Taking stock
A five-part series placing trends in context for today’s new world

Part 1: Volatility

In January and June of 2019, we addressed volatility spikes and their subsequent impact on future returns. The short of it is that after the dust settles, volatility spikes have been historically good (often times great) times to invest. At a minimum, they’ve proven to be times to not exit the equity market.

Certainly, the COVID-19 volatility spike has been the highest and longest since the Great Recession. It’s been sharper than could have been reasonably expected. It seemingly appeared without warning. And it delivered a recession to our doorstep in a box that nobody anticipated.

If you were to poll investors in 2019, it’s highly unlikely a pandemic would’ve been in the top five causes of the next recession, hence the unforeseen and unexpected nature of this economic slowdown. It’s evident today that this pandemic will prove to be the catalyst to the recession we’re in the midst of.

The COVID-19 recession and related equity bear market have been more painful and swift than nearly any other time in history. Whether we’re talking daily moves, weekly moves, or monthly moves, the comparisons were not to 2008–09. Instead, they were to 1987 and the Great Depression. That’s the historical context proving the unique time for equity markets today.

However, the basic principle that volatility provides opportunity for those with intestinal fortitude remains in place. While it’s impossible to know exactly what the path forward looks like, we believe market participants should look toward the future with the recent past representing nothing more than the starting point of the path to the future. While it’s unclear what the shape of the recovery will look like, whether it’s U-shaped, V-shaped, W-shaped, or something else entirely, the point is that there will eventually be a recovery.

Pivoting specifically to volatility, there’s a high correlation between the direction of the CBOE Volatility Index (VIX) and stock market moves. Clearly, when the VIX rises, equities have historically been challenged, while returns are much better when the index falls. The S&P 500 fell 34 percent peak-to-trough while the VIX was rapidly rising to its post-Great Recession high of 82.7 in March 2020. Since

![VIX chart]

Investors have experienced the worst volatility spike since the Great Recession, and the worst of the last 30 years, in 2020. While a pandemic was an entirely unforeseen risk at the start of the year, the silver lining is that returns are typically better than average coming out the other side of a recession.
then, the VIX has fallen to approximately 30 and stocks have rallied 33 percent. This has been quite the rally, but it’s important to note that the VIX is still well above longer-term averages and has further room to decline once the economy enters the recovery phase.

That’s the key. Volatility is likely linked to the recovery narrative in the near term, but given that a recovery is certain despite uncertain timing of its beginning, volatility has further room to fall when looking beyond the next quarter or two. While not predicting near-term moves or the “letter-shape” of a recovery, it’s evident that we’re still in a period of above-average volatility that will abate at some point, and we believe equities will benefit from this abatement when it arrives. In our view, the only question is when, not if.

<table>
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<tr>
<th>When the VIX is greater than 30</th>
<th>Forward return</th>
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<tbody>
<tr>
<td></td>
<td>6 months</td>
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<tr>
<td>Average</td>
<td>12.1%</td>
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<tr>
<td>High</td>
<td>50.2%</td>
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<tr>
<td>Low</td>
<td>-36.3%</td>
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<tr>
<td>% positive</td>
<td>83.1%</td>
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VIX levels at or worse than today’s have seen equities deliver positive returns over a 6-, 12-, 18-, and 24-month time horizon more than 80 percent of the time, with each time period having an above-average historical return.

Source - RBC Wealth Management, FactSet; data through 5/8/20
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