KIM: Recent volatility not out of ordinary

Mickey Kim
October 24, 2015

The S&P 500 stayed in the tightest range for the first half of the year ever in 2015, never down more than 3.2%, nor up more than 3.5%. As we're all acutely aware, that calm was shattered in August, as shockwaves from China's surprise currency devaluation and accompanying fears about global economic growth quickly hammered stock, commodity and currency markets in the U.S. and abroad.

We understand the road to reaching our goal of ***long-term*** outperformance will be bumpy, but that doesn't make these ***short-term*** periods of weakness any easier to take. ***We're encouraged U.S. stocks have rallied meaningfully at the start of Q4-2015, but expect extreme volatility to be a fact of investors' lives going forward.***

Though the newspaper headlines and talking heads blared *ad nauseam* about U.S. stocks suffering their worst quarterly loss since Q3-2011, we don't believe the sky is falling.

The stock market is *not* the economy. The U.S. economy remains on solid footing and we don't expect a recession anytime soon. The Conference Board Leading Economic Index (LEI) for the U.S. is one of the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The LEI is a composite of ten individual leading indicators measuring employment, manufacturing activity and new orders, housing and consumer expectations. The LEI is still in a solid uptrend. Bear markets are typically associated with recessions, so we do not anticipate a more serious decline.

The extreme stock market volatility and economic uncertainty witnessed in the third quarter of 2015 are nothing out of the ordinary or something to fear.

According to Crandall, Pierce & Company ("CP"), the U.S. stock market has experienced a correction (>10% decline), bear market (>20% decline) and/or recession 45.3% (i.e. almost half) of the time. It had been 46 months since the last correction, so U.S. stocks were probably overdue. In addition, CP's research shows since 1950, the S&P 500 has had negative returns in 15 calendar years (i.e. 23% of the time). Finally, CP determined the range of returns for each calendar year for the S&P 500 since 1935. On average for almost 80 calendar years, the S&P 500 moved in a range of -9.5% to 15.3% during a calendar year.

Taken together, these show how unusual the placidity of the first half of calendar 2015 was and what we experienced in fiscal 2015 is well within historical averages.

To repeat from a recent column, be a long-term investor and try to let short-term volatility be your friend, not your enemy. As Warren Buffett said, "Owners of stocks too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits – and, worse yet, important to consider acting upon their comments."

Buffett offered advice that's both sage and difficult to heed during turbulent times. "Tumbling markets can be helpful to the true investor if he has cash available when prices get far out of line with values. A climate of fear is your friend when investing; a euphoric world is your enemy."

This is what investors signed-up for, so fasten your seatbelts.

The opinions expressed in these articles are those of the author as of the date the article was published. These opinions have not been updated or supplemented and may not reflect the author's views today. The information provided in these articles does not provide information reasonably sufficient upon which to base an investment decision and should not be considered a recommendation to purchase or sell any particular stock or other investment.

Kim is the chief operating officer and chief compliance officer for Kirr Marbach & Co. LLC, an investment adviser based in Columbus, Ind. He can be reached at (812) 376-9444 or mickey@kirrmar.com.