PSG Wealth

Volatility – it's the nature of the beast

"You get recessions, you have stock market declines. If you don't understand that's going to happen, then you're not ready, you won't do well in the markets." - Peter Lynch

There will always be volatility in markets; it is the nature of the beast.

Unfortunately many people panic at the first sign of market corrections. This is usually when wealth managers receive frantic calls from their clients, complaining about the values of their investments which have suddenly decreased.

In these times saner heads must prevail. You need to inform your clients that market volatility will most likely accelerate in the coming months, but that this should not necessarily influence their investment approach to reaching their long-term goals.

Corrections in review

According to Ed Yardeni, the president and chief investment strategist of Yardeni Research Inc. in New York, corrections are typically defined as declines of 10% or more. Bear markets are defined as declines of 20% or more.

Yardeni found that in 2013, there were three corrections in the S&P 500 during the 2009 to 2013 bull market: in 2010 (-16% lasting 69 days), in 2011 (-19% lasting 154 days) and in 2012 (-10% lasting 59 days).

In addition, in September 2015 the S&P 500 Composite Index saw its first correction since the start of 2013.

On review of the preceding bull market (from 2002 to 2007), Yardeni again found that corrections aren't necessarily frequent occurrences during bull markets. According to his research there was only one correction during this bull market. Lastly, his data shows that between the bear market of 2000 and 2003, there were just two corrections on the S&P 500.

Corrections on the JSE

PSG Wealth's investment research and strategy team considered the performance of the FTSE/JSE All Share Index from 31 January 1960 to 30 September 2015. The following table illustrates that during this 55-year period, the JSE experienced larger corrections, for longer periods.

Over this half a century, the market experienced a contraction of more than 62% between 31 May 1969 and 28 February 1974. During two periods the index dropped by more than 51%, while during (and a few years after) the 2008 financial crisis, the index dropped by just over 42%. Before 2009 there were nine corrections of more than 21% and 19 corrections of more than 11% on the JSE. The index also dropped by more than 5% a total of 33 times.

INVESTMENT INSIGHTS

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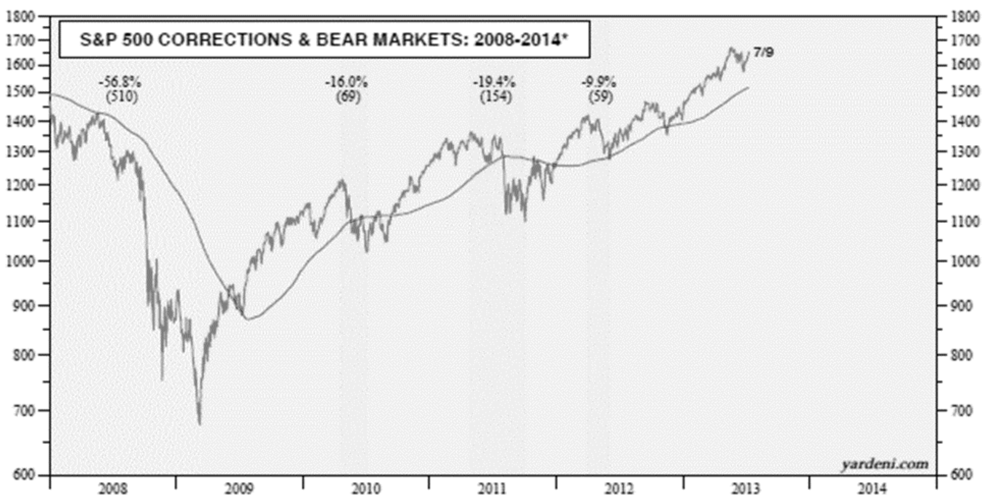

* Ratio scale. Corrections are declines of 10% or more (in blues shades). Bear markets are declines of 20% or more (in red shades). Number of days in parentheses.
Source: Standard & Poor's Corporation.

However, since 2009 the largest contraction the JSE experienced was a 9.63% dip from 31 May to 31 December 2011. The following dip of 5.8% took place in the middle of 2013. And then in this year, when the markets reacted to, amongst others, disappointing data from China, the JSE dropped by 8.21%.

As Yardeni found for the S&P 500, our JSE research confirms that corrections are indeed rare occurrences during bull markets.

These findings point to potentially hazardous influences on client expectations of equity return patterns. What people have experienced in the recent past – which has predominantly been dominated by a protracted bull market – is not the norm. Corrections, although part of the nature of equity investing, have been extremely rare. How will clients react to corrections if they have not been mentally prepared for them?

What does this mean?

If history is anything to go by, larger corrections can be (and should be) expected, but this does not necessarily mean that you need to make amendments to your investments approach. Equity markets are volatile, which is why they offer a premium in periods of uncertainty or poorer sentiment. In volatile times the uncertainty increases, which in turn translates into greater volatility. This should be expected. If you don't, you are probably not prepared well enough.

Date	Percentage drop*	Occurrence of % drop
31 May 1969 – 28 February 1974	62.39%	1
30 April 1974 – 30 April 1979	51.39%	2
30 June 2008 – 30 November 2010	42%	5
Before 2009	more than 21%	9
	more than 11%	19
	more than 5 %	33
Since 2009		
31 May – 31 December 2011	9.63%	1
30 June – 31 July 2013	5.8%	1
31 May – 30 September	8.21%	1

Source: PSG Wealth Investment Research team

*These corrections are based on month-end movements on the JSE.