

Interpreting Market Volatility

As the market does what we would expect, takes a breath after a long uphill run, investors should keep emotions in check.

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Volatility has returned to the stock market over the past week after an unusually long calm period. In all of 2017 a total of eight trading days saw price moves of 1% or more in either direction. Understandably, this makes the four such moves we've seen over the past seven trading days feel that much more impactful. Stocks began 2018 with one of their best starts in history. As of this week the S&P 500 is flat on the year.

If we take a breath – as the market seems to be doing after a long uphill run – and look at the bigger picture, the recent pullback makes sense. The risks highlighted in our 2018 outlook remain very much on the table. The Federal Reserve has untested leadership at a time when concerns over inflationary pressure are pushing bond yields higher. Expectations for economic growth and stock market earnings couldn't have been much higher as we entered the first quarter of the year. And even if these factors weren't in play, history would have told us to expect more volatility as we approach mid-term elections in November.

Heading into 2018, the overall weight of the evidence suggested a modest tailwind for stocks and a slightly bullish outlook. Current indicators could be tipping the weight of the evidence more neutral.

While news outlets are doing their jobs by shouting for people's attention to something more nuanced than a headline can explain, most investors would be better off tuning out this noise. Rather than react to headlines, you might see this as a test of your conviction and an opportunity to reevaluate your risk tolerance. The lack of volatility we saw in 2017 was an historical anomaly, not a new normal. Recalibrate your short-term expectations and work with your Baird Financial Advisor to make sure your investment strategy is appropriately aligned with your financial goals and time horizon.

Keeping this long-term perspective can be difficult in periods like these, but emotional reactions to short-term market movements can compound those challenges.