Thackray Sector Report

— Every Sector has a Season —

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Written by Brooke Thackray

Volatility...Get Ready ! (July 3rd to October 9th)

Volatility, on average increases at this time of the year... get ready !

In recent years volatility on average has been subdued compared to historical norms. There have been a lot of arguments put forward justifying why volatility is so low. Central banks own some of the responsibility by implementing artificially low interest rates and by stepping in to support the markets when the economy or stock markets have suffered. Investors have become used to a low volatility world. Every dip in the stock market has been a buying opportunity and investors have stepped into the stock market quickly when it has retreated 1%. In addition, a lot of computerized trading programs and hedge funds have followed suit, taking advantage of this trend. The result has been lower volatility.

When will a 1% decline turn into a 10% correction or a 20% bear market? When will buying the dips no longer work? No one knows. On a seasonal basis, the two worst contiguous months of the year, on average from 1950 to 2017, have been August and September. The stock market often starts to correct around mid-July. It is not a coincidence that volatility tends to increase around this time period. On average, volatility tends to increase from July 3rd to October 9th (*Thackray's 2018 Investor's Guide*, page 85).

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The Chicago Board Options Exchange Market Volatility Index (VIX) is often referred to as a fear index as it measures investors' expectations of market volatility over the next thirty-day period using put and call options on the S&P 500. A high reading of VIX indicates investor expectations of higher volatility in the stock market and vice versa. The VIX is widely referred to as a "fear gauge."

From 1990 to 2017, the VIX has averaged 19.5 on a daily basis. Besides the occasional spike in volatility, in recent years, the VIX has on average been lower than its long-term average from 1990 to 2017. After spiking in early 2016, the VIX worked its way downwards, only to spike once again at the beginning of 2018. Since that time, the VIX has been working its way lower and currently stands at 12.8, well below its long-term historical average.

Based upon historical trends, investors should not expect the VIX to remain at current low levels until early October. There has often been a spike in volatility in the upcoming months. From July 3rd to October 9th (1990 to 2017), on average the VIX has increased by 31% and has increased 74% of the time. The graph below shows the average yearly cumulative percent gain for the VIX from 1990 to 2016, with the corresponding cumulative return for the S&P 500. In the springtime, the stock market has generally increased, which has led to an average trend of the VIX moving lower ❶. Although the stock market tends to peak in May, the majority of the downturn for the stock market, on average, has occurred in August and September, the same time that the VIX has on average moved higher ❷. The S&P 500 has often found traction to move higher in October, the same time that the average trend of the VIX has moved lower ❸.

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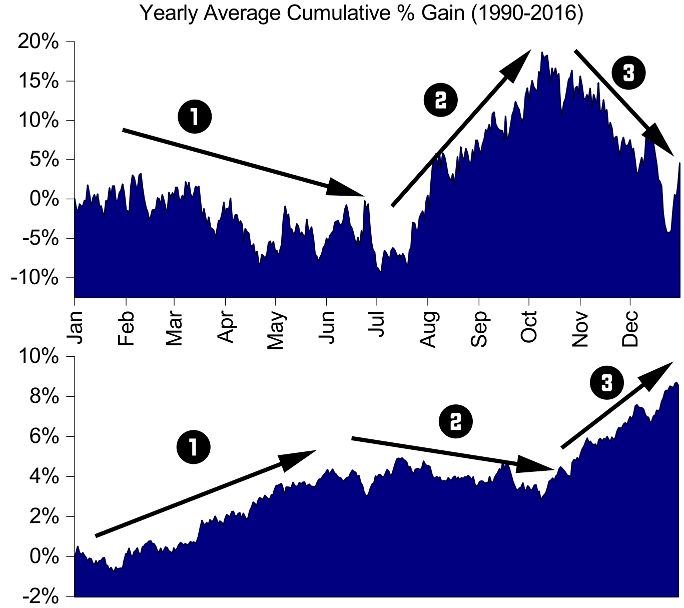
Chicago Board Options Exchange Market Volatility Index (VIX)
Yearly Average Cumulative % Gain (1990-2016)



S&P 500 Yearly Average Cumulative % Gain (1990-2016)

Source: Thackray's 2018 Investor's Guide

Although investors would not want to run their portfolios by looking just at VIX levels, it still important. It is like a secondary indicator on the instrument panel of a car that provides valuable information that is occasionally needed. The VIX is akin to the temperature gauge in the car. It typically does not provide valuable information on a minute-by-minute basis, but when it starts to run hot- watch out.

The average trend of the VIX moving higher does not necessarily mean that the stock market will decline. But there are VIX levels that investors often use in helping them to gauge possible inflection points in the stock market. A lot of investors consider that when the VIX stays above the 20 level for more than a few days, it is a cause for concern and reflects more stressful conditions which could lead to a large market drop. On the extreme, a lot of investors believe that if the VIX stays above 40 for more than a few days, it is often an indication of investor capitulation and could potentially be a good buying opportunity in the stock market.

It is possible this year that the VIX continues to remain low throughout the seasonal period in which it typically moves higher. Given that there are a large number of geopolitical issues including the trade war which is heating up, there is an increased possibility that the VIX will follow its seasonal trend and climb higher at some point over the next two and half months. Caution advised.