What the Past Doesn't Tell Us

The U.S. stock markets have entered another period of volatility, which reminds us a bit of last December before the market calm of January and February. Does this new bout of volatility mean that cautious investors should get out of the markets? What does history tell us about what to do when the markets get choppy?

The answer is that history is kind of all over the place, and not an especially reliable guide to the future. In a recent article in Bloomberg, the author looked at six episodes over the past five years where the two-day change in the so-called VIX volatility index exceeded a 6.45 point surge—which, the article noted, had recently taken place for the first time since January.

The first was August 2015, when China shocked the world by unexpectedly devaluing its currency. On August 21, the VIX index closed above 28, almost 13 points above where it had ended on Wednesday. On the next trading day, the VIX peaked at 53.29. This triggered a sell-off in the markets, on fears of a hard landing in China. The lesson: sell!

Another rapid shift in the VIX occurred in June 2016, after the shock results of the U.K. referendum on European Union membership gave us all the familiar term: "Brexit." The VIX index closed 6.6 points over the level it had been when the British people were heading to the polls.

In the coming month, the S&P 500 index rose more than 8%. The lesson: buy!

Remember February 2018? The fear gauge closed at 17.31 on Friday, February 2 and rose to 37.32 the following Monday. Stocks yawned, and were virtually flat over the next three months. The lesson: hold!

In late March 2018 the VIX rose 7 points over two days, after China announced its retaliation against tariffs proposed by President Donald Trump. Stocks struggled, and then the S&P 500 rose 6.4% over the next three months, reaching all-time highs. The lesson: buy!

In October 2018, Fed Chair Jerome Powell announced that the policy rate was "a long way from neutral," signaling the intention to raise the Fed funds rate. At the same time, there was news that the ongoing trade war with China was having a larger impact on Corporate America's profitability than previously thought. The VIX closed above 20, and stock market shares fell 16% in the weeks ahead. The lesson: sell!

In December 2018, the VIX rose 7.7 points on Christmas Eve, which marked the end of a tough month for the markets. The next month, the markets experienced their best start to a year since 1987. The lesson: buy!

Obviously, this suggests that this particular tea leaf is not a perfect predictor of how to profit in the U.S. stock market. But you are going to hear pundits, prognosticators and traders confidently tell you that the VIX is a surefire way to time the markets. They'll sound persuasive. And their rightness or wrongness will be entirely random.

Source:

https://www.bloomberg.com/news/articles/2019-05-08/what-to-expect-from-u-s-stocks-after-volatility-goes-haywire

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