

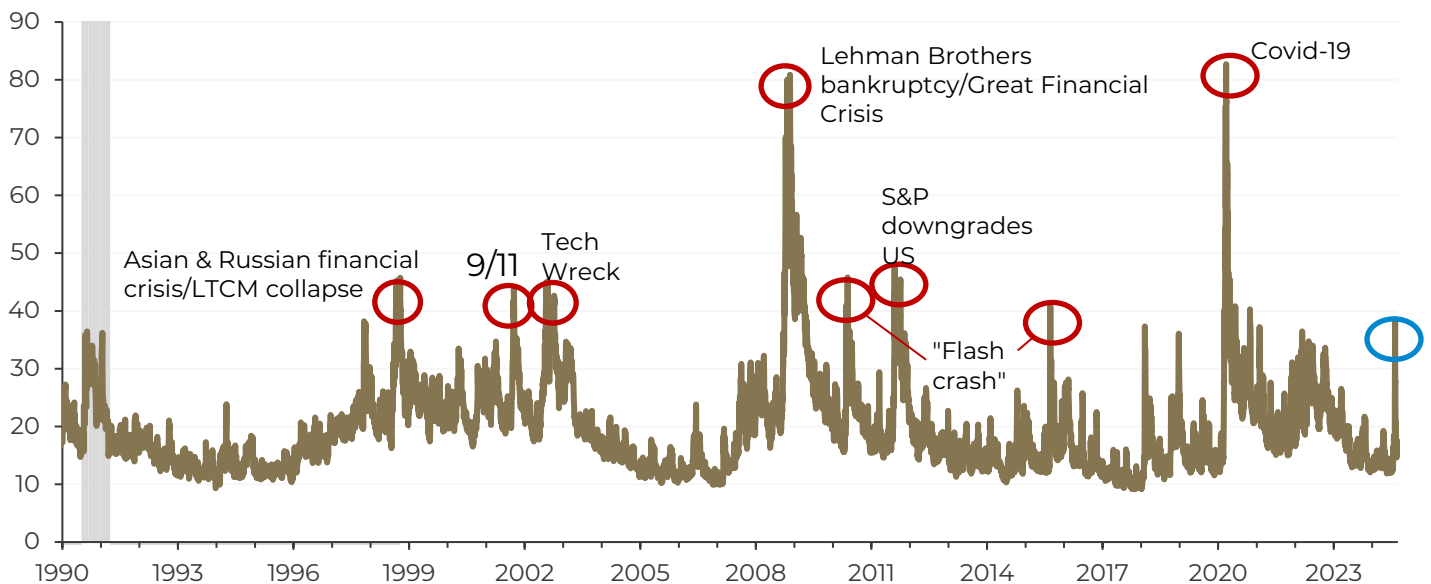
Ignorance can be bliss

For those who tuned out the financial news to enjoy the warm summer weather, it would appear that it was a quiet August for markets. After all, equities ended the month in positive territory (MSCI World +0.1% in Canadian dollar terms; S&P/TSX +1.2%) as did bonds (FTSE Canada Universe Bond Index +0.3%) as rates moved lower against data that raised the odds of further near-term rate cuts by the Bank of Canada.

That seeming calm, however, masked some significant volatility. Case in point, the Chicago Board Options Exchange's equity market volatility index (commonly known by its ticker "VIX") spiked to the highest level in its 35-year history, excluding the major market events noted below:

CBOE volatility index

(annualized percent)



Source: Guardian Capital based on data from Bloomberg to August 30, 2024.

The driver of the recent instability was the underwhelming data flow that began in late July and was punctuated by the soft US jobs report released on August 2.

The S&P 500 Index fell sharply in the aftermath of the US employment report and continued to fall further when markets opened the following Monday. This coincided with the surge in the VIX and the overall broad market weakness that saw the US equity benchmark down 8.5% from its July 16 peak (in US dollars).

Sell-offs are never pleasant for investors and sharp downward moves raise fears of further, sharper declines. Oftentimes, this is not the case, especially in the absence of a significant economic downturn.

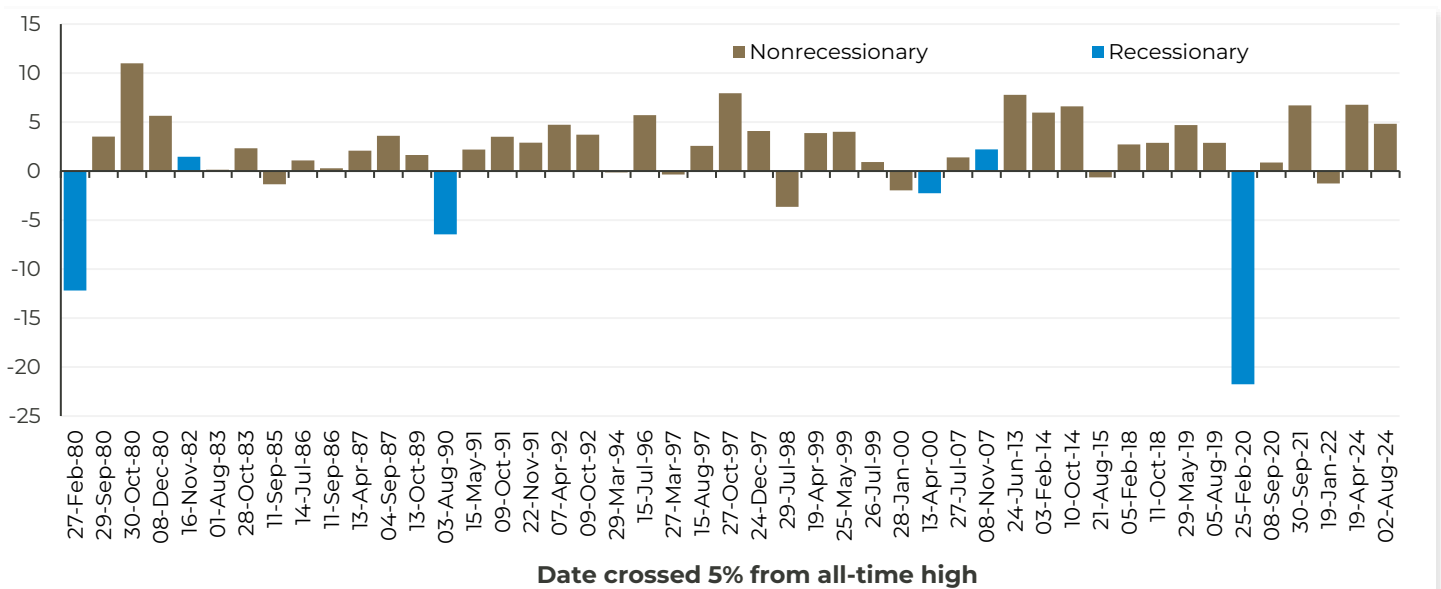
Looking at the daily data for the S&P 500 since 1980, there have been 46 previous instances where the index has breached the (arbitrary) 5% down threshold from an all-time market high, or an average of one of these drops from the market high per year. So, while unpleasant, not exactly uncommon.

In these previous periods, markets have increased over the subsequent month 76% of the time and by an average of +1.7% (median +2.5%) — generally recovering some, but not all, of the drawdown. There were only nine instances that saw a full reversal within a month, including this past April, supporting the old investing adage that “markets take the stairs up but the elevator down.”

Excluding the drawdowns that occurred in the context of recessionary bear markets, the likelihood of stocks broadly rising over the following four weeks rises to 83% and the magnitude of the move increases to +2.9% (median +2.9% as well). Notably, the largest subsequent four-week decline, outside of a recession, during this four-and-a-half-decade stretch was “just” 3.7% seen in 1998 (which occurred alongside the Russian financial crisis).

S&P 500 performance in the 4-weeks following a 5% decline from the all-time high

(percent; US dollar basis)



Source: Guardian Capital based on data from Bloomberg to August 30, 2024

In the absence of an imminent material downturn in the economy, there is little reason to anticipate that these market shocks represent anything other than a fairly run-of-the-mill, and short-lived, market correction. In fact, these episodes often prove beneficial to the longer-term health of the market as they help clear the froth and reset for the next leg higher.

Indeed, the subsequent data released have provided indications that the knee-jerk spike in growth concerns appears to be overblown with the S&P 500 rebounding from its lows. This once again suggests that when investors are faced with a sudden rise in market volatility, the best option may well be just to step outside and enjoy the weather.

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