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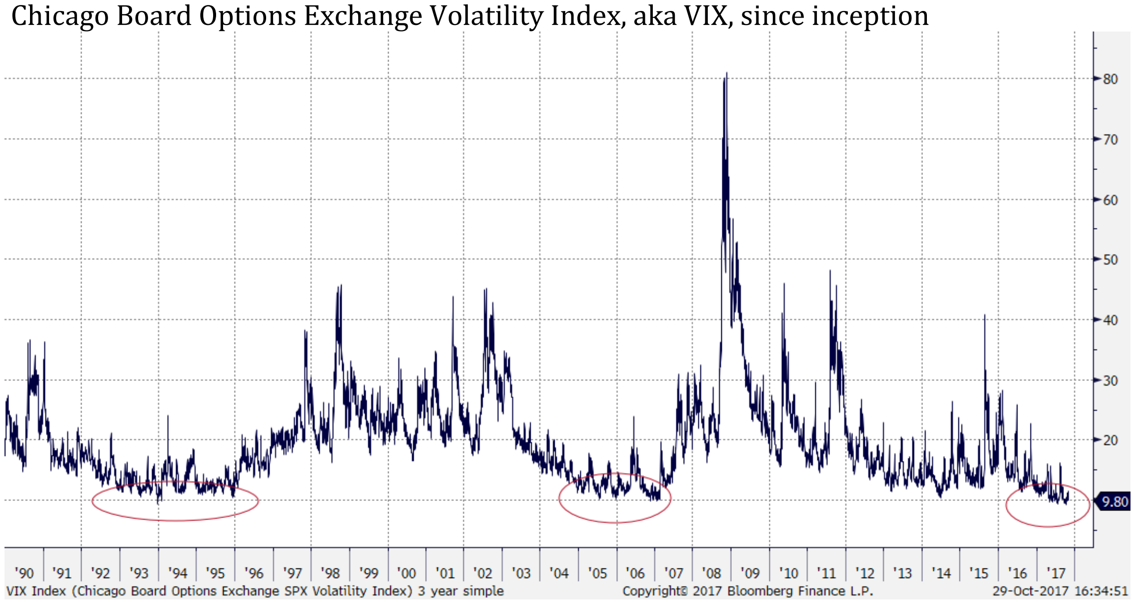
Waiting For Vol

Some people are born with a dark cloud over their heads, and seem determined to share the gloom with everyone they meet. As a case in point, for months -- or is it years? -- we have heard warnings from investors and market pundits about low volatility in US equity markets. This volatility, commonly quoted as the Chicago Board Options Exchange Volatility Index -- known as the VIX -- recently closed at a record low, and has of late registered levels at half its long-term average.

Chicago Board Options Exchange Volatility Index, aka VIX, since inception



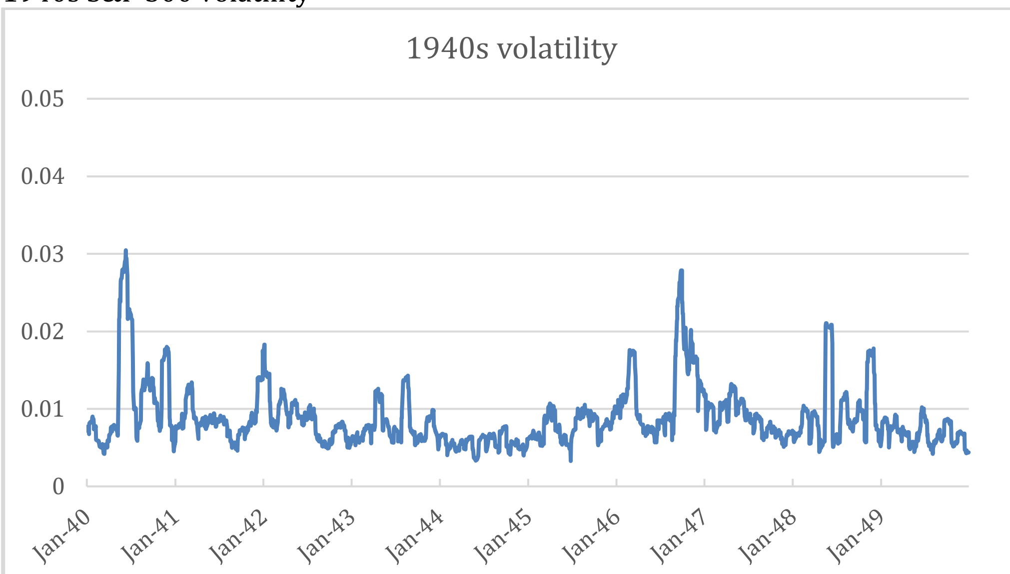
In examining the nearly three-decade history of the VIX, it is clear that equity volatility is currently low, and that it can remain low for extended periods of time, as highlighted above.

What is not clear is that depressed volatility levels are an ominous sign. In the mid-1990s, a low, then rising, VIX accompanied a soaring stock market. In the mid-2000s, a low, then rising, VIX gave some warning of the troubles ahead. While it is true that these changes in volatility presaged two different outcomes -- a historic boom and an equally historic crisis -- in neither case did the VIX remain low while the market's tenor changed. Furthermore, we would be hard-pressed to argue that the periods of tranquility either predicted or caused the subsequent stirrings.

Then again, perhaps three decades is too brief a perspective.

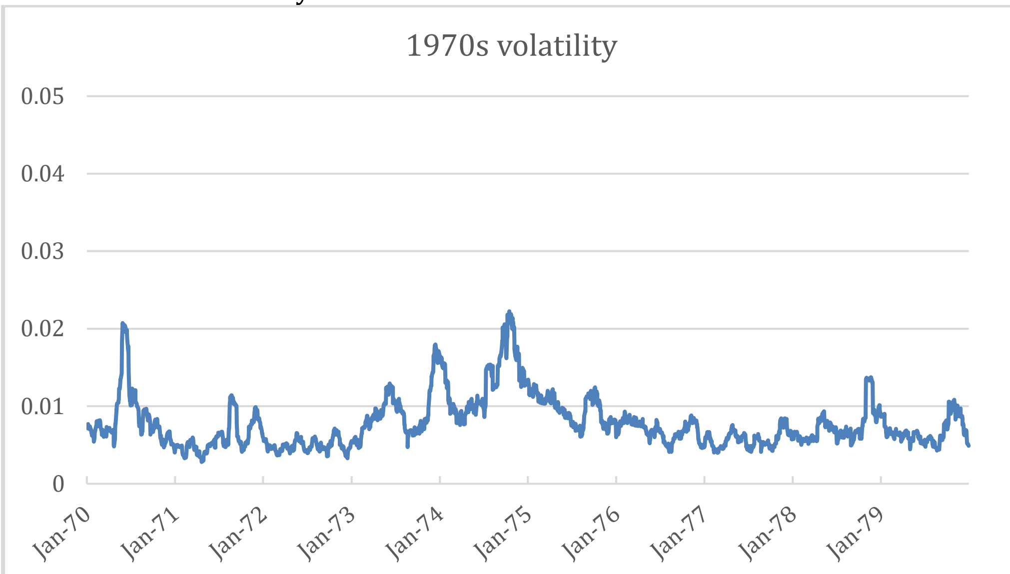
Shown below are volatility measures for select decades, starting with the 1940s. Most of these time-frames pre-date the creation of the VIX and its convenient one-size-fits-all measure. In examining past market cycles, we search for the cautionary signals of low volatility, something that gave fair warning of a market peak and subsequent bear market.

1940s S&P 500 volatility



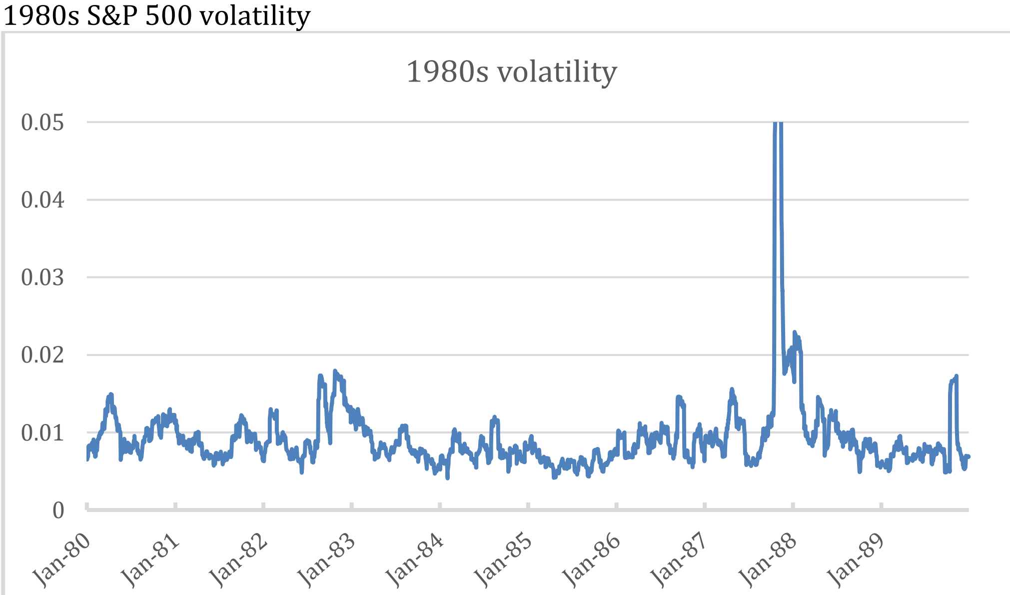
A bull market cycle peaked in May of 1946, preceded by a prolonged period of moderate price fluctuations, then a volatility spike in early 1946. In fact, volatility tripled ahead of the market peak, to levels well above norms of the era.

1970s S&P 500 volatility



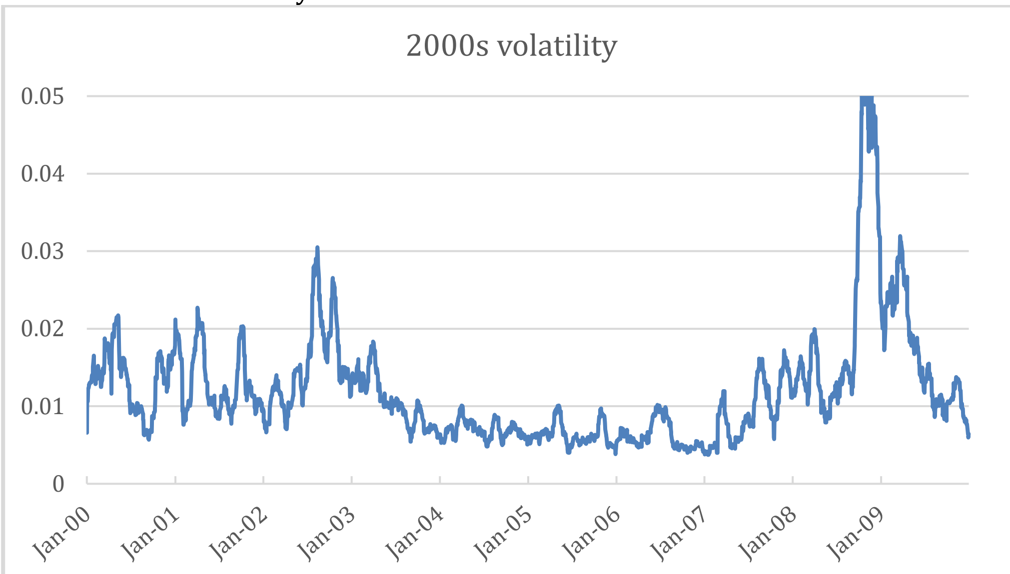
The 1970s were a lousy decade all around, and investors suffered through two bear markets. Was low volatility a problem, or a symptom of a problem?
Neither. Compared to the prior two decades, volatility was elevated in the '70s.

1980s S&P 500 volatility



The 1980s were at times rewarding, but far from tranquil. Did low volatility give warning of the October 1987 stock market crash? Hardly. Instead, volatility spikes became more frequent in the preceding months. For the most part, these spikes were ignored… foolishly as it turned out.

2000s S&P 500 volatility



Then there is the prior decade, which gave us the tech bust of 2000-2002 and the Global Financial Crisis of 2008-2009, two of the deepest bear markets since the 1930s depression. As shown above, volatility rose to extreme levels in the 2000s, and overall the period ranks as the most turbulent of the past seven decades.

To be fair, market history includes tranquil decades accompanied by spotty market performance. The 1960s, in particular, featured three bear markets that arose from relative calm.

Nonetheless, the record suggests that the entire narrative around low volatility is nonsense. The griping likely emanates from traders bored out of their minds -- and their livelihoods -- and commentators in need of alarmist talking points. Some people thrive on instability.

As counterpoints, we know from history that market weakness is usually accompanied by greater turbulence; stocks trade down faster than they trade up. We also know that the market will remain quiet until it decides otherwise; that the timing of a change in tenor is all but impossible to predict; and that a reawakening of equity market volatility might be an early warning sign, but today's placid environment is not.

Boring can be beautiful.

Source:
Bloomberg
The Wall Street Journal

Tidbits..

Trump Administration names Jerome Powell as new Chairman of Federal Reserve.
European Central Bank announces plan to taper its bond-buying program.
Federal Reserve begins long, slow reduction of its overgrown balance sheet.

Trump administration proposes to rescind Clean Power Plan of Obama era, tosses lifeline to suffering coal industry.
White House blocks proposed takeover of Lattice Semiconductor by China-backed bidder, cites security concerns over technology transfer to foreign interests.

17 Years After: US inflation-adjusted median family income reaches record level, finally exceeding 1999 peak.
US consumer confidence approaches 17-year high.
Preliminary figures show US economy grew by three percent for two consecutive quarters, best results in three years.
Surveys of US manufacturing and service industries approach highest combined readings on record.
US unemployment rate, at 4.1 percent, falls to 17-year low.

All systems go for US economy, so long as Washington does not screw it up.

Austria taps into bond market animal spirits, issues 100-year bond at yield just over two percent.

More signs of bond market bubble, does anybody care?

Credit-reporting company Equifax falls victim to cyberattack, exposing personal data of nearly half of US population; chief executive retires.
Securities and Exchange Commission discloses its system for gathering and disseminating corporate news and financial releases was hacked in 2016.
Yahoo revises scope of prior data breach, now estimated at three billion accounts, triple prior estimate.
Whole Foods, recently acquired by Amazon, discloses that its dining-area systems were hacked.

A fact of life... everybody gets hacked.

US household net worth reaches 96 trillion dollars, record level, and 40 percent above 2007 peak.
US federal government debt tops 20 trillion dollars.

CongratulationS! private sector, congratulations Washington.

Retailer Target commits to 15 dollars per hour minimum wage by 2020.
Retailer Toys R Us declares bankruptcy.

More to come in retail space.

NAFTA trade re-negotiations between US, Canada, and Mexico, making little progress, are extended into 2018.

Chicago area repeals tax on sugary drinks, deemed a failure after just two months.