StraightTalk
PROVIDED BY STRAIGHTLINE FINANCIAL OF RAYMOND JAMES VOLUME 2 APRIL 2018

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The Return of Volatility

"What did the market do today?" is an age old question, but one that people are asking more frequently today, due to the recent, almost schizophrenic moves in the market. One day the market is down 700 points, and the very next day it is up 450 - when no long-term economic indicator has changed. So, what's driving this market?

The obvious answer for many would be the daily conversations emanating from the White House, which, undoubtedly has given the mainstream media endless stories. However, the always disruptive, sometimes petulant tweets and quotes being tossed out by this President have pretty much remained constant since the election, and the market ignored the majority of them in 2017, and rose steadily all year. So it has to be something more than shocking headlines about inappropriate or disruptive comments. In my opinion, that "something more" is a return to normal, healthy volatility in our markets.

Over any meaningful time period, it is abnormal (and unhealthy) for the stock market to move in the same direction, up or down, without so much as a 3% reversal. The year 2017 actually set a record for the most trading sessions without having that kind of normal reversal, as good news and bad news were treated the same and the market trended higher all year. This year, the earnings news is unquestionably improved over last year, and yet we have had a yo-yo market that seems to reverse itself almost daily. However, rather than being a harbinger of the end of this bull market, I believe it is nothing more than a normal trading pattern which has returned to our markets.

Keep in mind that the average trading day is a move in the index of one percent or less in either direction. So, on a 25,000 point index like the Dow, a move down of 250 points, a move up of 250 points, or anything in between is a normal day, and is one that should garner no real attention. A 375 point loss on the Dow sounds like a lot of points, but is only a 1.5% move to the downside, which is just barely outside of the range of a ho-hum day on Wall Street. The evening news does not do any of us any favors on bigger down days, with orange and red blinking banners shrieking about a 700 point decline. However, a 3% reversal such as that is supposed to occur with some regularity; but since we had gone so long without having had one it just feels a bit more uncomfortable. Historically, a typical pattern is for the market to move higher for a period of time and then digest that move up by trading sideways – building a base for a while, and then resume an upward trend. We are in one of those sideways periods right now, with the S&P 500 only down half of one percent this year, even though it may feel much worse than that.

Let's look at some history on how markets digest news and move higher over time. The research group, Factset, recently did a study on the number of new highs set for the S&P 500 from 2016 back to 1957, when that index was first created. The result of their research was that the index experienced 964 new highs over that period of time. While almost one thousand new highs sounds like an impressive number, when you add the always important context of how many trading days were in that time period - the result looks less spectacular. Roughly calculated, there were over 15,000 trading days during that stretch of time, meaning that the stock market set a new high only 6.3% of the time.

The S&P 500 index first traded at 386.36, and as I write this, the index stands at 2,628.19, which is an almost seven-fold increase in value. However, if the market was only setting new highs 6.3% of the time, then by definition it was retracing those highs over 93% of the time. Put another way, over the last sixty years, the market had volatility that led it nowhere on nine out of every ten days.

The old expression, "volatility is the price of

return" is true. The reason that stocks have historically compounded at a higher return than other asset classes is the required endurance of their volatility. Anyone can put long-term money in a bank CD (or under the mattress) and avoid volatility altogether. Of course, without any volatility, there is no return beyond inflation for those long term dollars, which means they actually lose money after factoring in the long-term corrosive effects of inflation. So, in a sense, we should all be welcoming the return of volatility in prices, as this signals a more normal and healthy market than one that goes straight up.

Since the news is not likely to get any less sensational in the short run, we must try to tune out as much of it as is possible. As I have said to many of you in our conversations, with this President, more so than with most of them, we must watch what is done not what is said. The news will always focus on what is said, and then extrapolate what that could mean for the future – but the key for investors is to not act on the news narrative of what could happen. Warren Buffet said it best in the fourth quarter of 2008, when everything looked bleak, *"In the 20th century, the United States endured two world wars…the Depression, a dozen or so recessions and financial panics, oil shocks, a flu epidemic, and the resignation of a disgraced President. Yet the Dow rose from 66 to 11,497."* Had any investor reacted to the market's volatility during that period, or allowed the news view of what could happen next to be the basis for making investment decisions…that investor would have undoubtedly missed some of the market's superior return over inflation and taxes during that period.

We know that the news has been sensationalized all throughout history. From newsboys on the street corner a century ago shouting headlines in an effort to drive newspaper sales, to the advent of cable news competing with the networks over the last two decades, to today's internet websites scaring us all on a minute by minute basis – "if it bleeds, it leads." We may have the ability to shrug off some of the headlines and reporting, but the subconscious nature of that reporting still seeps into our collective psyche.

In his fantastic new book, "It's Better than It Looks: Reasons for Optimism in an Age of Fear," author Gregg Easterbrook offers some compelling information about how this dynamic affects us all. In the book he offers countless examples of how much improved life is around the world, and yet we collectively remain worried throughout each day, a term he calls "collapse anxiety."

As an example, he chose a random month of news coverage from The New York Times and counted the number of times the word *crisis* was used. The answer was 914 times, which works out to an average of 30 times per day, or more than one each hour! Is it any wonder that we are all as jumpy as a cat on a hot tin roof when every problem is a crisis, and there is a new one every hour? The fact that global poverty has dropped from over one-third of all humans on the planet in 1990, to under 10 percent today, or the fact that since 1993, violent crime in this country has dropped more than 300 percent go unreported and unnoticed by our news media. But, things are getting better! Eight out of ten Americans earn more than their parents did. Americans work twenty hours less per week than we did forty years ago, but are more productive today than at any time in our nation's history.

Inventions like 3D printing, GPS guided delivery drones, self-driving cars, refrigerators that order food when you run out, synthetic alcohol to eliminate the morning after headache…all are making life better for all of us....and the list of them goes on and on. In fact, you cannot find a year without a major new invention in the last hundred years. Clearly, life is getting better each and every day, despite the constant headlines about the crisis du jour. And yet, knowing that things are improving does not mean that the headlines have any less impact on our psyche, because for the stock market to go down 700 points in a day – someone somewhere has to be selling their shares. And if enough people sell for enough days, even the most resolute investor can become affected.

As Warren Buffet often says, "the stock market is a device for transferring money from the impatient to the patient." Now that our old friend volatility is back, try to remain patient, and let that volatility work in your favor over time…

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