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#UnvolatileTimes

Fed Chair Janet Yellen (June 18, 2014 - Press Conference)

"We have a highly accommodative monetary policy. We have diminishing fiscal drag. We have easing credit conditions. We have households who are becoming more comfortable with their debt levels and more able to service that debt, an improving job market. We have rising home prices and rising equity prices and an improving global economy at least in my estimation. So, I think all of those things ought to be working to produce above trend growth and I think that's what's reflected in the forecast."

In December 2007, the U.S. economy fell into a severe recession lasting 18 months, ending June of 2009. During the course of this contraction - employment, property values, stock prices and consumer sentiment fell 7%, 33%, 43% and 53%, respectively. Since the June '09 trough, the situation has made an about face in each of the above: jobs, housing, risk assets and confidence are noticeably upbeat. Now, as Chair Yellen states, *"Things ought to be working to produce above trend growth."*

We have witnessed colossal monetary intervention by Central Banks at large. Domestically, the Fed has flooded the system with vast liquidity by injecting new money into the money supply (quantitative easing), and pegging interest rates near zero. The Fed has increased its balance sheet from $900 billion to $4.3 trillion through its open market operations, purchasing treasuries and government agency securities. This capped long-term interest rates, which in turn invigorated the housing market, automobile industry and private enterprise. Stock markets around the globe have responded favorably. Where does this put us now? Fundamentally, the consensus view among Wall Street firms is that the stock market, as it currently stands, is priced to perfection. Year-end forecasts by leading economic strategists target the S&P 500 anywhere from 1,850 to 2,075, the median average 1,955. Goldman Sachs predicts the market will close out the year at 1,900 or down 4.2% from current levels. S&P 500 as reported earnings presently tabulate the market P/E ratio at 19x and project it to be 18x by year's end. It appears that further increases in stock prices may require P/E multiple expansion.

Optimists are eager to believe the U.S. economy is entering a new era of low volatility accompanied with sustained growth. From a technical perspective, there has been quite a bit of chatter lately regarding the absence of volatility in the stock market. It's understood that when risk markets ascend, volatility descends. The CBOE Volatility Index (VIX) is frequently cited as the gauge for market movement evaluation (VIX chart). After reviewing the VIX, I decided to take a deeper dive into the volatility question. I selected the Dow Jones Industrial Average (DJIA) as the index in which I would crunch the raw data[i].

The Dow commenced trading on May 26, 1896; the index is 118 years old. During this span there have been over 32,100 stock market trading sessions. Initially the stock market was open for trading six days a week, 300 days a year. The market is no longer open on Saturdays; there are now around 250 trading days. The DJIA has advanced 53% of the time and declined 47%. Since the bear market bottomed March 9th, 2009, the advance-decline percentage has shifted upwards to 55% up, 45% down. Advances have inched up further in the past 18 months moving to 57% versus 43%. Last quarter plus (+) days exceeded minus (-) days by a 65:35 ratio.

Volatility in the market is the index variance of movement in a given day. A closing change of 1% or more in either direction is a figure often referenced. Historically, the DJIA has recorded 1% or greater movements 23% of the time (~7,445 of ~32,100 days). In 2008, the market plummeted into a full-fledged bear market; 1% or more swings were common, occurring 53% of the time. In the past 18 months, fluctuations of 1% + have diminished to nearly 10%. In the past 3 months these moves for the DJIA have fallen to less than 5%; in June the number was zero.

Since the DJIA's inception, the average daily volatility (ADV) was 0.72%. The ADV has been 0.68% since 1950. In the past 10 years the rate rose to 0.71%, which included ADV of 1.07% and 1.66% during the bear market of '08-'09 respectively. March 5th, 2013 the Dow set an all time high of 14,253.77, eclipsing the previous high set October 9, 2007 of 14,164.93; since then the ADV has fallen to 0.49%. In Q2, it fell to .42% and in the last month was below 0.29%.

So there you have it. We have growth, low inflation, rising employment and increasing standards of living, all without the chaos of mood swings, aka volatility. From the classic tome, *Reminiscences of a Stock Operator*, a quote from the protagonist and legendary investor —Jesse Livermore...

> "*There is nothing new on Wall Street or in stock speculation. What has happened in the past will happen again, and again, and again. This is because human nature does not change, and it is human emotion, solidly build into human nature, that always gets in the way of human intelligence. Of this I am sure.*"

Respectfully,

William "Chip" Corley, MBA, RFC

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[i] As a disclaimer, filtering through thirty-two thousand lines of information is an undertaking in itself; hence, these figures represent my best assumptions.