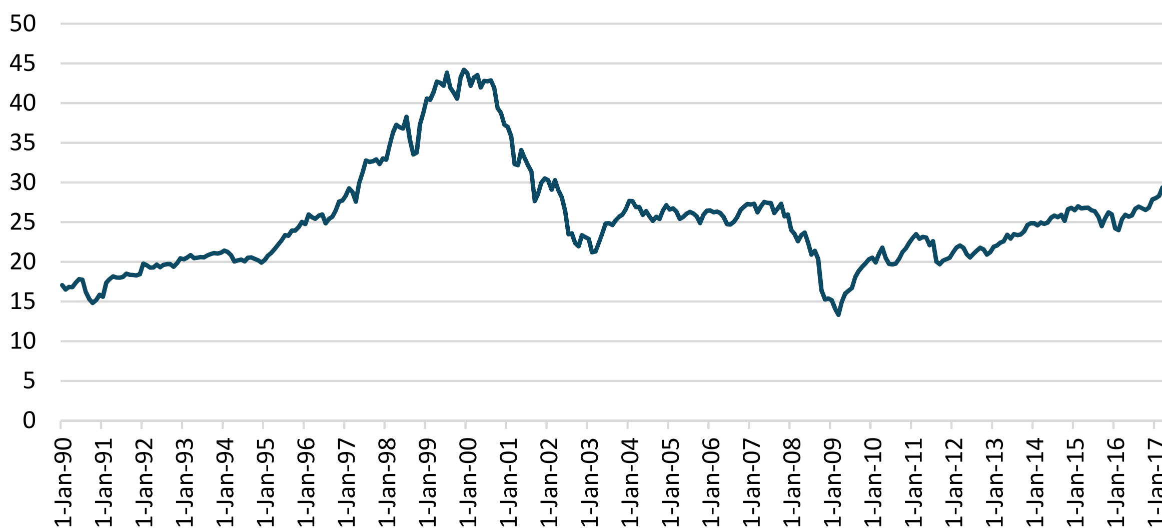
Market Perspective

Feb. 2017

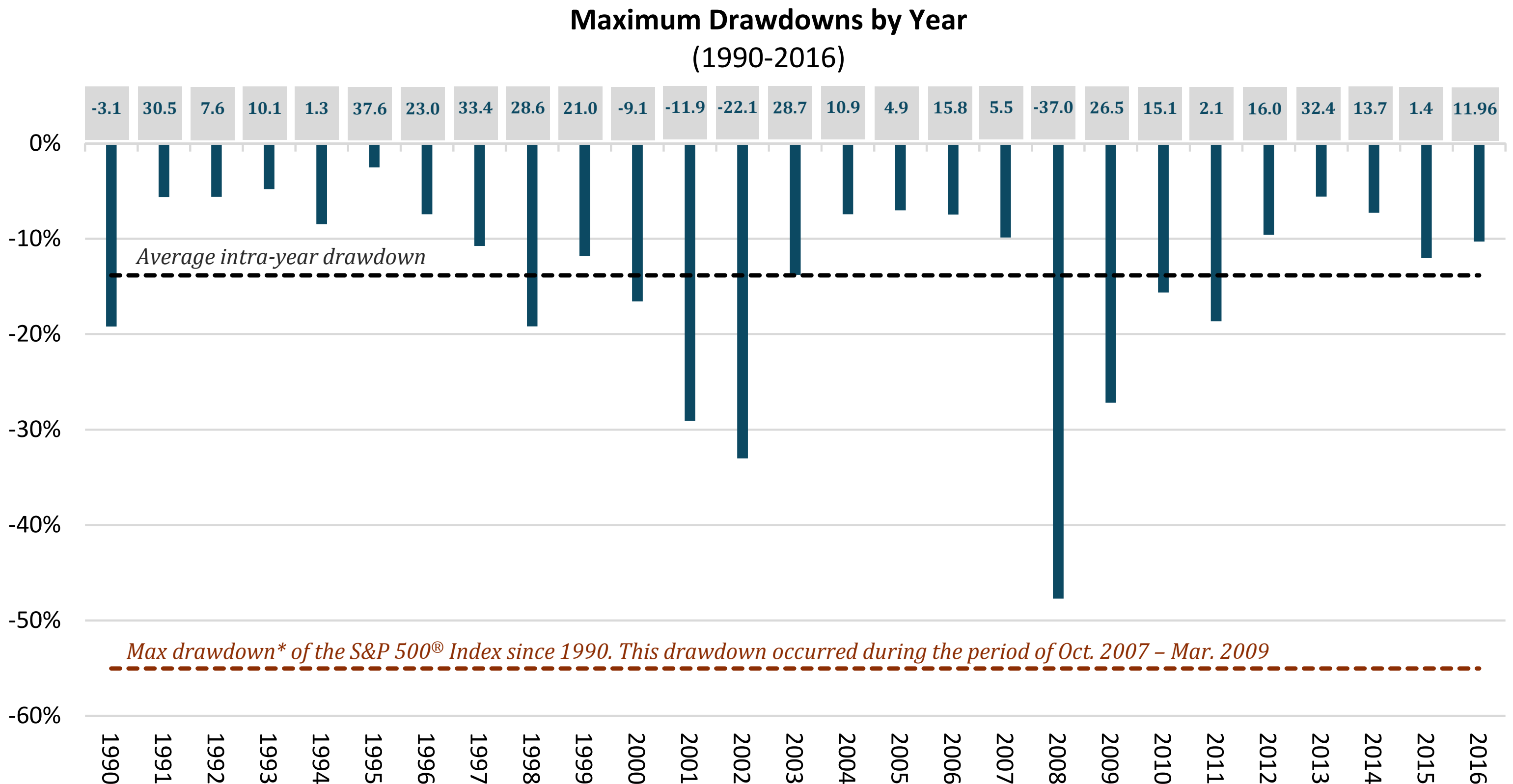
Equity market volatility continues to be surprisingly low. The year-to-date annualized standard deviation of the S&P 500® Index for the period ended February 28, 2017 has been just 5.80%, much closer to the long-term average of the bond market than its own long-term average. The steady march forward for the equity market has included very few daily moves that would be considered outliers, particularly on the downside. As of the end of February, there have been more than 90 market sessions since the S&P 500® Index has experienced a loss of more than 1% in one day. A bright spot for option writers is that implied volatility has maintained its typical premium to realized volatility with the VIX ® averaging 11.57 on a year-to-date basis, nearly six points greater than the realized volatility of the S&P 500® Index.

How long will the equity market advance and will the low volatility environment persist? Gateway's investment process does not incorporate a market forecast or anticipate changes to market conditions when executing its low-volatility strategies, but there are a few data points that suggest when investor caution is warranted. First, though corporate earnings have been expanding at a healthy clip, the market's accelerating advance in February brought the cyclically adjusted price-to-earnings ratio (also known as the Schiller PE) for the S&P 500® Index to over 29. Though valuation has not proven to be a good indicator of future market return or direction, this is a level not seen since the technology-media-telecom bubble inflated and burst from the late 1990's and into the early 2000's.



Source: www.multpl.com and Robert Schiller. Performance data shown represents past performance and is no guarantee of, and not necessarily indicative of, future results.

Second, there has historically been downside volatility in the equity market at some point in any given year. Though the market delivers positive returns in most years, every year since 1990 has included a downside event ranging from shallow to deep. Since 1990, the S&P 500 ® Index has experienced an intra-year peak-to trough drawdown averaging nearly 14%.



Source: Morningstar Direct. Performance data shown represents past performance and is no guarantee of, and not necessarily indicative of, future results.

Finally, in recent years the Federal Reserve (the Fed) and other central banks have often stepped in and announced new liquidity programs or increases and extensions to existing ones during equity market drawdowns. The equity market typically resumed its advance shortly after these announcements. With the Fed well down the path of removing its accommodative monetary policy stance, can investors expect central bank intervention to halt the decline the next time the equity market hits a soft patch? If not, investors may benefit from taking a more proactive approach to risk management and downside protection while staying positioned for long-term growth.