Wealth Management

Market and Economic Perspective

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Volatility makes a comeback

The shattering of the market's long abnormal calm in Q1 reacquainted investors with volatility. But with no recession in sight, we think the equity bull market will reassert itself.

Investor concerns over potential inflation, higher interest rates, a potential trade war, and a host of uncertainties coming out of Washington have brought turbulence back to the market.

This pullback for the most part was overdue. The S&P 500 had just come off of a 10-month winning streak, the longest since 1958–59, and market volatility had been very low for more than a year. The 4% selloff on February 5 was the first 4% single-session decline since August 2011 when Washington dawdled about raising the federal debt ceiling, which put the country's credit rating at risk. There have been only six sessions with 4% or more selloffs since this bull market began in March 2009. Declines of this magnitude happened on only 145 occasions since 1929— meaning they are not very common.

Through March 29, the S&P 500 had notched 23 days in which it moved 1% or more in either direction. That compares to only eight days in all of 2017.

In fairness, the increase in volatility during the quarter was less unusual than the long period of low volatility enjoyed in financial markets since the summer of 2015. Investors may have been lulled into complacency, and the market simply reverted to normal patterns.

Let's put volatility on the back burner for a minute and focus on fundamentals. Bull markets end from recessions, not nervousness. Nervousness creates volatility, but at this time, according to the equity strategists from RBC Capital Markets and our national research correspondent, there are no recessionary signs on the horizon.

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Current pace of realized volatility not outside normal levels of longer-term averages

S&P 500

Year	# of days with moves greater than +/- 1%	# of days with moves greater than +/- 2%
50-year average	58	13
2018 pace*	92	24
2017	8	0
2016	48	9
2015	72	10
2014	38	6
2013	38	4
2012	50	6
2011	96	35
2010	76	22
2009	117	55
2008	134	72

* Current pace represents the occurrences as of 3/29/18, annualized for the remainder of the year. In 2018, we've experienced 23 days of market moves greater than +/- 1%.
Source - RBC Wealth Management, Bloomberg

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Most importantly for equity investors, the market's three-legged stool remains sturdy: the U.S. economy is strong, corporate profit trends remain solid, and the market's valuation has improved. Our research sources' economists argue that we are still in the "late" stage of the economic cycle, meaning the next downturn would normally occur within the next couple of years, but not tomorrow. The 2018 consensus earnings per share forecast for the S&P 500 stands at almost $156, or 17.9% y/y growth, up from $146 reported in 2017. The combination of significant earnings growth expectations combined with the market's decline has shifted the S&P 500's valuation down to 16.4x, a more reasonable level compared to 2017's 17.6x, and not too far from the 16.0x average of the past 20 years.

Key takeaways:

- 2017 was unusually calm, and the recent swings, while surprising, are more normal by historical standards.
- RBC Wealth Management does not forecast a recession in 2018, and sees key data points like real estate valuations, gas prices and corporate profits continuing to do well this year.
- This is a good time to review your overall portfolio to make sure you are comfortable with your stock-bond-cash allocation.

Disclosures

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