swing over two days in early December based on changing messages about whether a thaw in the trade war was likely.
- **Oil price roller-coaster.** The price of oil has mirrored market volatility, spiking to a four-year high in October and seeing a record losing streak in November.
- **Watching the Fed.** Investors have been nervous that the U.S. Federal Reserve would go too far in raising interest rates. Stocks rose after Fed Chairman Jerome Powell's speech in late November was interpreted to indicate a softening of plans to raise rates multiple times in 2019.

2. Skewed point of view

The volatility of 2018 might have seemed like an even bigger shock after what came before. 2017 saw record low volatility in the broad equity market as defined by the S&P 500 Index. In contrast to the unusually low level of volatility in 2017, 2018 saw several record or near-record single-day point losses and some significant daily gains as well.

Volatility spikes from 2017 to 2018.
The CBOE Volatility Index measures expected volatility in the S&P 500 Index.
The difference is stark between 2017 and 2018.

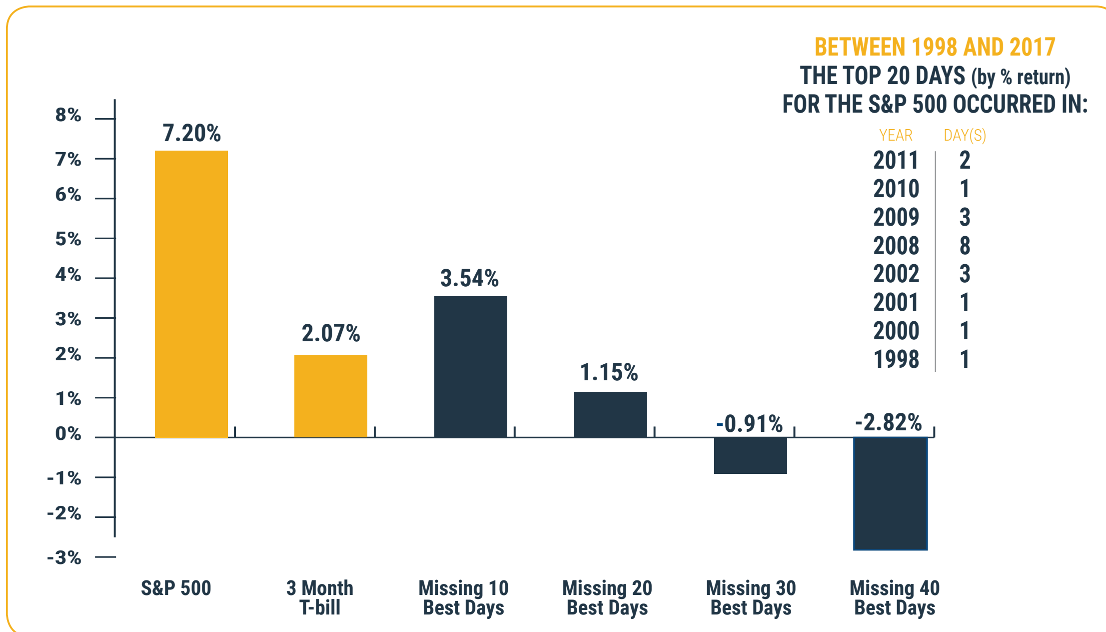


Source: Morningstar

3. Market timing isn't an answer

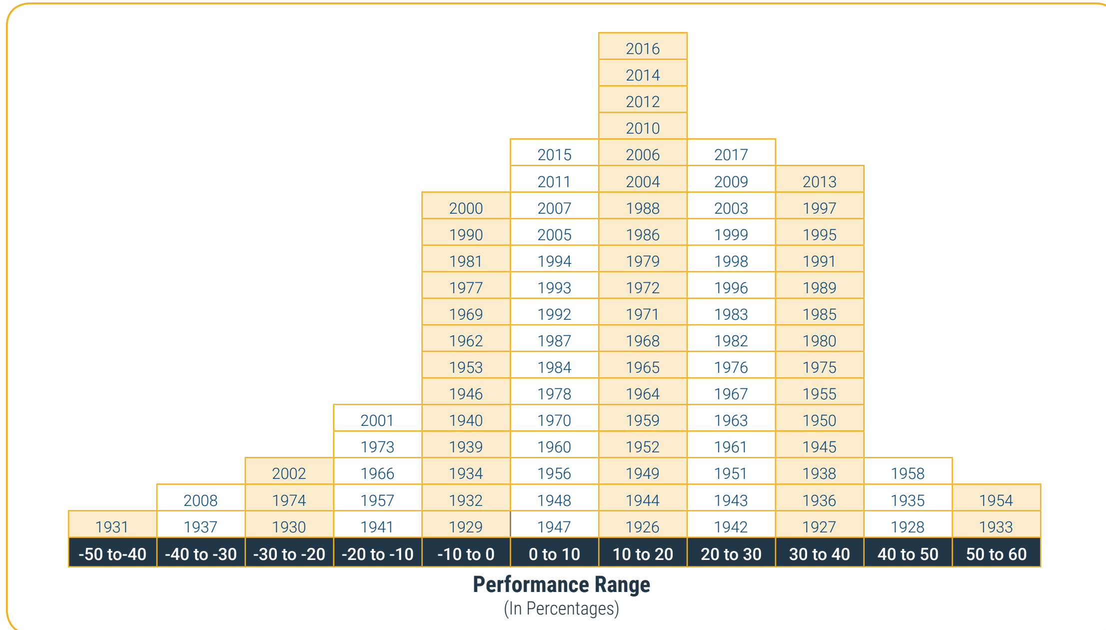
Volatility might be nerve-wracking, but equity investors need to remember long-term goals. Investors often fail to realize the importance of staying invested through market downturns and corrections. In periods of heightened volatility, investors sometimes panic and "cut their losses." Really, this may be "cutting their gains." It is virtually impossible to time the market correctly, which could lead to compounding of losses if you are not in position to reap the biggest market gains when they happen. Consider that investors who missed the 10 best days in the broad equity market, as measured by growth in the S&P Index, since 1998 would have seen their return sharply reduced compared to someone who stayed invested.

As shown below, since 1998, if an investor simply missed the best 10 days of the S&P 500, she would have experienced an overall return significantly less than the index. Missing the best 20 or 30 days would have had a profound effect on total return.



All investing involves risk and you may incur a profit or a loss. Past performance is not a guarantee of future results. The S&P 500 Index measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 75% of the investable US equity market. Citigroup 3 Month US Treasury Bill:The US Treasury Bill Indexes measure monthly return equivalents of yield averages that are not marked to market. The Three Month Treasury-Bill Index is an average of the last three-month Treasury bill month-end rates. Indices are not available for direct investment. Any investor who attempts to mimic the performance of an index would incur fees and expenses which would reduce return. Source: FactSet and Callan.

Over the past 90-plus years, returns for the S&P 500 have been positive seven out of every 10 years.



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*Source: Ibbotson Associates. The S&P 500 Index measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividends reinvested. The S&P 500 represents approximately 75% of the investable US equity market. Indices are not available for direct investment. Any investor who attempts to mimic the performance of an index would incur fees and expenses which would reduce returns. Stocks in this example are represented by the Standard & Poor's 90 index from 1926 through February 1957 and the S&P 500® index thereafter, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general.

4. The outlook ahead

It is impossible to predict when a market bottom has been reached, or whether the sharp drops in the fourth quarter might continue and bring about a bear market. But many who study the markets note two major points. Given that the United States may be nearing the limits of the longest bull market in history, we are likely to see more volatility ahead. However, fundamental economic markers are healthy. Earnings growth remains strong, consumer confidence is high, and unemployment is at record lows with signs of some wage growth. Despite slowing global economic growth, some portfolio managers see opportunities in 2019. Abe Sheikh, FSA, MAAA, is chief investment officer of Cougar Global Investments, an affiliate of Carillon Tower Advisers. He said the potential exists for "an upside surprise" for U.S. stocks going into 2019. Reasons include strong consumer sentiment, low unemployment, low taxes and now the removal of political uncertainty – which a divided Congress brings. Those could combine to be a positive for U.S. stocks, Sheikh believes.

5. Understand the role of active management

During times of volatility, investors may wish to more fully understand the difference between active management and passive investing. A passive or index-focused fund seeks to mirror a particular benchmark index. If the index goes up, the fund should grow. If the index drops, the fund should lose value. Active managers do not seek to match the performance of an index, but employ strategies they hope will outperform the benchmark in a particular asset class, such as small- or large-cap stocks. Actively managed funds also experience losses. In periods of volatility, they will attempt through their research to seek out well-positioned companies rather than those that fill out requirements for an index, which investors may want to consider in their overall strategy.

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